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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.1 OVERVIEW



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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OVERVIEW

This Module gives a general introduction to the series of Modules dealing with the settlement of international investment disputes at ICSID. It explains the close link between economic development and foreign direct investment. Foreign direct investment depends in large measure on the economic, political and legal conditions prevailing in the host State. Access to an impartial and effective method of dispute settlement is an important element of the legal conditions.

This Module then gives an outline of the various traditional methods for the settlement of disputes between host States and foreign investors and explains the shortcomings of these traditional methods. The idea underlying the ICSID Convention is to close the gaps caused by these shortcomings.

This Module explains the origins and history of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). It also explains why the mechanism created by the ICSID Convention works to the advantage of the investor as well as of the host State.

It also gives a broad description of the leading principles underlying dispute settlement under the ICSID Convention. These include the choice of methods between conciliation and arbitration, the specialization on investment disputes, the substantive law applicable to investment disputes, the mixed nature of proceedings between a State and a foreign investor, the requirement of consent to ICSID's jurisdiction, the institutional support given by the International Centre for Settlement of Investment Disputes (the Centre), the self-contained and automatic nature of proceedings and the overall effectiveness of the system.

At the same time this Module summarizes the most important points that are explained in more detail in the subsequent Modules 2.2 to 2.9. The idea is to offer the reader a broad and general picture before (s)he turns to the specific issues covered in these Modules. Where appropriate, this Module offers references to the Modules which explain these points in more detail.

OBJECTIVES

Upon completion of this Module the reader should be able to:

- Describe the significance of foreign investment for development.
- Appreciate the influence of dispute settlement on a country's investment climate.
- Compare dispute settlement under the ICSID Convention with other methods of dispute settlement.
- Recount the history of the ICSID Convention.
- Identify the institutional framework of ICSID.
- Analyse the object and purpose of the ICSID Convention.
- Define the respective interests of host States and investors in dispute settlement under the ICSID Convention.
- Describe the most important characteristics of dispute settlement under the ICSID Convention.

INTRODUCTION

Investment and development

Foreign direct investment (FDI) plays a pivotal role in economic development. It provides access to a number of economic factors which are indispensable in this context. These include capital, technology and know-how. The volume of capital transfers through FDI is considerably larger than all forms of development aid, bilateral and multilateral. During the 1990s and the first years of the twenty first century, the amount of FDI has grown dramatically.

In addition, FDI facilitates access to world markets, to worldwide distribution channels and other networks. Not infrequently, FDI contributes to the improvement of infrastructures in developing countries like tele-communication systems, roads and airports, to the training of the local workforce and to the development of indigenous industries.

This is not to say that all phenomena associated with FDI and with globalization in general have been welcomed in all quarters. But there is broad consensus, that private investment constitutes the most important factor in economic development. This has led many developing countries to revise their previously reserved attitudes towards FDI and to adopt an open and welcoming attitude towards foreign investors.

Investment climate

The recognition that FDI is an important element in development has led many if not most developing countries to strive to create conditions that are attractive to foreign investors. In fact, nowadays developing countries often compete for FDI.

Economic and political factors

Much of the investment climate in a country will consist of economic and political factors such as market access, the availability and cost of production factors, taxation, the existence of infrastructures, the existence of a functioning public administration, the level of corruption and political stability.

Legal factors

In addition to economic and political factors, the legal framework for FDI is also important in determining its investment climate. This legal environment is, in turn, determined by a number of factors. These include the stability of the legal conditions under which an investor can operate, the quality of the local public administration in applying relevant regulations, the transparency of the system of local regulations and an effective system of dispute settlement.

Investment codes

Many developing countries have attempted to improve their domestic legal framework by passing specialized legislation, often referred to as investment codes. These investment codes are designed to combine clarity with favourable conditions for foreign investments.

BITs

In addition to guarantees contained in domestic law, potential host States to investment also give international legal guarantees to investors. First and foremost among these are bilateral investment treaties (BITs). These contain

substantive as well as procedural guarantees to investors of the respective countries. It is estimated that over 2000 such BITs have been concluded worldwide.

Regional treaties

In a similar vein, regional treaties offer guarantees to investors. These include the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty.

Dispute settlement

A particularly important aspect of the legal protection of foreign investments is the settlement of disputes between host States and foreign investors. Impartial and effective dispute settlement is an essential element in investor protection. This element had serious shortcomings until the creation of the ICSID system.

Summary:

- **Foreign direct investment is widely regarded as the most important factor in economic development.**
- **The investment climate of a country is determined by economic, political and legal factors.**
- **Among the legal factors, an impartial and effective system of dispute settlement is essential.**

1. SETTLEMENT OF INVESTMENT DISPUTES

Domestic courts of host State

In the absence of other arrangements, a dispute between a host State and a foreign investor will normally be settled by the domestic courts of the host State. From the investor's perspective, this type of dispute settlement carries important disadvantages. Rightly or wrongly, the courts of the host State are often not seen as sufficiently impartial in this type of situation. In addition, domestic courts are bound to apply domestic law even if that law should fail to protect the investor's rights under international law. In addition, the regular courts will often lack the technical expertise required to resolve complex international investment disputes (see Module 2.2).

Domestic courts of other States

Domestic courts of other States are usually not a realistic alternative. In most cases, they will lack territorial jurisdiction over investment operations taking place in another country. Even if a host State were to agree to a choice of forum clause pointing to the courts of the investor's home State or of a third State, sovereign immunity or other judicial doctrines will usually make such proceedings impossible (see Module 2.2).

Diplomatic protection

Diplomatic protection is a frequently used method to settle investment disputes. It requires the espousal of the investor's claim by his home State and the pursuit of this claim against the host State. This may be done through negotiations or through litigation between the two States before an international court or arbitral tribunal. But diplomatic protection has several disadvantages. The investor must have exhausted all local remedies in the host country. Moreover, diplomatic protection is discretionary and the investor has no right to it. Also, diplomatic protection is unpopular with States against which it is exercised and may lead to tensions in the relations of the States concerned (see Module 2.2).

Arbitration

Direct arbitration between the host State and the foreign investor is another option for the settlement of investment disputes. International arbitration provides an attractive alternative to the settlement of investment disputes by national courts or through diplomatic protection. Arbitration is usually less costly and more efficient than litigation through regular courts. It offers the parties the opportunity to select arbitrators who enjoy their confidence and who have the necessary expertise in the field. Moreover, the private nature of arbitration, assuring the confidentiality of proceedings, is often valued by parties to major economic development projects.

Ad hoc arbitration

If arbitration is not supported by a particular arbitration institution, it is referred to as *ad hoc* arbitration. *Ad hoc* arbitration requires an arbitration agreement (called a *compromis*) that regulates a number of issues. These include the selection of arbitrators, the applicable law and a large number of procedural questions. A number of institutions, like UNCITRAL, have developed standard rules that may be incorporated into the parties' agreement. *Ad hoc* arbitration is subject to the rules of the arbitration law of the country in which the tribunal

has its seat. The enforcement of awards rendered by such tribunals is subject to the same rules as awards by tribunals dealing with commercial cases (see Module 2.2).

Summary:

- **Domestic courts of the host State are usually not seen as offering sufficient guarantees to foreign investors.**
- **Domestic courts of the investor's home State and of third States are usually not available for the settlement of investment disputes.**
- **Diplomatic protection is a form of dispute settlement that carries uncertainties for the investor and inconvenience for the host State.**
- ***Ad hoc* arbitration between the investor and the host State is a useful option but carries several procedural disadvantages.**

2. THE HISTORY OF THE ICSID CONVENTION

a) Preparation

Origin of the ICSID Convention

The gaps in the existing structures for the settlement of investment disputes led to a new initiative in the 1960s. The plan was to create a mechanism specifically designed for the settlement of disputes between host States and foreign investors. The initiative came from the World Bank, an institution that is concerned with economic development. The driving force behind the Convention's drafting was the World Bank's General Counsel at the time, Aron Broches.

Drafting

The Convention's drafting took place from 1961 to 1965. The main bodies involved were the World Bank's legal department, the World Bank's Executive Directors and a series of regional meetings in which experts from 86 States participated.

Adoption

The text of the Convention together with a short explanatory report was adopted by the Executive Directors of the World Bank on 18 March 1965. Its official designation is Convention on the Settlement of Investment Disputes between States and Nationals of Other States.¹ It created the International Centre for Settlement of Investment Disputes (ICSID).² This is why the Convention is commonly referred to as the ICSID Convention.

b) Entry into Force and Participation

Entry into force

The ICSID Convention entered into force on 14 October 1966 after its ratification by 20 States.³ Of the early participating States most were developing countries notably in Africa.

Participation

Over the years, participation in the Convention has grown steadily. By mid-2002 135 countries were parties to the Convention. Another 17 had signed but not yet ratified the Convention.⁴ All major industrialized countries with the exception of Canada have become parties.⁵ Most African countries are parties. The majority of Arab countries are represented. Most Asian countries, including China, are parties. A number of former Soviet Republics, including the Russian Federation, have signed but not yet ratified the Convention.

¹ The text of the Convention is published in 575 United Nations Treaty Series 159; 4 International Legal Materials 524 (1965) and 1 ICSID Reports 3 (1993). An electronic version is available at <http://www.worldbank.org/icsid/basicdoc/9.htm>.

² See Articles 1-24 of the Convention.

³ See Article 68 of the Convention.

⁴ For a current list of participating States see: <http://www.worldbank.org/icsid/constate/c-states-en.htm>.

⁵ Of the 29 Member States of OECD only Canada, Mexico and Poland are not parties to the Convention.

Latin America

During the Convention's drafting, Latin American countries displayed a reserved attitude. Until 1980 Latin American countries uniformly stayed away from the Convention. This position softened in the 1980s. During the 1990s the picture changed completely: most countries in Latin America ratified the Convention. But a few important countries, including Brazil and Mexico, have so far stayed away.

c) Subsequent Developments

Case load

The use of the Convention's mechanisms was scant during its early years. The first case was not decided before 1974.⁶ This situation has since changed profoundly. Especially the 1990s have seen a dramatic increase in the number of registered cases. The current rate of new registered cases is about one per month. By September 2002 there were 66 concluded cases and 39 cases were pending.

Additional Facility

In 1978 the Additional Facility was created (see Module 2.2). It is designed primarily to offer methods for the settlement of investment disputes where only one of the relevant States, either the host State or the State of the investor's nationality, is a party to the Convention. This has turned out to be important in the context of NAFTA and, more recently, of the Energy Charter Treaty. The Additional Facility may also be used for disputes which do not directly arise out of an investment or for fact-finding proceedings.⁷ The Additional Facility is subject to its own rules and regulations. The ICSID Convention does not apply to it.

Summary:

- **The ICSID Convention was conceived and drafted in the framework of the World Bank.**
- **The ICSID Convention is widely ratified by industrialized as well as developing countries.**
- **Use of the arbitration mechanism under the ICSID Convention is widespread and intensive.**
- **The Additional Facility was created in 1978.**

⁶ *Holiday Inns v. Morocco (Case No. ARB/72/1) Decision on Jurisdiction, 12 May 1974. Unpublished.*

⁷ *For documentation on the Additional Facility see 1 ICSID Reports 213-280 (1993) and <http://www.worldbank.org/icsid/facility/facility.htm>.*

3. THE PURPOSE OF THE ICSID CONVENTION

Economic development

The Convention's primary aim is the promotion of economic development. The Convention is designed to facilitate private international investment through the creation of a favourable investment climate. The Preamble to the Convention expresses this purpose in the following terms:

Considering the need for international cooperation for economic development, and the role of private international investment therein;

Stimulation of investment

The link between an orderly settlement of investment disputes, the stimulation of private international investments and economic development is explained in the Report of the Executive Directors on the Convention in the following terms:

9. In submitting the attached Convention to governments, the Executive Directors are prompted by the desire to strengthen the partnership between countries in the cause of economic development. The creation of an institution designed to facilitate the settlement of disputes between States and foreign investors can be a major step toward promoting an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital into those countries which wish to attract it.

...

12. ... adherence to the Convention by a country would provide additional inducement and stimulate a larger flow of private international investment into its territories, which is the primary purpose of the Convention.⁸

The Tribunal in *Amco v. Indonesia* explained that ICSID arbitration is in the interest not only of investors but also of host States. It concluded:

Thus, the Convention is aimed to protect, to the same extent and with the same vigour the investor and the host State, not forgetting that to protect investments is to protect the general interest of development and of developing countries.⁹

Advantages of ICSID Convention

Compared to *ad hoc* arbitration, the ICSID Convention offers considerable advantages: it offers a system for dispute settlement that contains not only standard clauses and rules of procedure but also institutional support for the conduct of proceedings. It assures the non-frustration of proceedings and provides for an award's recognition and enforcement.

Balance of Interests

ICSID arbitration offers advantages to the investor as well as to the host State. Proceedings may be instituted by either side but in the majority of cases the investor is in the position of claimant. The Report of the Executive Directors

⁸ 1 ICSID Reports 25.

⁹ *Amco v. Indonesia, Decision on Jurisdiction*, 25 September 1983, 1 ICSID Reports 400. See also *Award*, 20 November 1984, 1 ICSID Reports 493.

on the Convention describes this balance of interests in the following terms:

13. While the broad objective of the Convention is to encourage a larger flow of private international investment, the provisions of the Convention maintain a careful balance between the interests of investors and those of host States. Moreover, the Convention permits the institution of proceedings by host States as well as by investors...¹⁰

Advantage to investor

The advantage for the investor is obvious: it gains direct access to an effective international forum should a dispute arise. The possibility of going to arbitration is an important element of the legal security required for an investment decision.

Advantage to host State

The advantage for the host State is twofold: by offering arbitration it improves its investment climate and is likely to attract more international investments. In addition, by consenting to ICSID arbitration the host State protects itself against other forms of foreign or international litigation.¹¹ Also, the host State effectively shields itself against diplomatic protection by the State of the investor's nationality.¹²

Summary:

- **The purpose of the Convention is the promotion of economic development through the creation of a favourable investment climate.**
- **The creation of an effective system for the settlement of disputes is an important element in the improvement of the investment climate.**
- **The ICSID Convention operates in the interest of investors as well as of host countries.**

¹⁰ 1 ICSID Reports 25.

¹¹ Article 26 of the Convention.

¹² Article 27 of the Convention.

4. CHARACTERISTICS OF THE ICSID CONVENTION

a) Choice of Methods

Conciliation

The ICSID Convention provides for two methods of dispute settlement, conciliation and arbitration. Conciliation is a more flexible and informal method that is designed to assist the parties in reaching an agreed settlement.¹³ Conciliation ends in a report that suggests a solution but is not binding on the parties. Therefore, this method ultimately depends on the continuing willingness of both parties to cooperate (see Module 2.2).

Arbitration

Arbitration is a more formal and adversarial process. Nevertheless, a considerable number of arbitration cases end in an agreed settlement. If no agreed settlement is reached, the outcome is an award that is binding on both parties and may be enforced (see Modules 2.2 and 2.9).

Preference for arbitration

In practice, arbitration is preferred over conciliation. The vast majority of cases brought to ICSID relate to arbitration. In fact, conciliation under the ICSID Convention is very rare.¹⁴ This is due, in part, to the fact that in case of a submission to both methods of settlement, the choice is with the party initiating proceedings. As a rule, it will seem wiser to direct the necessary effort and expense to proceedings that lead to a binding decision.

Summary:

- **The ICSID Convention provides for arbitration and conciliation.**
- **In practice, arbitration is nearly always the preferred method.**

b) Specialization on Investment Disputes

Meaning of «investment»

The ICSID Convention is specialized in the settlement of investment disputes. Therefore, the existence of a legal dispute arising directly out of an investment is a prerequisite for ICSID's jurisdiction.¹⁵ (See Module 2.5). The concept of an investment is not defined in the Convention.

Many BITs and multilateral treaties contain definitions of investment. But these definitions are not necessarily decisive for the meaning of the concept under the ICSID Convention. For instance, whereas some of these treaties extend rights also for the establishment of an investment, the Convention only applies once an investment has actually been made.

Broad concept of «investment»

In actual practice, the concept of “investment” has been given a wide meaning. A variety of activities in a large number of economic fields have been accepted

¹³ See Articles 28-35 of the Convention.

¹⁴ For this reason, this Module concentrates on arbitration and does not deal with conciliation.

¹⁵ Article 25(1) of the Convention.

as investments. In addition to traditional typical investment activities, these include pure financial instruments like the purchase of government bonds and the extension of loans. Decisive criteria are a certain duration of the relevant activities, the regularity of profit and return, the presence of a certain economic risk, a substantial commitment as well as the relevance of the project for the host State's development.

Summary:

- **The procedure under the Convention is available for investment disputes only.**
- **Practice under the Convention has interpreted the concept of investment widely.**

c) Applicable Law

<u>No substantive rules</u>	The ICSID Convention does not contain any substantive rules. It merely offers a procedure for the settlement of investment disputes. Any effort to codify the substantive law of international investment in the framework of the Convention would have led to insurmountable difficulties.
<u>Choice of law</u>	But the ICSID convention does contain a rule on applicable law (see Module 2.6). In other words, it directs tribunals how to find the rules to be applied to particular disputes. Tribunals are to follow any agreed choice of law by the parties. In the absence of an agreed choice of law, the Tribunal is to apply the law of the host State and international law. ¹⁶
<u>Importance of proper law</u>	Choice of law issues have played a prominent role in the practice of tribunals. The application of the correct system or systems of law is an essential requirement for a legitimate award. Failure to apply the proper law is regarded as an excess of powers and may lead to an award's annulment (see Modules 2.6 and 2.8).
<u>International law</u>	In applying international law, tribunals have applied treaties, especially BITs, as well as customary international law. General principles of law and judicial practice, especially of previous ICSID tribunals, have also played a prominent role (see Module 2.6).
<u>International and host State law</u>	The relationship of international law and domestic law has played an important role in ICSID practice. ICSID tribunals have held that where both systems of law are applicable, recourse to the host State's law is indispensable but international law has a supplementary and corrective function (see Module 2.6).
<u>Equity</u>	A tribunal may decide <i>ex aequo et bono</i> , that is on the basis of equity rather than law, only if it has been so authorized by the parties.

¹⁶ Article 42 of the Convention.

Summary:

- **The Convention does not contain substantive rules.**
- **The applicable law may be agreed upon by the parties.**
- **In the absence of an agreement, the applicable law is the host State's law and international law.**

d) The Parties to Proceedings

<u>Mixed proceedings</u>	Proceedings under the Convention are always mixed. One party (the host State) must be a Contracting State to the Convention. The other party (the investor) must be a national of another Contracting State ¹⁷ (see Module 2.4). Either party may initiate the proceedings.
<u>Constituent subdivisions and agencies</u>	States may also authorize constituent subdivisions or agencies to become parties in ICSID proceedings on their behalf.
<u>Natural or legal persons</u>	The investor can be an individual (natural person) or a company or similar entity (juridical person). Both types of persons must meet the nationality requirements under the Convention.
<u>Participation in Convention</u>	Both the host State and the investor's State of nationality must be Contracting Parties, that is, they must have ratified the ICSID Convention. The decisive date for participation in the Convention is the time of the institution of proceedings. If either State is not a party to the Convention, ICSID is not available but it may be possible to proceed under the Additional Facility.
<u>Locally incorporated company</u>	An additional requirement is that the investor must not be a national of the host State. But if a foreign investor operates through a company that is registered in the host State, it is possible for the investor and the host State to agree that the company will be treated as a foreign investor because of foreign control. ¹⁸

Summary:

- **Proceedings under the Convention are always mixed.**
- **Proceedings are between a host State that is a party to the Convention and an investor that has the nationality of another State party to the Convention.**
- **Under certain circumstances entities of the host State may become parties to proceedings.**
- **The investor may be a natural person or a juridical person.**
- **Under certain circumstances locally incorporated companies may be recognized as foreign investors for purposes of the Convention.**

¹⁷ Article 25(1) of the Convention.

¹⁸ Article 25(2)(b) of the Convention.

e) Consent to Jurisdiction

Requirement of consent

Participation in the ICSID Convention does not, by itself, constitute a submission to the Centre's jurisdiction. For jurisdiction to exist, the Convention requires separate consent in writing by both parties¹⁹ (see Module 2.3).

Forms of consent

Consent to the Centre's jurisdiction may be given in one of several ways. Consent may be contained in a direct agreement between the investor and the host State such as a concession contract. Alternatively, the basis for consent can be a standing offer by the host State which may be accepted by the investor in appropriate form. Such a standing offer may be contained in the host State's legislation. A standing offer may also be contained in a treaty to which the host State and the investor's State of nationality are parties. Most BITs and some regional treaties dealing with investments contain such offers. The more recent cases that have come before ICSID show a trend from consent through direct agreement between the parties to consent through a general offer by the host State which is later accepted by the investor often simply through instituting proceedings.

Binding nature of consent

Consent by the parties to arbitration under the Convention is binding. Once given by both parties, it may not be withdrawn unilaterally. A party may not determine unilaterally whether it has given its consent to ICSID's jurisdiction: the decision on whether jurisdiction exists is with the tribunal.²⁰

Limitations and conditions on consent

Consent can be given subject to conditions and limitations. For instance, host States may submit to ICSID's jurisdiction only in respect of certain types of disputes such as questions concerning compensation for expropriation. Consent may also be conditioned on certain procedural steps such as a prior attempt to reach a settlement by other means.

Summary:

- **Participation in the Convention does not amount to submission to proceedings under the Convention.**
- **Both parties must have given their written consent to jurisdiction.**
- **Consent may be given in a direct agreement between the parties.**
- **Consent may also be given through a general offer by the host State, contained in its legislation or a treaty, which is accepted by the investor.**

f) Institutional Support

Support by ICSID

Institutional support by the International Centre for Settlement of Investment Disputes (ICSID, the Centre) is one of the main advantages of arbitration

¹⁹ Article 25(1) of the Convention.

²⁰ Article 41 of the Convention.

under the ICSID Convention. The Centre performs a number of supportive functions in relation to arbitration.

Keeping of records

The Secretary-General of ICSID keeps a list of Contracting States that contains all information relevant to their participation in the Convention. In addition, the Secretary-General maintains lists of the Panels of Arbitrators, a register for requests for arbitration containing all significant procedural developments and archives containing the original texts of all instruments and documents in connexion with any proceeding.

Support in proceedings

The Secretary-General of ICSID and the staff of the Secretariat provide administrative support in arbitration proceedings. This support includes provision of a place for meetings at the Centre or elsewhere. ICSID also provides other assistance such as translations, interpretations and copying. The Secretary-General appoints an experienced member of the Centre's staff as Secretary for each tribunal. The Secretary of the tribunal makes the necessary arrangements for hearings, keeps minutes of hearings and prepares drafts of procedural orders. The Secretary also serves as the channel of communication between the parties and the arbitrators.

Accounting

The Secretary-General determines the charges payable to the Centre and consults with the tribunal on fees and expenses. He determines the fees of arbitrators. He receives advance payments from the parties and makes the payments necessary for the conduct of proceedings. He determines and receives the fees for lodging requests and the charges for specific services. In a particular proceeding, the Secretary of the tribunal administers this system on behalf of the Secretary-General.

Summary:

- **The Centre gives important institutional support in arbitration proceedings.**

g) Self-Contained and Automatic Nature of Proceedings

Self-contained proceedings

Proceedings under the ICSID Convention are self-contained. This means that they are independent of the intervention of any outside bodies. In particular, domestic courts have no power to stay, to compel or to otherwise influence ICSID proceedings. Domestic courts would have the power to order provisional measures only in the unlikely case that the parties agree thereto.²¹ An ICSID tribunal has to obtain evidence without the legal assistance of domestic courts. An annulment or other form of review of an ICSID award by a domestic court is not permitted.²² It follows that the place of proceedings

²¹ Under Article 47 of the Convention a tribunal has the power to recommend provisional measures.

²² Article 52 of the Convention provides for an autonomous system for the annulment of awards under narrowly defined circumstances.

²³ It is advisable to hold proceedings in a State that is a party to the ICSID Convention since another State would not be bound by the guarantees of independence and non-interference provided by the Convention.

has no practical legal consequences under the ICSID Convention²³ (see Module 2.7).

Non-frustration of proceedings

ICSID proceedings are not threatened by the non-cooperation of a party. The parties have much flexibility in shaping and influencing the proceedings. But if one of them should fail to act, the proceedings will not be stalled. The Convention provides a watertight system against the frustration of proceedings by a recalcitrant party. Arbitrators not appointed by the parties will be appointed by the Centre²⁴. The decision on whether there is jurisdiction in a particular case is with the tribunal.²⁵ Non-submission of memorials or non-appearance at hearings by a party will not stall the proceedings.²⁶ Non-cooperation by a party will not affect the award's binding force and enforceability (see Module 2.7).

Summary:

- **Arbitration proceedings under the Convention are self-contained and independent of outside interference.**
- **Non-cooperation by a party will not frustrate the proceedings.**

h) Effectiveness of the System

Overall effectiveness

The system of arbitration is highly effective. This effectiveness is the result of several factors. Submission to ICSID's jurisdiction is voluntary but once it has been given it may not be withdrawn unilaterally. The principle of non-frustration means that a case will proceed even if one party fails to cooperate. This circumstance alone will be a strong incentive to cooperate.

Binding nature of awards

Awards are binding and final and not subject to review except under the narrow conditions provided by the Convention itself²⁷ (see Module 2.8). Non-compliance with an award by a State would be a breach of the Convention²⁸ and would lead to a revival of the right to diplomatic protection by the investor's State of nationality.²⁹

Enforcement of awards

The Convention provides an effective system of enforcement. Awards are recognized as final in all States parties to the Convention. The pecuniary obligations arising from awards are to be enforced like final judgements of the local courts in all States parties to the Convention³⁰ (see Module 2.9). Domestic courts have no power to review ICSID awards in the course of their enforcement. However, in the case of an award against a State the normal rules on immunity from execution will apply. In actual practice this will usually

²⁴ Article 38 of the Convention.

²⁵ Article 41 of the Convention.

²⁶ Article 45 of the Convention.

²⁷ Articles 49-52 of the Convention.

²⁸ Article 53 of the Convention.

²⁹ Article 27 of the Convention.

³⁰ Article 54 of the Convention.

³¹ Article 55 of the Convention.

mean that execution is not possible against assets that serve the State's public functions³¹.

Preventive effect

The system of dispute settlement under the ICSID Convention is likely to be effective even without its actual use. The mere availability of an effective remedy tends to affect the behaviour of parties to potential disputes. It is likely to have a restraining influence on investors as well as on host States. Both sides will try to avoid actions that might involve them in arbitration that they are likely to lose. In addition, the prospect of litigation will strengthen the parties' willingness to settle a dispute amicably.

Summary:

- **The system of dispute settlement under the ICSID Convention is highly effective.**
- **It leads to a binding award that may be enforced in all States parties to the Convention.**

TEST MY UNDERSTANDING

After having studied this Module you should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. How do you evaluate the importance of private investment for economic development?
2. What factors influence a country's investment climate?
3. What are the most important legal aspects of the conditions for investment in a country?
4. What is the most important type of treaty in contemporary investment law?
5. What are the traditional methods of settlement for investment disputes between States and foreign investors? What are their advantages and disadvantages?
6. In what institutional framework was the ICSID Convention created?
7. What is the full official name of the ICSID Convention?
8. What does the acronym ICSID stand for?
9. What is the Additional Facility?
10. What is the purpose of the ICSID Convention?
11. Is the ICSID Convention in the mutual interest of the host State and the investor? If so, why?
12. What are the methods for the settlement of disputes under the ICSID Convention? Which is used more often in actual practice?
13. Does the Convention contain substantive rules of investment law?
14. What is the applicable law on the merits in ICSID proceedings?
15. ICSID proceedings are always mixed. What does that mean?
16. Does participation of a State in the Convention entail consent to jurisdiction in ICSID proceedings?
17. In what way may the parties give consent to jurisdiction?
18. What type of institutional support does ICSID offer?
19. In what way are ICSID proceedings self-contained?
20. Can a party frustrate ICSID proceedings through non-cooperation?
21. What makes ICSID proceedings effective?

HYPOTHETICAL CASE

This is a hypothetical case. But it contains elements that have arisen in real cases or may well arise in future cases.

The purpose of this hypothetical case is twofold:

1. After you have studied this Module, you should look at this case as an illustration of the various legal questions that can arise in proceedings under the ICSID Convention. These legal questions are discussed in more detail in Modules 2.2 to 2.9.
2. After you have studied all Modules on the Settlement of International Investment Disputes and ICSID (Modules 2.1 to 2.9) you should be able to discuss the questions arising in this case in detail and you should be able to offer answers to all of them.

Veggies UnLtd v. Felafistan

Veggies UnLtd is a corporation registered under the law of Lechuga. The majority of its shares are in the hands of citizens of Pommonia. It is specialized in large scale agricultural projects. In 2003 Veggies UnLtd successfully competes for a contract to develop the agriculture of Felafistan, a small developing country. On 3 March 2003 Felafistan and Veggies UnLtd sign a Protocol of Understanding which outlines the basic features of a contract. Veggies UnLtd is to register a local company in Felafistan for the purpose of carrying out the project. This company, Veggies UnLtd(FE) is to provide the capital and know-how and is to establish twelve large farms called “industrial crop concerns” within three years from the date of signature of the Protocol of Understanding. After that, it is to operate the farms for a period of 25 years in order to recoup its expenses and to make a profit. After that period it is to hand over the facilities to the Government of Felafistan. The contract contains an Article 7 according to which “The investor shall have full access to the courts of Felafistan in case any disputes under the present Protocol of Understanding should arise.” Further details are to be worked out in subsequent contracts. The project is valued at •120 million.

After a change of government in Felafistan in August 2003, the new administration needs time to study the project. Veggies UnLtd, aware of the limited period it has for the establishment of the industrial farms, incorporates a wholly owned subsidiary Veggies UnLtd(FE) and starts work in May 2004. It continues to do so until September 2004. In the meantime, enthusiasm for the project fades in public opinion and in government circles in Felafistan. In particular, there is widespread criticism that the control over a major part of agricultural production and over natural resources connected with it should be in foreign hands for a quarter of a century. On 7 September 2004, the Parliament of Felafistan passes a resolution calling upon the government to

cancel the project. The government simply informs Veggies UnLtd(FE) of that decision without any further comment. By that time none of the more detailed contracts subsequent to the Protocol of Understanding have been signed. Veggies UnLtd, which claims to have invested over •80 million discontinues work immediately after it hears of the decision to cancel the project.

After some unproductive attempts to reach an agreed settlement, the government of Lechuga starts exercising diplomatic protection on behalf of Veggies UnLtd against Felafistan. After about a year of fruitless negotiations, Veggies UnLtd decides to institute arbitration against Felafistan. The Bilateral Investment Treaty between Lechuga and Felafistan of December 2003 (the BIT) contains the following provision on the settlement of disputes between host States and foreign investors in its Article 11:

- (2) *If such disputes cannot be settled according to the provisions of paragraph (1) of this article within a period of six months from the date either party to the dispute requested amicable settlement, the dispute shall be submitted to international arbitration or conciliation.*
- (3) *Where the dispute is referred to international arbitration or conciliation, the aggrieved party may refer the dispute either to:*
 - (a) *the International Centre for the Settlement of Investment Disputes ...; or*
 - (b) *an international arbitrator or an ad hoc arbitration tribunal to be appointed by a special agreement or established under the arbitration rules of the United Nations Commission on International Trade Law.*
- (4) *Each Contracting Party hereby consents to the submission of an investment dispute to international arbitration or conciliation.*

Lechuga is a party to the ICSID Convention since 1975. Felafistan ratified the Convention in November 2003. Veggies UnLtd as well as Veggies UnLtd(FE) institute proceedings with ICSID. The request is registered in February 2006. Veggies UnLtd relies on Article 11 as well as on Article 1 of the BIT which says:

For the purposes of this Agreement:

- (a) *“investment” means every kind of asset and in particular, though not exclusively, includes:*
 - (i) *movable and immovable property and any other property rights such as mortgages, liens or pledges;*
 - (ii) *shares in and stock and debentures of a company and any other form of participation in a company;*
 - (iii) *claims to money or to any performance under contract having a financial value;*
 - (iv) *intellectual property rights, goodwill, technical processes and know-how;*



- (v) *business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources...*

Felafistan does not, at first, respond to the communications from ICSID. The Tribunal is composed in accordance with Article 38 of the ICSID Convention. After its constitution, the Tribunal holds its first session at which Felafistan is not represented. The Tribunal sets time limits for the submission of memorials. Felafistan misses the first deadline, whereupon Veggies UnLtd requests the Tribunal to render an award in its favour on the basis of its submissions. The Tribunal instead gives Felafistan an extension of the deadline. Felafistan submits a memorial within the extended deadline signed by the law firm Avocado, Legume & Krautkopf. The memorial contains detailed arguments on jurisdiction and on the merits.

On jurisdiction, Felafistan argues that there was no legitimate investment since the parties never signed the detailed contracts envisaged in the Protocol of Understanding. Felafistan also argues that both Veggies UnLtd and Veggies UnLtd(FE) do not fulfil the nationality requirements under the ICSID Convention. Veggies UnLtd is controlled by shareholders of Pommonian nationality and is hence a Pommonian national. But Pommonia is neither a party to the ICSID Convention nor has it entered into a BIT with Felafistan. Veggies UnLtd(FE) is registered in Felafistan and hence not a national of another Contracting State. In addition, Felafistan argues that the Protocol of Understanding contained a choice of forum in favour of the local courts thereby ousting ICSID's jurisdiction. Finally, Felafistan argues that Article 11 of the BIT requires an agreement of the parties to choose between arbitration and conciliation as well as between ICSID and UNCITRAL.

On the merits, Felafistan argues that it has violated neither the standards of fair and equitable treatment nor of most favoured nation treatment guaranteed in the BIT. Moreover, the investment (if it was indeed an investment) was contrary to the law of Felafistan since Veggies UnLtd never obtained the necessary licences that were to be issued on the basis of the detailed contracts.

Veggies UnLtd contests all the arguments put forward by Felafistan. It insists that it made an investment on the basis of a binding contract. It also insists that it has the nationality of Lechuga. It also argues that the reference in the Protocol of Understanding to the courts of Felafistan did not deprive it of its right under the BIT to resort to ICSID arbitration. It also argues that it can exercise the choice of settlement procedures provided in Article 11 of the BIT unilaterally.

Veggies UnLtd relies on the protection offered by the BIT and on the international law doctrines of acquired rights and good faith. It refers to Article 12 of the BIT which provides:

The arbitration Tribunal established in accordance with Article 11 shall decide on the basis of the law of the Contracting Party which is a party to the dispute (including its rules on the conflict of law), the provisions of the present Agreement, special Agreements concluded in relation to the investment concerned as well as such rules of international law as may be applicable

In a second memorial, Felafistan reiterates its arguments on jurisdiction as well as on the merits and indicates that it shall seek the annulment of the award should the Tribunal find against it. It also adopts a defiant attitude towards compliance with an adverse award.

You are a member of the arbitral tribunal. The tribunal will discuss all the issues raised by the parties and reach a conclusion on them. These conclusions should be reflected in the award which must comply with all the requirements under the ICSID Convention.

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Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- List of Contracting States and other Signatories of the Convention:
<http://www.worldbank.org/icsid/constate/c-states-en.htm>
- ICSID Cases:
<http://www.worldbank.org/icsid/cases/cases.htm>

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.2 SELECTING THE APPROPRIATE FORUM



UNITED NATIONS
New York and Geneva, 2003

NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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OVERVIEW

This Module gives an overview of the most important legal questions concerning the selection of the appropriate forum for investment disputes between States and private parties. In this context arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention) is just one alternative.

An important aspect of the efficiency of any dispute settlement mechanism lies in its ability to avoid uncertainties concerning the appropriate forum where a dispute is to be resolved. Thus, a duplication or multiplication of available fora for the settlement of a particular dispute may lead to protracted litigation before the merits of a dispute are even touched.

This is also true for the settlement of investment disputes where a whole range of dispute settlement forums are potentially available, among them national courts, ad hoc or various institutional kinds of arbitration or conciliation, ICSID conciliation or ICSID arbitration, Additional Facility conciliation or arbitration and, to some extent also, diplomatic protection, ultimately leading to international courts or tribunals.

Past practice before ICSID (International Centre for Settlement of Investment Disputes) panels has sometimes involved complex disputes over jurisdictional issues. Although the majority of these jurisdictional disputes did not directly concern choice-of-forum issues, it is highly advisable to draft dispute settlement clauses as precisely and unambiguously as possible in order to avoid time-consuming disputes over the appropriate dispute settlement forum.

This Module will illustrate the main types of forums available and shortly describe their main advantages and disadvantages in order to assist in assessing the most appropriate forum for a particular dispute.

OBJECTIVES

Upon completion of this Module the reader should be able to:

- Appreciate the limited usefulness of domestic courts for investment disputes.
- Compare the characteristics of conciliation and arbitration.
- Explain the difference between ad hoc and ICSID arbitration.
- Describe the advantages of ICSID arbitration.
- Delineate the availability of ICSID arbitration.
- Define the function of the Additional Facility.
- Explain the nature and function of diplomatic protection.
- Discuss the role of international courts and tribunals other than ICSID in investment disputes.

INTRODUCTION

Proliferation of dispute settlement mechanisms

An important aspect of the efficiency of any dispute settlement system lies in its ability to avoid uncertainties concerning the appropriate forum in which a dispute is to be resolved. Thus, a duplication or multiplication of available forums for the settlement of a particular dispute may lead to protracted litigation over jurisdiction before the merits of a dispute are even touched.

In the case of investment disputes a whole range of dispute settlement mechanisms is potentially available. Among them are national courts, ad hoc or institutional arbitration, ICSID conciliation or arbitration, ICSID Additional Facility conciliation or arbitration and, to some extent also, diplomatic protection possibly leading to inter-State dispute settlement forums of last resort, such as the International Court of Justice (ICJ).

Imprecise dispute settlement provisions

Unfortunately, States are often deliberately vague in consenting to dispute settlement. It is thus quite common that national investment legislation or bilateral investment treaties (BITs), through which States can make a valid offer to consent to ICSID arbitration under Art. 25 of the ICSID Convention¹, contemplate domestic courts, International Chamber of Commerce (ICC)², the United Nations Commission on International Trade Law (UNCITRAL)³ or ad hoc arbitration as alternatives to ICSID disputes settlement without making a clear choice.

Alternative dispute settlement in BITs

The dispute settlement clauses in many BITs refer to ICSID as one of several possibilities. Some of these composite settlement clauses require a subsequent agreement of the parties to select one of these procedures. Others contain the State's advance consent to all of them, thereby giving the parties a choice. A relatively simple example of this technique may be found in some Swiss BITs. For instance, the Switzerland-Ghana BIT of 1991 provides in its Art. 12:

- (2) *If such disputes cannot be settled according to the provisions of paragraph (1) of this article within a period of six months from the date either party to the dispute requested amicable settlement, the dispute shall be submitted to international arbitration or conciliation.*
- (3) *Where the dispute is referred to international arbitration or conciliation, the aggrieved party may refer the dispute either to:*
 - (a) *the International Centre for the Settlement of Investment Disputes ...; or*
 - (b) *an international arbitrator or an ad hoc arbitration tribunal to be appointed by a special agreement or established under the arbitration rules of the United Nations Commission on International Trade Law.*

¹ See Module 2.3 on Consent to Arbitration.

² International Chamber of Commerce.

³ United Nations Commission on International Trade Law.

(4) *Each Contracting Party hereby consents to the submission of an investment dispute to international arbitration or conciliation.*

**Importance of an
express choice-of-
forum selection**

Parties to an investment agreement may help avoiding these uncertainties by expressly designating a specific competent forum for the settlement of their disputes. Ideally, such a choice-of-forum should form part of the initial investment agreement but it can also be included in a subsequent agreement.

Summary:

- **The proliferation of dispute settlement mechanisms may lead to protracted litigation over jurisdiction.**
- **Investment disputes may be settled before national courts, ad hoc, ICSID, or ICSID Additional Facility conciliation or arbitration, as well as diplomatic protection possibly leading to inter-State arbitration or to the International Court of Justice.**
- **ICSID conciliation or arbitration is just one option among many.**
- **Dispute settlement provisions in the investment field are frequently imprecise.**
- **An express choice-of-forum selection helps to avoid jurisdictional uncertainties.**

1. SPECIAL NATURE OF INVESTMENT DISPUTES

Mixed nature of investment disputes involving States and private parties

While commercial disputes between private parties are usually settled before national courts or arbitral panels, disputes of an economic character between States may fall under the jurisdiction of the International Court of Justice or other (specialized or regional) judicial dispute settlement systems. In the past, mixed disputes, i.e. disputes between States and private parties, in particular those relating to investments, were mostly settled either before national courts or through ad hoc arbitration⁴ both of which have serious disadvantages. For such disputes no appropriate forum seemed to be generally available.

Purpose of ICSID

It was one of the main purposes of the ICSID Convention to close this gap in available procedures.

Different forums for investment disputes

As will be explained in this Module, dispute settlement through ICSID arbitration is the most appropriate form of settlement for investment disputes. Still, it would be incorrect to maintain that other forms of dispute settlement including national and international courts, other (non-ICSID) arbitration or conciliation, would not be available for investment disputes as a matter of principle. In fact, there is a substantial jurisdictional overlap, i.e. situations where one and the same dispute may be settled in different forums.

Summary:

- **Commercial disputes between private parties are normally settled before national courts or by arbitration.**
- **Economic disputes between States are normally settled before international tribunals or by inter-State arbitration.**
- **Mixed disputes, i.e. disputes between States and private parties, in particular those relating to investments, may be settled before a variety of forums.**
- **ICSID was expressly designed to provide a forum for the settlement of such mixed disputes.**

⁴ See infra Sections 1 and 5.

2. NATIONAL COURTS

National courts as “subsidiary” forum

In the absence of any specific agreement, investment disputes between States and private parties would normally fall under the jurisdiction of national courts,⁵ most likely those in the host State of an investment. The courts of which particular State will have jurisdiction is a question of conflict of laws rules. They will normally point to the national courts of the host State.

Consent to ICSID arbitration excludes national courts

The ICSID Convention does not exclude access to national courts as such. In other words, States parties and nationals of States parties to the Convention are not automatically prevented from litigating before their own or foreign national courts. However, once they have both consented to ICSID arbitration, such consent, in principle, excludes any other remedy including national courts.

Art. 26, first sentence of the ICSID Convention provides:

Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy.

Exhaustion of local remedies

A limited exception may apply in cases where the State has given its consent to arbitration under the condition of the exhaustion of local remedies. Art. 26, second sentence of the ICSID Convention provides:

A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.

Only a few States have conditioned their consent to ICSID jurisdiction on the prior exhaustion of local remedies. A relatively small number of bilateral investment treaties and a few investment agreements with investors contain such a condition.

a) Courts of the Host State

Closest connexion to host State

Because of the specific nature of investment relations between a private party and a State it is likely that these relations will be held to have their closest connection to the State where the investment is made, i.e. the host State. Thus, most applicable jurisdictional rules will point to the domestic courts of that State as competent forums for the settlement of any disputes arising from an investment.

Consequences of host State forum

Such a forum will usually entail a number of specific consequences that will be viewed differently by the parties involved.

Application of mandatory host State law

As far as the applicable law is concerned, courts of host States of investments

⁵ Cf. Preambular paragraph 3 to the ICSID Convention recognizes “national legal processes” as the usual method of dispute settlement.

– like any national courts – will be guided by their own domestic rules of private international law/conflict of laws. This implies that even if they – as a general principle – respect the parties’ choice-of-law, they will demand the application of non-derogable norms under the law of the host State, which may, in particular, relate to the law of foreign investments.

Preference for national over international law

Further, depending on the forum State’s legal approach towards the incorporation of international law into the domestic legal order, national courts may give automatic preference to the application of national over international law even if the former clearly contradicts the latter.

Actual or perceived inequality

In addition to these objective technical difficulties, actual or perceived partiality, prejudice, and/or lack of expertise on the part of national judges may prevent the parties from litigating on an equal footing. These consequences usually make national courts unattractive for investors.

b) Courts of the Home State of Investors and Courts of Third States

Choice-of-forum clauses

The courts of host countries may be avoided by express choice-of-forum clauses or agreements opting for other national courts, such as the courts in the home State of the investor or courts in third States. Courts in the home State of the investor are unlikely to be accepted by the host State in the case of traditional investment agreements. However, this is not uncommon in the case of loan contracts. Opting for courts in third States is common in international commercial disputes settlement, e.g. a sales contract between a US buyer and an Indian seller providing for the jurisdiction of Swiss courts. But it is an unlikely choice for investment disputes.

State immunity

Dispute settlement before the courts of home States of investors or of third States may be impracticable in the context of investment disputes because it involves sovereign States in an area where they frequently act not only commercially (*jure gestionis*), but also in the exercise of their sovereignty (*jure imperii*). Thus, even in jurisdictions following a restrictive concept of State/sovereign immunity, actions brought by private parties against host States of investments would face major procedural obstacles, in particular, a high likelihood that the courts would regard such actions inadmissible. This is especially true in the case of outright expropriations or regulatory action which may amount to an expropriation (“constructive takings” or “*de facto* expropriations”).

Waiver of immunity

As a consequence, parties considering a stipulation according to which the courts of the home State of investors or of a third State should be competent to decide any future investment dispute between them, should be aware of the risk of inadmissibility of litigation as a result of sovereign immunity and, take the necessary precautionary steps, e.g. by including an express waiver of immunity.

Act-of-State doctrine or non-justiciability

One should be aware, however, that such precaution does not eliminate the risk that some national courts, in particular those following the Anglo-American tradition of the act-of-State doctrine might abstain from questioning the legality of sovereign acts of the host State taken within the territory of that State. The justiciability of investment disputes may also be questionable in other domestic legal systems. The legality of expropriations or the validity of national legislation affecting foreign investments will frequently give rise to questions of a political nature and therefore be considered inappropriate for judicial dispute settlement.

Sabbatino Case

The *Sabbatino*⁶ decision of the United States Supreme Court is one of the leading cases on the act-of-State doctrine. On its face, the dispute between the Cuban National Bank and a court-appointed receiver of an American-owned company which had been expropriated by the Cuban Government concerned the entitlement to the proceeds of sugar sales on the United States market. In essence, however, it was about the legality of the Cuban expropriations in the early 1960s. On appeal, the United States Supreme Court held that

*[...] the Judicial Branch will not examine the validity of a taking of property within its own territory of a foreign sovereign government, [...] even if the complaint alleges that the taking violates customary international law.*⁷

As a result the American courts upheld the effectiveness of the Cuban expropriations, irrespective of their legality under international law.⁸

Chilean Copper Nationalization Cases

The 1971 nationalization measures of the Government of Chile equally led to litigation in foreign domestic courts. One of the affected United States companies brought actions in French and German courts asserting its continuing property rights in imported Chilean copper. It argued that the Chilean expropriations were illegal because they were discriminatory and not accompanied by compensation and should thus not be recognized in France or Germany. Both a court in Paris⁹ and one in Hamburg¹⁰ rejected the immunity defense raised by a Chilean state-owned export/import enterprise because of the “commercial activity” of its trading business. However, on the merits, they both refused to rule on the validity of the Chilean expropriation measures – although they expressed severe doubts whether the nationalizations were in conformity with the requirements of public international law – on rather technical grounds. They reasoned that under the “territoriality principle” expropriations which do not cover property located outside the borders of the

⁶ *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964); 3 ILM (1964) 381-416.

⁷ 376 U.S. 398 (1964) at 428.

⁸ See also *First National City Bank v. Banco Nacional de Cuba*, 406 U.S. 759 (1972).

⁹ *Corporación del Cobre c. Société Braden Copper Corporation et Société le Groupement d’Importation des Métaux*, *Tribunal de grande instance de Paris*, 29 November 1972; 12 ILM 182-189 (1973).

¹⁰ *Chile-Kupfer-Streit*, *Landgericht Hamburg*, 22 January 1973; 12 ILM (1973) 251-289, 13 ILM 1115-1125 (1974).

expropriating State “must in principle be recognized as formally valid.” In addition, the Hamburg court stated that a "de-recognition" of the Chilean expropriation measures – as a result of being contrary to the German “ordre public” – were only possible “if the German legal system [were] substantially affected by the violation of public policy and thus a close relationship between what [had] been done and German interests [were] created.”

No immunity, act-of-State or non-justiciability risk in ICSID

All these risks can be avoided by choosing ICSID arbitration which does not contain any limitation relating to State immunity, act-of-State and justiciability.

Summary:

- **National courts are available forums, in principle, for the settlement of investment disputes.**
- **Only consent to arbitration, not ratification of the ICSID Convention excludes national courts from the settlement of investment disputes.**
- **Domestic courts of host States of investments are likely to favour the application of their own national law over foreign law and international law.**
- **Litigation before domestic courts of the home State of investors or of third States may be inconvenient or outright impossible because of State immunity, act-of-State or non-justiciability.**

3. ICSID CONCILIATION

ICSID conciliation rare

The ICSID Convention itself offers both conciliation and arbitration (Art. 1 para. 2) and treats both methods of dispute settlement in an equal manner. In practice, however, ICSID conciliation has been relatively infrequently resorted to,¹¹ while ICSID arbitration has become a very significant and successful method of settling international investment disputes.

a) Conciliation or Arbitration?

Ambiguous ICSID clauses

The parties may have consented to both conciliation and arbitration without specifying any preference. This is reinforced by the fact that Art. 25 of the ICSID Convention speaking of the “jurisdiction of the Centre” does not differentiate between the two dispute settlement techniques. An unspecified submission under the Centre’s jurisdiction will be ambiguous and may lead to a dispute about the appropriate method of dispute settlement.

Choice of party instituting proceedings

Past practice, however, has not proven very contentious in this respect. Clauses providing for the submission under the jurisdiction of the Centre cumulatively or alternatively envisaging conciliation and/or arbitration have been generally treated as leaving the choice to the party instituting proceedings.

SPP v. Egypt

This view was most clearly expressed by the ICSID Tribunal in *SPP v. Egypt*, where jurisdiction was based on Art. 8 of Egypt’s Law No. 43 of 1974, which provided, in an unspecified fashion, for the settlement of disputes “within the framework of the Convention.” The Tribunal held that the ICSID Convention does not require that:

[...] consent to the Centre’s jurisdiction must specify whether the consent is for purposes of arbitration or conciliation. Once consent has been given “to the jurisdiction of the Centre”, the Convention and its implementing regulations afford the means for making the choice between the two methods of dispute settlement. The Convention leaves that choice to the party instituting the proceedings.¹²

Nevertheless, an indeterminate submission under the jurisdiction of the Centre may lead to problems if one party opts for conciliation. In such a situation the other party is prevented from instituting or ultimately insisting on arbitral proceedings unless it is clearly provided for that unsuccessful conciliation is followed by arbitration at some stage.

It is thus advisable to specify in advance whether the parties’ consent relates to conciliation or arbitration or – if both methods should remain available – to

¹¹ As of December 2001 only three request for conciliation have been filed. Cf. the ICSID homepage at <<http://www.worldbank.org/icsid/cases/cases.htm>>.

¹² *SPP v. Egypt, Decision on Jurisdiction II, 14 April 1988, 3 ICSID Reports 156.*

spell out clearly which party may choose or whether there should be conciliation followed, if necessary, by arbitration.¹³

b) Conciliation as a Method of Dispute Settlement

Consensual nature of conciliation

Like other forms of conciliation, ICSID conciliation is a highly flexible and informal method of dispute settlement involving a third party that assists the disputants in reaching an agreed settlement. Whereas arbitration – like adjudication – follows an adversarial procedure leading to a binding decision by a third party, the outcome of conciliation ultimately requires agreement by both parties. A conciliator or conciliation commission may suggest a solution¹⁴ to the parties in order to “bring about agreement between them upon mutually acceptable terms.”¹⁵ Such a solution can never be imposed on the parties against their will.

c) Pros and Cons of ICSID Conciliation

Advantages

Conciliation offers considerable flexibility and informality. It has generally – and also in the limited ICSID experience – proven to be less expensive than arbitration. Further, the fact that ultimately any settlement remains in the hands of the parties prevents excessive antagonisms. Because of its consensual nature it may be particularly useful in cases of disputes where the parties are willing to continue their investment cooperation.

Disadvantages

As with conciliation in general, ICSID conciliation does not stand for independent third-party dispute settlement resolution. Thus, each party to the dispute can always block a solution. This is generally considered to be the major weakness of conciliation.

Summary:

- **Though the ICSID Convention treats arbitration and conciliation equally, in practice it is nearly always arbitration that is chosen.**
- **If the “consent” of the parties to the jurisdiction of the Centre does not clearly indicate whether arbitration or conciliation should be pursued, the party instituting proceedings may choose between the two.**
- **Conciliation is a highly flexible and informal method of dispute settlement involving a third party that assists the disputants in reaching an agreed settlement.**
- **Where parties intend to continue their investment cooperation the consensual nature of ICSID conciliation may be particularly useful.**
- **Dispute settlement under ICSID conciliation may be obstructed by an uncompromising party.**

¹³ Cf. 1993 ICSID Model Clauses, 4 ICSID Reports 357.

¹⁴ According to Art. 34 (1) ICSID Convention a Conciliation Commission may “recommend terms of settlement.”

¹⁵ Art. 34 (1) ICSID Convention.

4. ICSID ARBITRATION

ICSID Convention as framework

ICSID arbitration is not obligatory for States and investors from other States merely because both States are parties to the Convention. The last paragraph of the preamble to the ICSID Convention provides the following:

Declaring that no Contracting State shall by the mere fact of its ratification, acceptance or approval of this Convention and without its consent be deemed to be under any obligation to submit any particular dispute to conciliation or arbitration,

Rather, the Convention provides them with an option to agree on arbitration. Arbitration becomes binding only upon the written consent of the parties to arbitration either in an investment agreement or otherwise.¹⁶

ICSID arbitration – institutional support and flexibility

The ICSID Convention intends to offer a compromise between a fixed set of rules and the benefits of institutional support on the one hand, and the flexibility and autonomy usually regarded as the advantages of arbitration, on the other.

a) Institutional Support Provided by ICSID

Institutional support by the Centre

The Convention establishes the Centre endowed with separate international legal personality.¹⁷ However, it is not the Centre itself which engages in arbitration. Rather, the Centre provides facilities for the arbitration of investment disputes.¹⁸ This institutional facilitation is manifold and includes:

- keeping lists ("panels") of possible arbitrators;¹⁹
- screening and registering arbitration requests;²⁰
- assisting in the constitution of arbitral tribunals and the conduct of proceedings;²¹
- adopting rules and regulations;²²
- drafting model clauses for investment agreements.

b) An Effectively Functioning System

Non-frustration of proceedings

ICSID arbitration is designed to prevent a potential danger inherent in many arbitration systems, i.e. the risk that one party having previously consented to arbitration obstructs the arbitration proceedings by its refusal to cooperate.

ICSID precautions

With this overriding purpose in mind, the Convention provides that consent, once given, may not be unilaterally withdrawn (Art. 25 para. 1); that arbitral tribunals have the exclusive competence to decide on their own jurisdiction

¹⁶ See Module 2.3 on Consent to Arbitration.

¹⁷ Arts. 1 and 18 ICSID Convention.

¹⁸ Art. 1 ICSID Convention.

¹⁹ Arts. 12 et seq. ICSID Convention.

²⁰ Art. 36 para. 3 ICSID Convention.

²¹ Art. 38 ICSID Convention.

²² Art. 6 para. 1 ICSID Convention.

(Art. 41 para. 1); that awards are binding and enforceable (Arts. 53, 54) and may not be disregarded or challenged on the ground of nullity except under the Convention's own annulment procedure (Art. 52).

The Convention also attempts to foreclose unilateral attempts of obstruction during the proceedings. It specifically provides for the appointment of arbitrators by the Centre in case a party fails to do so (Art. 38) and generally assures that lack of cooperation by any party will not prevent continuation of the proceedings (Art. 45).

c) Which Investment Disputes May be Settled Through ICSID Arbitration?

Jurisdictional requirements for ICSID arbitration

Not all investment disputes may be brought before ICSID arbitration panels. Rather, access to ICSID arbitration depends upon the fulfilment of the jurisdictional requirements provided for in Art. 25 of the Convention. These requirements relate both to the nature of the dispute (*ratione materiae*) and to the parties of the dispute (*ratione personae*).

Ratione materiae and ratione personae requirements

According to Art. 25 of the Convention the subject-matter jurisdiction of the Centre is limited to "legal disputes" arising "directly" out of an "investment."²³ Its personal jurisdiction extends over "Contracting States (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State)", on the one hand, and "nationals of another Contracting State", on the other.²⁴

Objective nature of jurisdictional requirements

These are objective jurisdictional requirements which cannot be replaced by an agreement of the parties. In other words, even if parties to an investment agreement expressly gave their consent to ICSID arbitration, any arbitral panel would have to satisfy itself of the fact that the dispute directly arose from an investment, was of a legal nature and that both the home State of the investor and the host State of the investment were Contracting Parties of the ICSID Convention.

Additional Facility as an alternative

This limit to the jurisdiction of ICSID was one of the major reasons for creating the Additional Facility granting access to the Centre's arbitration even in situations where the ICSID Convention's objective jurisdictional requirements are not wholly met.²⁵

d) Advantages of ICSID Arbitration

Advantages for investors

ICSID arbitration offers a number of advantages to investors.

- ICSID arbitration provides investors with direct access to a form of international dispute settlement.

²³ See Module 2.5 on requirements *ratione materiae*.

²⁴ See Module 2.4 on requirements *ratione personae*.

²⁵ See *infra* Section 3.

- Investors are not restricted to national courts in the host State.
- Investors do not depend upon the willingness of their home States to exercise diplomatic protection on their behalf.
- The enforcement provisions of the ICSID Convention make it highly probable that a final ICSID award will be effectively enforceable.²⁶

Advantages for host States

Host States too may benefit in various ways from the availability of ICSID arbitration.

- Legal security for investors attracts investment; it creates a "favourable investment climate". In this respect the mere availability of an effective remedy and not necessarily its ultimate use is likely to be crucial for increasing the respect of investment rules.
- Consent to ICSID arbitration excludes the "harassment" potential of diplomatic protection exercised by the home State of investors against host States.

e) Relation of ICSID Arbitration to Other Dispute Settlement Methods

Exclusivity of ICSID arbitration

ICSID arbitration is one of a number of available forums for the settlement of investment disputes between private parties and States. Even investors from a contracting party of the ICSID Convention in their agreements with host States that are equally contracting parties of the Convention are not obligated to submit to ICSID arbitration. The "exclusivity" provided for in Art. 26 of the Convention operates only once the parties have consented to ICSID arbitration. With such consent, however, they lose their right to avail themselves of other – international or national – forums since they have consented to ICSID arbitration "to the exclusion of any other remedy".

Attorney-General v. Mobil Oil NZ Ltd

The case of *Attorney-General v. Mobil Oil NZ Ltd*.²⁷ provides an example of a domestic court respecting the Centre's exclusive right to determine its own jurisdiction. In this case the New Zealand government instituted parallel proceedings before its own domestic courts in order to obtain an interim injunction seeking to restrain Mobil Oil from continuing the proceedings before ICSID. Basing its decision, inter alia, on Art. 26 of the ICSID Convention, the New Zealand High Court stayed the proceedings until the ICSID Tribunal had determined its jurisdiction in *Mobil Oil v. New Zealand*.²⁸

²⁶ See Module 2.9 on binding force and enforcement.

²⁷ *Attorney-General v. Mobil Oil NZ Ltd.*, High Court, Wellington, 1 July 1987, 4 ICSID Reports 117.

²⁸ *Mobil Oil v. New Zealand, Findings on Liability, Interpretation and Allied Issues*, 4 May 1989, 4 ICSID Reports 140, 164.

MINE v. Guinea

Also in the protracted litigation of *MINE* against *Guinea* Belgian²⁹ and Swiss³⁰ courts refused to exercise their jurisdiction to provide interim remedies on the basis of Art. 26 of the ICSID Convention because ICSID proceedings were pending.

The ICSID Tribunal in *Maritime International Nominees Establishment (MINE) v. Guinea*³¹ strongly affirmed the exclusivity of ICSID arbitration vis-à-vis national court proceedings.

Summary:

- **ICSID arbitration combines the advantages of institutional support and the flexibility and party-autonomy of ad hoc arbitration.**
- **ICSID itself does not serve as an arbitration body.**
- **The Centre provides institutional support of various kinds.**
- **ICSID arbitration is designed to function effectively even if one party fails to cooperate in the proceedings.**
- **ICSID arbitration is available for “legal disputes” arising “directly” out of an “investment” between “Contracting States” and “nationals of another Contracting State”.**
- **ICSID arbitration offers a high level of effectiveness for investors, including direct access to international dispute settlement and increased enforceability of awards.**
- **By creating a “favourable investment climate” ICSID arbitration enhances foreign investment in host States.**
- **ICSID arbitration becomes the “exclusive” remedy for investment disputes only once “consent” has been given.**

²⁹ *Maritime International Nominees Establishment (MINE) v. Guinea, Court of First Instance, Antwerp, 27 September 1985, 4 ICSID Reports 32.*

³⁰ *Maritime International Nominees Establishment (MINE) v. Guinea, Tribunal de 1^{ère} instance, Geneva, 13 March 1986; 4 ICSID Reports 41; 1 ICSID Review 383 (1986).*

³¹ *Maritime International Nominees Establishment (MINE) v. Guinea, ICSID Award, 6 January 1988, 4 ICSID Reports 54, 76.*

5. ICSID ADDITIONAL FACILITY

Jurisdictional limits of ICSID

Access to ICSID conciliation and arbitration does not only depend upon the consent of the parties involved, it also has to meet certain objective jurisdictional requirements, most important among them the requirement that both the host State and the home State of the investor must be contracting parties of the ICSID Convention.³² As a consequence, a number of investment or investment-related disputes between investors and host States may not be brought before the Centre even if both parties were willing to do so.

a) Additional Facility Jurisdiction

Additional Facility Rules

This situation was, at least partially, remedied by adoption of the Additional Facility Rules in 1978. They specifically opened access to the Centre in a number of additional cases. These are laid down in Art. 2 of the Additional Facility Rules and can be categorized in three groups:

- Conciliation or arbitration of investment disputes where only one side is either a party to the ICSID Convention or a national of a party to the ICSID Convention.
- Conciliation or arbitration of legal disputes which do not directly arise out of an investment provided that at least one side is either a party to the ICSID Convention or a national of a party to the ICSID Convention.
- Fact-finding proceedings between a State and a national of another State.

Disputes “indirectly” arising out of an investment

Most interesting is Art. 2 para. b) of the Additional Facility Rules extending the ICSID Convention’s rather limited subject-matter jurisdiction over “investment disputes” to disputes “not directly aris[ing] out of an investment”. This provision has to be read in conjunction with Art. 4 para. 3 of the Additional Facility Rules which makes Additional Facility dispute settlement conditional on the fact “that the underlying transaction has features which distinguish it from an ordinary commercial transaction”. If one reads the “not directly aris[ing] out of an investment”-phrase of Art. 2 para. b) of the Additional Facility Rules as requiring that such disputes do at least “indirectly” arise out of an investment, then this implies that a certain “investment-nexus” remains a precondition for Additional Facility dispute settlement.

Not “ordinary” commercial disputes

Interestingly, the Centre appears to follow an even broader approach, not even requiring an “indirect” link to an investment ,by stressing that the underlying transaction only has to be distinguishable from an ordinary commercial transaction.³³

Additional Facility cases in NAFTA

So far only the first group of cases, where either the host State or the home State of an investor is not a party to the ICSID Convention, has been practically relevant. Additional Facility arbitration has become very important in the

³² See supra Section 2 c).

³³ Cf. Schreuer, *The ICSID Convention: A Commentary* (2001), Article 25, para. 111.

context of NAFTA (North American Free Trade Agreement)³⁴ since only the United States is a party to the ICSID Convention but Canada and Mexico are not.

**Arts. 1120 and 1122
NAFTA**

Art. 1120 in NAFTA's Chapter Eleven on Investments provides:

1. *Except as provided in Annex 1120.1, and provided that six months have elapsed since the events giving rise to a claim, a disputing investor may submit the claim to arbitration under:*
 - (a) *the ICSID Convention, provided that both the disputing Party and the Party of the investor are parties to the Convention;*
 - (b) *the Additional Facility Rules of ICSID, provided that either the disputing Party or the Party of the investor, but not both, is a party to the ICSID Convention; or*
 - (c) *the UNCITRAL Arbitration Rules.*
2. *The applicable arbitration rules shall govern the arbitration except to the extent modified by this Section.*

Further, Art. 1122 provides in relevant part:

1. *Each Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement.*
2. *the consent given by paragraph 1 and the submission by a disputing investor of a claim to arbitration shall satisfy the requirement of:*
 - (a) *Chapter II of the ICSID Convention (Jurisdiction of the Centre) and the Additional Facility Rules for written consent of the parties;...*

As long as Canada and Mexico are not parties to the ICSID Convention, the NAFTA will not operate to confer jurisdiction under the Convention. Since the United States is a party to the Convention, ICSID Additional Facility arbitration is available between United States investors and Canada or Mexico and between Canadian or Mexican investors and the United States. In disputes between Canadian investors and Mexico or, Mexican investors and Canada, not even the ICSID Additional Facility may be used. In disputes of the latter kind only UNCITRAL arbitration is available.

Metalclad Case

One of the NAFTA investment cases rendered under the Additional Facility is *Metalclad v. Mexico*³⁵ which raised considerable concern among environmentalists. This Additional Facility award held that Mexico, through actions of a local municipality, had effectively expropriated a United States investor which had previously obtained all required permits to operate a hazardous waste facility.

Cartagena Free Trade Agreement

The 1994 Free Trade Agreement between Mexico, Colombia and Venezuela offers another example of consent to ICSID or Additional Facility dispute

³⁴ 32 ILM 605 (1993).

³⁵ *Metalclad Corporation v. The United Mexican States*, 30 August 2000, Case No. ARB(AF)/97/1, 16 ICSID Review 1 (2001); 40 ILM 36 (2001).

settlement by multilateral agreement. Under Arts. 17-18, the investor is given the option to institute ICSID arbitration, Additional Facility arbitration or UNCITRAL arbitration, depending on the state of ratification of the ICSID Convention by the three States.

Energy Charter Treaty

In a similar vein, the 1994 Energy Charter Treaty³⁶ between the European Communities and 49 mostly European States provides in its Art. 26 consent to ICSID's jurisdiction by the States parties in relation to investors of all other States parties. The Treaty contains an unconditional consent to ICSID and to the Additional Facility, whichever may be available. The Article specifically requires consent in writing also on the part of the investor. Apart from the ICSID Convention or the Additional Facility, the investor is given the choice of the courts and administrative tribunals of the host State, previously agreed procedures, UNCITRAL arbitration and arbitration in the framework of the Arbitration Institute of the Stockholm Chamber of Commerce.

b) Nature of Additional Facility Dispute Settlement

Institutional support of the Centre for Additional Facility

Dispute settlement initiated under the Additional Facility is not ICSID conciliation or arbitration but rather Additional Facility conciliation or arbitration. This means that such proceedings may be administered by the Secretariat of the Centre and thus benefit from the institutional support and expertise provided by the Centre. However, since Additional Facility proceedings are by definition outside the jurisdiction of the Centre, the ICSID Convention does not apply to proceedings, recommendations, awards, or reports under the Additional Facility (Art. 3 Additional Facility Rules).

Recognition and enforcement to be governed by New York Convention

This implies, in particular, that the ICSID Convention's rules on recognition and enforcement of arbitral awards are not applicable to awards rendered under the Additional Facility. In order to secure the effectiveness of such awards, Art. 20 of the Arbitration (Additional Facility) Rules provide that arbitral proceedings must be held only in States that are parties of the 1958 UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).³⁷

Metalclad Case

In *Metalclad v. Mexico*³⁸ the Additional Facility arbitral tribunal determined the place of arbitration to be Vancouver, Canada, in order to comply with this requirement which is also expressed in Art. 1130 NAFTA.

³⁶ 34 ILM 360 (1995).

³⁷ 330 UNTS 38; 7 ILM 1046 (1968).

³⁸ *Metalclad Corporation v. The United Mexican States*, 30 August 2000, Case No. ARB(AF)/97/1, 16 ICSID Review 1 (2001).

c) Pros and Cons of Additional Facility Dispute Settlement

The Additional Facility provides dispute settlement similar to proceedings under the ICSID Convention in situations which are not strictly covered by the Convention.

However, the enforcement provision of Art. 54 of the ICSID Convention does not apply because the Convention as such is not applicable to Additional Facility dispute settlement (Art. 3 Additional Facility Rules).

d) Relation of Additional Facility Dispute Settlement to Other Dispute Settlement Methods

Subsidiarity towards ICSID

Additional Facility conciliation or arbitration may be used as an alternative to dispute settlement before national courts, ad hoc arbitration, or diplomatic protection. It is not available, however, when the Centre has jurisdiction under Art. 25 of the ICSID Convention.³⁹

Waste Management Case

In *Waste Management*⁴⁰ an Additional Facility arbitral panel has also held that it lacked jurisdiction to decide a dispute under Chapter XI of NAFTA where the waiver required by Art. 1121 NAFTA as a condition precedent to submit a claim was not sufficiently unambiguous. Art. 1121 para. 1, subsection (b) NAFTA provides that:

A disputing investor may submit a claim under Article 1116 to arbitration only if:

...

(b) the investor [...] waive[s] [his] right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

Waste Management had qualified its waiver by exempting dispute settlement involving claims based on the municipal law of Mexico and had actually instituted proceedings before Mexican courts. The Additional Facility tribunal justified its denial of jurisdiction by stating that

[i]t is possible to consider that proceedings instituted in a national forum may exist which do not relate to those measures alleged to be in violation of the NAFTA by a member state of the NAFTA, in which case it would be feasible that such proceedings could coexist simultaneously with an

³⁹ Schreuer, *Commentary, Article 25, para. 136.*

⁴⁰ *Waste Management, Inc. v. United Mexican States, 2 June 2000, Case No. ARB(AF)/98/2, 15 ICSID Review 214 (2000).*

arbitration proceeding under the NAFTA. However, when both legal actions have a legal basis derived from the same measures, they can no longer continue simultaneously in light of the imminent risk that the Claimant may obtain the double benefit in its claim for damages. This is precisely what NAFTA Article 1121 seeks to avoid.⁴¹

Summary:

- **Disputes that do not meet the *ratione materiae* and/or *ratione personae* requirements under the ICSID Convention cannot be brought before ICSID for conciliation or arbitration.**
- **Some of these disputes may be settled under the Additional Facility Rules in the case of**
 1. **Investment disputes where only one side is either a party to the ICSID Convention or a national of a party to the ICSID Convention;**
 2. **Legal disputes which do not directly arise out of an investment provided that at least one side is either a party to the ICSID Convention or a national of a party to the ICSID Convention;**
 3. **Fact-finding proceedings between a State and a national of another State.**
- **Additional Facility dispute settlement is not dispute settlement under the ICSID Convention. Thus, the Convention's rules on recognition and enforcement of arbitral awards do not apply to Additional Facility arbitration.**
- **Additional Facility dispute settlement is excluded if the Centre has jurisdiction over an investment dispute under the ICSID Convention.**

⁴¹ 15 ICSID Review 235/236 (2000).

6. OTHER INSTITUTIONAL AND AD HOC ARBITRATION

Like commercial disputes, investment disputes may be settled by various types of institutionally supported or ad hoc arbitration. The specific nature of one of the parties as a State or State agency, instrumentality or other State-related entity is no obstacle to arbitration. Such arbitration may, but does not need to be, “mixed” dispute settlement.⁴²

a) Institutionally Supported Arbitration other than ICSID or Additional Facility

ICC, LCIA, AAA

Most of the major arbitration institutions, such as the International Court of Arbitration of the International Chamber of Commerce (ICC) established in 1923, the London Court of International Arbitration (LCIA) set up in 1892 or the American Arbitration Association (AAA) founded in 1926, focus on international commercial arbitration, i.e. arbitration between private parties. Similar to ICSID they do not arbitrate disputes themselves but support the arbitral processes conducted under their auspices by rendering various administrative services, such as providing lists of arbitrators or participating in the process of their appointment, calculating fees, etc.

Parties are free, however, to submit also investment disputes to these institutionally supported arbitration facilities.

MINE v. Guinea

Before turning to ICSID arbitration to settle its investment dispute with Guinea, as originally stipulated, MINE had recourse to AAA arbitration. In the ensuing ICSID arbitration the AAA proceedings, including a 1980 award, were held to be in violation of the exclusivity provision of Art. 26 of the ICSID Convention.⁴³

SPP v. Egypt

In *SPP v. Egypt* the foreign investor had already secured an ICC arbitral award before turning to ICSID arbitration. However, a tribunal constituted under the ICSID rules did not exercise jurisdiction until the previous ICC award had been annulled. The tribunal reasoned:

“When the jurisdictions of two unrelated and independent tribunals extend to the same dispute, there is no rule of international law which prevents either tribunal from exercising its jurisdiction. However, in the interest of international judicial order, either of the tribunals may, in its discretion and as a matter of comity, decide to stay the exercise of its jurisdiction pending a decision by the other tribunal.”⁴⁴

⁴² *Inter-State arbitration as a result of the “espousal” of a private party’s claim will be dealt with in Section 5 infra.*

⁴³ *Maritime International Nominees Establishment (MINE) v. Guinea, ICSID Award, 6 January 1988, 4 ICSID Reports 76.*

⁴⁴ *Decision on Jurisdiction I, 27 November 1985, 3 ICSID Reports 121, 129.*

b) Ad hoc Arbitration as a Primary “Fall-Back” Option for Settling Investment Disputes

Subsidiarity of ad hoc arbitration

In the context of investment disputes ad hoc arbitration is of high practical value as a potential fall-back option if ICSID or Additional Facility dispute settlement are not available.

NAFTA

This may be the case where neither the host State nor the home State of the investor is a party to the ICSID Convention. An example where only ad hoc arbitration according to the UNCITRAL Arbitration Rules is currently available are investment disputes between Canadian investors and Mexico and Mexican investors and Canada under NAFTA’s Chapter Eleven on Investments.⁴⁵

Cartagena Free Trade Agreement

Also under the 1994 Free Trade Agreement between Mexico, Colombia and Venezuela Arbitration under the UNCITRAL Arbitration Rules, depending on the ICSID Convention’s state of ratification by the three States, may be the only available option.

Inter-State and private disputes

Ad hoc arbitration is also a settlement option for disputes not of a “mixed” character, e.g. between the host State and the home State of an investor or between a private investor and another private entity.

c) Flexible Rules

Flexibility

Ad hoc arbitration may take place according to rules agreed upon by the parties to the dispute. The parties may adopt existing rules, such as the UNCITRAL Arbitration Rules, or they may leave it to the arbitrators to adopt their own rules of procedure.

AMINOIL Case

In accordance with the ad hoc arbitration agreement between the US oil company Aminoil and Kuwait, the arbitral tribunal in the *Aminoil* case⁴⁶ adopted its own rules of procedure “on the basis of natural justice and of such principles of transnational arbitration procedure as it may find applicable.”

Adoption of ICSID rules

It is within the discretion of the parties to designate the Secretary-General of ICSID as the appointing authority of the arbitrator(s) and they may even adopt procedural rules by reference to the ICSID Convention and its rules and regulations. In such a situation, however, the Convention and, in particular, its rules on enforcement do not apply. Still, the actual arbitration would largely resemble ICSID arbitration.⁴⁷

⁴⁵ See supra Section 4 a).

⁴⁶ Award in the Matter of an Arbitration between Kuwait and the American Independent Oil Company (Aminoil), 24 March 1982; 21 ILM 976-1053 (1982).

⁴⁷ Cf. Schreuer, *Commentary, Article 25, para. 140*.

d) Disadvantages of Ad hoc Arbitration

No institutional support, enforcement problems

As opposed to ICSID and ICC or LCIA arbitration, ad hoc arbitration lacks any institutional support. It is equally deprived of a strong enforcement mechanism. Thus, enforcement of awards rendered by ad hoc arbitration tribunals will be greatly facilitated by the applicability of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.⁴⁸

e) Widespread Practice of Ad hoc Arbitration in the Field of Investment Disputes

Libyan expropriation cases

Many major investment disputes were settled through ad hoc arbitration in the past, among them the Libyan expropriation cases, *British Petroleum v. Libya*,⁴⁹ *Liamco v. Libya*,⁵⁰ and *Texaco/Calasiatic v. Libya*.⁵¹

Summary:

- **Ad hoc arbitration is an important subsidiary remedy in cases where ICSID or Additional Facility dispute settlement is not available.**
- **Ad hoc arbitration is provided for in a number of bi- and multilateral agreements including NAFTA and the Cartagena Protocol.**
- **Ad hoc arbitration provides the most flexible way of conducting arbitral proceedings.**
- **Ad hoc arbitration of investment was widely used before the creation of the ICSID system.**

⁴⁸ 330 UNTS 38; 7 ILM 1046 (1968).

⁴⁹ *British Petroleum v. Libya*, 10 October 1973; 53 ILR (1979) 297-388.

⁵⁰ *Libyan American Oil Company (Liamco) v. Libya*, 12 April 1977; 20 ILM 1-87 (1981).

⁵¹ *Texaco Overseas Petroleum Company/California Asiatic (Calasiatic) Oil Company v. Libya*, 19 January 1977; 17 ILM 1-37 (1978).

7. DIPLOMATIC PROTECTION

Frequent use for investment disputes in the past

Diplomatic protection is the traditional technique for settling international disputes originating from disagreements between States and private parties. In the past many expropriation and compensation claims, typical core aspects of investment disputes, were settled by this method.

Nature of diplomatic protection

Its broad availability stems from the fact that diplomatic protection does not require any advance agreement between disputing parties. It is in principle always within the discretion of the home State of a (natural or legal) person to take up this private party's claim ("espousal of claims") and to make it the home State's own against the State allegedly having harmed its national.

Procedural requirements

The only procedural preconditions under traditional (customary) international law are the continuous nationality of the injured private party ("continuity of claims") and the exhaustion of local remedies.

Discretion of home State

International law conceives diplomatic protection as a right of the home State, not of its national. This implies that investors are wholly dependent upon the willingness of their home States to "espouse" their claims. International law never, and national law only rarely, provide for such a right of the investor vis-à-vis his or her own home State. The willingness of home States of investors to espouse such claims will be influenced by various political considerations and thus, ultimately, remains unpredictable. Further, they always have the possibility to waive "espoused" claims as a whole or in part.

Barcelona Traction Case

In the *Barcelona Traction Case*⁵² the ICJ characterized diplomatic protection in the following words:

... within the limits prescribed by international law, a State may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the State is asserting. Should the natural or legal persons on whose behalf it is acting consider that their rights are not adequately protected, they have no remedy in international law. All they can do is to resort to municipal law, if means are available, with a view to furthering their cause or obtaining redress.

The Court continued by stating that

[t]he State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case.

⁵² Case concerning the Barcelona Traction, Light and Power Company, Limited (*Belgium v. Spain*), (New Application 1962), ICJ Reports (1970) 3-357.

- Lump-sum agreements** In case of widespread expropriations, e.g. in case entire industrial sectors are nationalized, the home States of affected investors have frequently been content to conclude lump-sum agreements with the expropriating State by which they accept a portion of the total outstanding claims as a global settlement payment. Injured private parties have no entitlement under international law to receive the proceeds of such agreements from their home States. As a rule, however, national legislation will provide for the proportionate distribution of the lump-sum payment to them.
- Freedom of means to exercise diplomatic protection** States are relatively free in their choice of means when exercising diplomatic protection. They may avail themselves of any lawful, but unfriendly measures (retorsions). They may also adopt certain otherwise wrongful measures as long as such measures may be justified as proportionate reprisals or countermeasures.
- Limits to the exercise of diplomatic protection** Today, the customary international law prohibition of the use of force clearly limits the range of available reprisals/ countermeasures. This principle has a prominent precursor in the 1907 Drago-Porter Convention⁵³ which restricted the means available for the exercise of diplomatic protection on behalf of loan creditors vis-à-vis debtor States.
- Exclusivity of ICSID only after “consent”** Parties to the ICSID Convention are not automatically prevented from exercising diplomatic protection over investment disputes involving their own nationals vis-à-vis other Contracting Parties. However, they are prevented from doing so in cases where the disputing parties have consented to or have actually started arbitration under the Convention.
- Art. 27 of the ICSID Convention provides:
- (1) *No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.*
 - (2) *Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute.*
- Preference for diplomatic protection** Since consent to ICSID arbitration need not be expressed in a single instrument, but may also result from an investor “accepting” a host State’s “offer” contained in national investment legislation or in a BIT by instituting proceedings,⁵⁴ a private party retains its option to ask for diplomatic protection even where it could already demand arbitration.⁵⁵

⁵³ *Convention Respecting the Limitation of the Employment of Force for the Recovery of Contract Debts*, 2 *AJIL Supp.* 81 (1908).

⁵⁴ See Module 2.3 on consent.

⁵⁵ See also Schreuer, *Commentary, Article 27, para. 28*.

Revival of diplomatic protection

Further, even in situations covered by Art. 27 of the ICSID Convention the right to exercise diplomatic protection will revive if the host State fails to comply with an ICSID award.

Summary:

- **Diplomatic protection was frequently exercised with regard to expropriation and compensation claims in the past.**
- **Exercising diplomatic protection requires the continuous nationality of the injured private party ("continuity of claims") and the exhaustion of local remedies.**
- **Diplomatic protection is a discretionary right of the home State of investors.**
- **Claims have frequently been settled by lump-sum agreements at a reduced value.**
- **Diplomatic protection must not be exercised with regard to claims submitted to ICSID arbitration.**

8. INTERNATIONAL COURTS OR TRIBUNALS

<u>Investment disputes as “mixed” disputes</u>	Investment disputes are normally of a “mixed character”, i.e. they regularly involve a State and a private party. This does not, however, exclude the possibility that they may either successively or concurrently turn into international disputes of an inter-State character.
<u>Transformation into inter-State disputes</u>	Investment disputes between a State and a private party may become inter-State disputes if the home State of the private party “espouses” the latter’s claim.
<u>International arbitration and adjudication</u>	In such a situation the two States are in general free to use any peaceful means of dispute settlement as contained in Art. 33 of the UN Charter, including arbitration and adjudication.
<u>Jurisdiction of international courts and tribunals</u>	Since investment disputes are usually not only “legal disputes”, but also involve legal issues of a public international law nature they are likely to give rise to the jurisdiction of international courts or tribunals.
<u>State behaviour as treaty violation</u>	Independent of a potential “espousal” of a private party’s claim an investment dispute may also lead to an inter-State dispute if the State behaviour involved does not only affect the private investor’s legal position but may be characterised as a violation of rules of international law. This is regularly the case with regard to bi- or multilateral investment protection treaties. In fact many BITs contain arbitration clauses for the settlement of disputes between the States parties in addition to ICSID and other arbitration between the investor and the host State.

a) Iran-United States Claims Tribunal

<u>Iran-United States Claims Tribunal</u>	Already in the past, states have repeatedly resorted to quasi-institutionalized arbitration by setting up bilateral “Mixed Claims Commissions” to adjudicate claims by nationals of one State against the other State. A recent example in this tradition is the Iran-United States Claims Tribunal, established by the so-called Algiers Accord in 1981, ⁵⁶ with the express mandate to adjudicate disputes arising out of alleged property rights violations in the aftermath of the Iranian revolution and the Tehran hostage crisis.
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b) International Court of Justice

<u>Broad jurisdiction <i>ratione materiae</i></u>	Among the permanently established international tribunals the International Court of Justice is undoubtedly the most prominent option for settling investment disputes between States. Its personal jurisdiction is expressly limited
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⁵⁶ *Claims Settlement Declaration of Algiers, 19 January 1981, 20 ILM 223 (1981).*

to States while its jurisdiction *ratione materiae* is very widely drawn encompassing any legal dispute over the application or interpretation of international law.

In the past, a number of investment disputes were brought via espousal of claims before the ICJ and its predecessor, the Permanent Court of International Justice (PCIJ). Many of these actions, however, did not reach the merits because the plaintiff States failed to overcome jurisdictional hurdles.

Anglo-Iranian Oil Co. Case

The *Anglo-Iranian Oil Co. Case*⁵⁷ arose from Iranian nationalization measures and the subsequent refusal of the Iranian Government to proceed to arbitration in accordance with a 1933 concession agreement. British efforts to exercise diplomatic protection vis-à-vis Iran, ultimately by instituting proceedings before the ICJ, failed because the Court declined to exercise jurisdiction. The ICJ had to interpret an ambiguously worded unilateral declaration of Iran from 1932 by which it had accepted the Court's jurisdiction according to Art 36 para. 2 PCIJ Statute. In a majority opinion the ICJ held that this acceptance did not extend to disputes arising under treaties which had entered into force before the declaration was made. Since the treaties invoked by the United Kingdom dated from 1857 and 1903 it found that it had no jurisdiction.

Barcelona Traction Case

The best-known investment dispute ever brought before the ICJ is the *Barcelona Traction Case*⁵⁸ where the Court held that Belgium could not bring proceedings against Spain for injury caused to a corporation, incorporated and having its headquarters in Canada, although a majority of the shareholders were Belgian nationals.

In substance, the dispute concerned the issue whether certain measures by Spanish authorities in the context of insolvency proceedings constituted expropriatory action. The Court, however, did not reach these merits because it found that Belgium did not have standing to exercise diplomatic protection. In this respect the Court noted that

*[t]he traditional rule attributes the right to diplomatic protection of a corporate entity to the State under the laws of which it is incorporated and in whose territory it has its registered office. These two criteria have been confirmed by long practice and by numerous international instruments.*⁵⁹

The Court also accepted that some States in addition required a company's actual seat (*siège social*) or management or centre of control

⁵⁷ Anglo-Iranian Oil Co. Case (*UK v. Iran*), *Judgment (Preliminary Objections)*, *ICJ Reports (1952) 93-171*.

⁵⁸ Case concerning the Barcelona Traction Light & Power Company (*Belgium v. Spain*), *ICJ Reports (1970) 3*.

⁵⁹ *ICJ Reports (1970) 42*.

within their territories or national ownership in order to exercise diplomatic protection. However, it rejected ownership or control as sole connecting factors entitling a State to exercise diplomatic protection.

The Court considers that the adoption of the theory of diplomatic protection of shareholders as such, by opening the door to competing diplomatic claims, could create an atmosphere of confusion and insecurity in international economic relations.⁶⁰

ELSI Case

The *Elettronica Sicula Case*⁶¹ is the most recent example of an investment dispute brought before the ICJ as the ultimate form of exercising diplomatic protection on behalf of an investor.

The United States espoused the claim of two United States corporations which together owned 100 per cent of the shares of the Italian corporation Elettronica Sicula (ELSI). It argued that a number of judicial and administrative measures taken in connexion with insolvency proceedings before Italian courts had effectively deprived the United States companies of their property in violation of a bilateral 1948 United States-Italian Treaty of Friendship, Commerce and Navigation (FCN Treaty).

In this case the United States successfully invoked the jurisdiction of the ICJ on the basis of the FCN Treaty. In addition the ICJ rejected Italy's jurisdictional challenge that local remedies had not been exhausted by holding that

... the local remedies rule does not, indeed cannot, require that a claim be presented to the municipal courts in a form, and with arguments, suited to an international tribunal, applying different law to different parties: for an international claim to be admissible, it is sufficient if the essence of the claim has been brought before the competent tribunals and pursued as permitted by local law and procedures, and without success.⁶²

On the merits, however, the United States failed to convince the majority on the Court that the Italian measures constituted an expropriation or other measure in violation of the FCN Treaty.

ICJ jurisdiction to interpret the ICSID Convention

Jurisdiction over genuine investment disputes between States should not be confused with the ICJ's jurisdiction over disputes concerning the interpretation or application of the ICSID Convention under Art. 64 of the Convention. No such case has been brought to the ICJ yet.⁶³

⁶⁰ Id., 49.

⁶¹ Case concerning Elettronica Sicula S.p.A. (ELSI) (*United States of America v. Italy*), ICJ Report (1989) 15-121.

⁶² ICJ Report (1989) 46.

⁶³ Schreuer, *Commentary, Article 41, para. 8.*

c) Inter-State Arbitration

Inter-State arbitration as a traditional mechanism to settle investment disputes

With the increased opportunities of investors to bring disputes with host States directly before arbitral panels, resort to inter-State arbitration as an ultimate remedy in the exercise of diplomatic protection has become less important.

In the past, however, a number of investment claims were espoused by the home States of investors and settled by inter-State arbitration with the host States.

Canevaro Arbitration

When a dispute about the repayment on Peruvian Government bonds to Italian nationals, the *Canevaro* claims, could not be settled amicably, Peru and Italy agreed to submit the issue to arbitration under the auspices of the Permanent Court of Arbitration.⁶⁴

Norwegian Shipowners' Claims

A 1917 United States wartime requisition order led to the espousal of the affected *Norwegian Shipowners' Claims*⁶⁵ which were ultimately adjudicated by an inter-State arbitral tribunal making important statements on the law of expropriation.

Martini Case

In the *Martini* case the Italian Government espoused the claim of an Italian company which had been granted a coal mining concession in Venezuela. Ultimately, the two States entered into a *compromis* providing for the establishment of an arbitral tribunal to decide whether the Venezuelan measures negatively affecting the Italian company constituted a denial of justice or a violation of a bilateral commercial treaty.⁶⁶

Summary:

- **Through the “espousal” of a claim a “mixed” investment dispute may be transformed into an inter-State dispute.**
- **If State behaviour vis-à-vis private investors violates rules of customary international law or treaty provisions it may also give rise to an inter-State dispute.**
- **Investment disputes were brought before the International Court of Justice in the past and may come before it also in the future.**
- **Investment disputes may also be brought before inter-State arbitral tribunals.**
- **International courts and inter-State arbitration panels are under an obligation to decline jurisdiction over claims submitted to ICSID arbitration.**

⁶⁴ Canevaro Claims Arbitration (*Italy v. Peru*), 3 May 1912; 11 RIAA (1961) 397-410.

⁶⁵ Norwegian Shipowners' Claims (*Norway v. US*), 13 October 1922; 1 RIAA (1948) 307-346.

⁶⁶ Martini Case (*Italy v. Venezuela*), 3 May 1930; 2 RIAA (1949) 974-1008.

TEST MY UNDERSTANDING

After having studied this Module the reader should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. What is a “mixed dispute”?
2. Does consent to ICSID arbitration exclude recourse to national courts?
3. Why are national courts other than the courts of host States likely to be unsuited for litigating investment disputes?
4. Does consent to the “jurisdiction of the Centre” mean consent to conciliation or to arbitration?
5. In which situations may conciliation be preferable to arbitration?
6. Does the Centre provide arbitration services?
7. Which elements contribute to the high level of effectiveness of ICSID arbitration?
8. In what way do host States benefit from consenting to ICSID arbitration?
9. Is it legally possible for an investor to agree on ICSID arbitration with a host State which is not a Contracting Party to the ICSID Convention?
10. Which types of cases may be settled under the ICSID Additional Facility?
11. In which context has the ICSID Additional Facility been used most frequently in the past?
12. What do we understand by ad hoc arbitration?
13. May a State exercise diplomatic protection at any time?
14. Which means are available for States in exercising diplomatic protection?
15. Are investors entitled to receive diplomatic protection by their home States?
16. Are Contracting Parties to the ICSID Convention prevented from exercising diplomatic protection?
17. May the ICJ sit in judgment over investment disputes?
18. Does the ICSID Convention provide for the jurisdiction of the ICJ?

HYPOTHETICAL CASE

E-Switch Corp. v. Gloomistan

E-Switch Corp. is an electricity company incorporated and having its registered office in Lightnia. In March 1996 it entered into a long-term energy concession agreement with a group of municipalities in Gloomistan for the provision and supply of electrical energy for a period of 20 years with an optional renewal on demand by the investor for another 10 years. The concession agreement contains an express choice-of-forum clause providing:

“The Parties agree to submit any dispute arising under this agreement to

1. *ICSID arbitration;*
2. *ICSID Additional Facility arbitration;*
3. *Ad hoc arbitration according to the UNCITRAL Arbitration Rules upon a request by either Party.”*

In addition, a 1979 Bilateral Investment Treaty between Lightnia and Gloomistan, which entered into force in July 1981, provides:

“The Contracting Parties are willing to submit any dispute arising from an investment made within their territories by a national of the other Contracting Party to the International Centre for Settlement of Investment Disputes.”

The investment was initiated in February 1997 and already by October 1999 80 per cent of the total energy supply envisaged under the concession agreement was provided for by *E-Switch Corp.* In July 2000 a dispute arose over the rates charged by *E-Switch Corp.* to the municipal distributor undertakings. In October 2000 Gloomistan decided to step in and enacted a decree fixing the rates at a level “required to maintain this service of a general economic importance.”

E-Switch Corp. claims that this regulatory action constitutes a *de facto* expropriation.

Lightnia and Gloomistan are parties to the ICJ Statute and have made unconditional declarations accepting the jurisdiction of the International Court of Justice in 1956 and 1967 respectively. Lightnia and Gloomistan are parties to the Energy Charter Treaty. Lightnia is a Contracting Party to the ICSID Convention since 1973. Gloomistan signed in 1989 but, due to constitutional difficulties, has never ratified it.

1. Can *E-Switch Corp.* force Lightnia to take diplomatic steps on its behalf?
2. Does *E-Switch Corp.* have a possibility to bring its claim before an ICSID panel?
3. In the alternative, are there other arbitration forums available to *E-Switch Corp.*?
4. Is there a possibility to have the ICJ decide the merits of the dispute?

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.3 CONSENT TO ARBITRATION



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NOTE

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OVERVIEW

This Module gives an overview of the most important legal questions that arise in connexion with consent to arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention).

Arbitration is always based on a consent agreement between the parties. But the fact that ICSID arbitration is, by necessity, between a host State and a foreign investor leads to some peculiarities in the giving of consent. The most conspicuous peculiarity is that consent agreements need not be based on a document that is signed by both parties. Rather, the host State may make a general offer to foreign investors or to certain categories of foreign investors to submit to arbitration. This offer may be contained in legislation or in a treaty to which the host State is party. To perfect a consent agreement, the investor has to accept this offer in writing. This acceptance can be quite informal and may even be expressed through the act of instituting proceedings.

Consent to ICSID arbitration, once it is perfected, carries a number of important consequences. These include the irrevocability of consent, the exclusion of other remedies and the prohibition of diplomatic protection. Therefore, the time of consent must be considered carefully.

Consent agreements may be subject to limitations and conditions. Their interpretation can at times raise considerable difficulties.

In some countries, it is not the federal government but a smaller entity or a public company that deals with foreign investors. Therefore, the Convention opens the possibility for a constituent subdivision or agency of the host State to become a party to ICSID arbitration. But host States retain strict control over consent by such entities: the constituent subdivision or agency must have been designated to the Centre and its consent must have been approved by the State to which it belongs.

OBJECTIVES

Upon completion of this Module the reader should be able to:

- Understand the significance of consent to jurisdiction for ICSID's jurisdiction.
- Identify the different forms in which consent to jurisdiction may be given.
- Appreciate the nature of an offer of consent contained in legislation or a treaty.
- Describe the ways in which such an offer may be accepted.
- Understand the principle of the non-revocability of consent.
- Determine the time at which consent was given.
- Define the limitations and conditions that may be attached to consent.
- Discuss the methods whereby consent is interpreted.

INTRODUCTION

Arbitration agreements

Arbitration is always based on an agreement between the parties. In the case of ICSID, there must be an agreement to arbitrate between the host State and the foreign investor. Art. 25, first sentence, of the ICSID Convention provides to this effect:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.

The parties giving consent must be a State party to the ICSID Convention (or a designated constituent subdivision or agency) and a national of a State party to the ICSID Convention (see Module 2.6). In addition, there must be a legal dispute arising directly out of an investment (see Module 2.7).

Participation in the Convention alone does not carry any obligation or even expectation that there will be consent to jurisdiction. A Contracting State remains free as to whether or not, and if so to what extent, it wishes to give consent.

Requirements of form

Under the Convention, consent must be in writing. But there is no particular form in which this must be done. Consent in writing will normally be communicated between the parties but there is no need to notify the Centre at the time of consent. In fact, the Centre has no precise knowledge of the number and the contents of various consent clauses covering investments. But proof of consent in writing will be required at the time a request for arbitration is made.

Consent in writing must be explicit and not merely construed.

In *Cable TV v. St. Kitts and Nevis*, the Respondent was not a party to the agreement containing the consent clause. The Claimant argued that consent by the Respondent could be construed from the institution of proceedings by the Attorney-General of St. Kitts and Nevis against the Claimants in a domestic court of the Respondent. The purpose of the domestic court proceedings was to obtain an injunction to restrain the Claimant from raising its rates prior to the resolution of the dispute through ICSID arbitration. The Tribunal held that the references in the court documentation to the ICSID clause in the agreement were merely statements of fact and did not amount to consent by any person to ICSID jurisdiction.¹

¹ *Cable TV v. St. Kitts and Nevis, Award, 13 January 1997, 13 ICSID Review–Foreign Investment Law Journal 328, 354-361 (1998).*

**Three different ways
of giving consent:
Direct agreement**

In practice, consent is given in one of three ways. The most obvious way is a consent clause in a direct agreement between the parties. Dispute settlement clauses referring to ICSID are very common in contracts between States and foreign investors. ICSID has prepared and published a set of Model Clauses to facilitate the drafting of these contracts.²

National legislation

Another technique to give consent to ICSID dispute settlement is a provision in the national legislation of the host State, most often its investment code. Such a provision offers ICSID dispute settlement to foreign investors in general terms. Many capital importing countries have adopted such provisions. Since consent to jurisdiction is always based on an agreement between the parties, the mere existence of such a provision in national legislation will not suffice. The investor may accept the offer in writing at any time while the legislation is in effect. In fact, the acceptance may be made simply by instituting proceedings.

Treaties

The third method to give consent to ICSID jurisdiction is through a treaty between the host State and the investor's State of nationality. Most bilateral investment treaties (BITs) contain clauses offering access to ICSID to the nationals of one of the parties to the treaty against the other party to the treaty. The same method is employed by a number of regional multilateral treaties such as the NAFTA and the Energy Charter Treaty. Attempts to create a global Multilateral Agreement on Investment that would include a similar dispute settlement clause have not come to fruition. Offers of consent contained in treaties must also be perfected by an acceptance on the part of the investor.

Summary:

- **ICSID arbitration is always based on an agreement between the parties to the arbitration, i.e. the host State and the foreign investor.**
- **No particular formalities are required for the parties' consent to arbitration, except that it must be in writing and that it must be explicit.**
- **In practice, consent to ICSID arbitration is given in one of three ways:**
 1. **A clause in a direct agreement between the host State and the foreign investor.**
 2. **A provision in the host State's national legislation offering ICSID arbitration to foreign investors. Such an offer must be accepted by the foreign investor.**
 3. **A provision in a treaty between the host State and the investor's State of nationality offering ICSID arbitration to the nationals of the other side. Such an offer must be accepted by the foreign investor.**

² ICSID Model Clauses, Doc. ICSID/5/Rev. 2 of 1993. Reproduced in 4 ICSID Reports 357.

1. CONSENT THROUGH DIRECT AGREEMENT BETWEEN THE PARTIES

Consent for future or existing disputes

An agreement between the parties recording consent to ICSID arbitration may be achieved through a compromissory clause in an investment agreement between the host State and the investor submitting future disputes arising from the investment operation to ICSID jurisdiction. It is equally possible to submit a dispute that has already arisen between the parties through consent expressed in a *compromis*. Therefore, consent may be given with respect to existing or future disputes.

The majority of cases brought to ICSID arbitration are based on agreements between the parties containing a consent clause for future disputes.³ Agreements to submit to the Centre disputes that have arisen already are rare.⁴ It is obvious that consent by both parties is much easier to obtain before the outbreak of a disagreement.

Model clauses

It is important to give careful attention to the drafting of consent clauses when negotiating investment agreements. The Centre has developed a set of Model Clauses for the convenience of the parties to facilitate the drafting of consent clauses between them.⁵ The Model Clauses, as published, are merely offered as examples and the parties are entirely free to adapt them to the specific circumstances of their relationship. They are useful not only as blueprints for actual contracts but also as a checklist for the various questions to be considered when submitting to ICSID. The Model Clauses have undergone two revisions.⁶

The 1993 Model Clauses suggest the following basic submission clause in respect of future disputes for insertion in investment agreements between host States and foreign investors:

Clause 1

The [Government]/[name of constituent subdivision or agency] of name of Contracting State (hereinafter the "Host State") and name of investor (hereinafter the "Investor") hereby consent to submit to the International Centre for Settlement of Investment Disputes (hereinafter the "Centre")

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³ *Holiday Inns v. Morocco*, Lalive, *The First 'World Bank' Arbitration*, 51 *British Year Book of International Law* 128 (1980), *Adriano Gardella v. Ivory Coast*, 1 *ICSID Reports* 287; *Kaiser Bauxite v. Jamaica*, 1 *ICSID Reports* 301, 303/4; *AGIP v. Congo*, 1 *ICSID Reports* 313; *Benvenuti & Bonfant v. Congo*, 1 *ICSID Reports* 340/1; *Amco v. Indonesia*, 1 *ICSID Reports* 392; *Klöckner v. Cameroon*, 2 *ICSID Reports* 10, 13; *SOABI v. Senegal*, 2 *ICSID Reports* 179, 204, 272; *LETCO v. Liberia*, 2 *ICSID Reports* 347, 350/1; *Atlantic Triton v. Guinea*, 3 *ICSID Reports* 17; *Vaccum Salt v. Ghana*, 4 *ICSID Reports* 329; *Mobil Oil v. New Zealand*, 4 *ICSID Reports* 147, 158.

⁴ See *MINE v. Guinea*, 4 *ICSID Reports* 67, 80; *Swiss Aluminium Ltd. and Icelandic Aluminium Co. Ltd. v. Iceland*, Case No. ARB/83/1; *Compania del Desarrollo de Santa Elena S.A. v. Costa Rica*, Case No. ARB/96/1.

⁵ *Doc. ICSID/5/Rev.2*.

⁶ The earlier versions have been published in 7 *ILM* 1159 (1968) and 1 *ICSID Reports* 197. The 1993 version is published in 4 *ICSID Reports* 357.

any dispute arising out of or relating to this agreement for settlement by [conciliation]/[arbitration]/[conciliation followed, if the dispute remains unresolved within time limit of the communication of the report of the Conciliation Commission to the parties, by arbitration] pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (hereinafter the "Convention").⁷

Square brackets indicate alternatives from which the parties may choose. Underlined text indicates information to be supplied by the drafters.

If the parties have not given their consent in respect of future disputes, the 1993 Model Clauses offer the following formula for the submission of an existing dispute:

Clause 2

*The [Government]/[name of constituent subdivision or agency] of name of Contracting State (hereinafter the "Host State") and name of investor (hereinafter the "investor") hereby consent to submit to the International Centre for Settlement of Investment Disputes (hereinafter the "Centre") for settlement by [conciliation]/[arbitration]/[conciliation followed, if the dispute remains unresolved within time limit of the communication of the report of the Conciliation Commission to the parties, by arbitration] pursuant to the Convention on the Settlement of Investment Disputes between States and nationals of Other States, the following dispute arising out of the investment described below:...*⁸

Consent through separate instruments

The agreement on consent between the parties need not be recorded in a single instrument:

In *Amco v. Indonesia*, the investor had submitted an application to the Indonesian Foreign Investment Board to establish a locally incorporated company for the purpose of carrying out the investment operation. The application provided that any disagreements would be put before ICSID. The application was approved. Before the Tribunal, the government accepted the validity of the consent clause in principle while disputing its applicability to the parties to the dispute and to the subject-matter.⁹ The Tribunal said: ...

*while a consent in writing to ICSID arbitration is indispensable, since it is required by Article 25(1) of the Convention, such consent in writing is not to be expressed in a solemn, ritual and unique formulation. The investment agreement being in writing, it suffices to establish that its interpretation in good faith shows that the parties agreed to ICSID arbitration, in order for the ICSID Tribunal to have jurisdiction over them.*¹⁰

⁷ 4 ICSID Reports 359/60.

⁸ 4 ICSID Reports 360.

⁹ *Decision on Jurisdiction*, 25 September 1983, 1 ICSID Reports 392.

¹⁰ *At p.400.*

**Consent through
reference to another
instrument**

An agreement between the parties may record their consent to ICSID jurisdiction by reference to another legal instrument:

In *CSOB v. Slovakia*, an agreement entered into between the parties to the dispute contained the clause “this agreement shall be governed by the laws of the Czech Republic and the [BIT between the Czech and Slovak Republics]”. The Claimant contended that this constituted an incorporation by reference of consent to ICSID arbitration as provided for in the BIT. The Respondent argued that the clause was merely a choice-of-law provision. Moreover, the BIT had never entered into force. The Tribunal carefully examined the drafting history of the agreement between the parties. It noted that the clause in question had replaced a clause in an earlier draft providing for domestic arbitration. In addition, the reference to the BIT had included the words “after it is ratified” in a later draft but these words were deleted in the final agreement. The Tribunal concluded that under these circumstances the parties by referring to the BIT had intended to incorporate the ICSID clause in the BIT into their agreement.¹¹

Summary:

- **Consent to ICSID arbitration may be contained in a direct agreement between the parties.**
- **Consent may be given with respect to future disputes or with respect to existing disputes.**
- **The Centre has put a set of Model Clauses at the disposal of parties that may facilitate the drafting of consent agreements.**

¹¹ *CSOB v. Slovakia, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review—Foreign Investment Law Journal 251, 268-271 (1999).*

2. CONSENT THROUGH HOST STATE LEGISLATION

The host State may offer consent to ICSID arbitration in general terms to foreign investors or to certain categories of foreign investors in its legislation. Such an offer, in order to become operative, must be accepted by the foreign investor.

a) Offer by the Host State

Offers of consent in national laws

Some national investment laws provide unequivocally for dispute settlement by ICSID. For instance, Art. 8(2) of the Albanian Law on Foreign Investment of 1993 states in part:

...the foreign investor may submit the dispute for resolution and the Republic of Albania hereby consents to the submission thereof, to the International Centre for Settlement of Investment Disputes.¹²

A more common method to provide for settlement by the Centre is to include a reference to the Convention as one of several possible means of dispute settlement. The alternatives offered may include procedures expressly agreed to by the parties, procedures provided by bilateral investment treaties, the International Chamber of Commerce and *ad hoc* arbitration. Some laws specifically state that the consent of the State to ICSID's jurisdiction is constituted by the Articles referring to the Convention. Provisions to this effect may be found in the legislation of the Central African Republic,¹³ of Cote d'Ivoire¹⁴ and of Mauritania.¹⁵

Other provisions are not so clear, but it may still be inferred from them that they express the State's consent to ICSID's jurisdiction. Thus, national laws state that the foreign investor "shall be entitled to request" that the dispute be conclusively settled by one of several methods including the ICSID Convention,¹⁶ that any of the parties to the dispute "may transfer the dispute" to one of several institutions, including ICSID,¹⁷ or that the dispute "shall be settled" by one of these methods.¹⁸

¹² See *Tradex v. Albania, Decision on Jurisdiction, 24 December 1996, 14 ICSID Review-Foreign Investment Law Journal 161, 174 (1999)*. Similar provisions may be found in the legislation of Guinea, Ordinance No. 001/PRG/87 of January 3, 1987, which sets forth the Investment Code; Botswana Sec. 11 of *The Settlement of Investment Disputes (Convention) Act, 1970*; Sri Lanka, Sec. 26 (1) of *the Greater Colombo Economic Commission Law, 1978*; Togo, Art. 4 of Law No. 85-3 of January 29, 1985, which provides for readjustment of the Investment Code.

¹³ Art. 30 of the Investment Code, 1988.

¹⁴ Art. 10 of the Investment Code, 1984.

¹⁵ Art. 7(2)(d) of the Investment Code, 1989.

¹⁶ Art. 45 (1) of the Cameroon Investment Code, 1990.

¹⁷ Art. 27 (2) of the Kazakhstan Law on Foreign Investments, 1995.

¹⁸ Art. 19 of the Somalia Foreign Investment Law, 1987; Sec. 40(6) of the *Zambian Investment Act, 1991*.

In *SPP v. Egypt*. The Request for Arbitration was based on Art. 8 of Egypt's Law No. 43 of 1974 Concerning the Investment of Arab and Foreign Funds and the Free Zone.¹⁹ Art. 8 provided in relevant part:

*Investment disputes in respect of the implementation of the provisions of this Law shall be settled in a manner to be agreed upon with the investor, or within the framework of the agreements in force between the Arab Republic of Egypt and the investor's home country, or within the framework of the Convention for the Settlement of Investment Disputes between the State and the nationals of other countries to which Egypt has adhered by virtue of Law No. 90 of 1971, where such Convention applies.*²⁰

Egypt claimed that the clause referring to ICSID was not self-executing and required a separate implementing agreement with the investor. In Egypt's view, Law No. 43 was too ambiguous and equivocal to establish consent to ICSID arbitration.²¹ Rather, it was intended only to inform potential investors that ICSID arbitration was one of a variety of dispute settlement methods that investors may seek to negotiate with Egyptian authorities in appropriate circumstances.²²

The Tribunal rejected the idea that Art. 8 had the consequence only of informing potential investors of Egypt's willingness, in principle, to negotiate a consent agreement. There was nothing in the legislation requiring a further *ad hoc* manifestation of consent to the Centre's jurisdiction.²³

The Tribunal's conclusion was as follows:

*116. On the basis of the foregoing considerations, the Tribunal finds that Article 8 of Law No. 43 establishes a mandatory and hierarchic sequence of dispute settlement procedures, and constitutes an express "consent in writing" to the Centre's jurisdiction within the meaning of Article 25(1) of the Washington Convention in those cases where there is no other agreed-upon method of dispute settlement and no applicable bilateral treaty.*²⁴

Since the parties had not agreed on another method of dispute resolution and since there was no applicable bilateral treaty in force, the Tribunal found "that Article 8 of Law No. 43 operates to confer jurisdiction upon the Centre with respect to the Parties' dispute."²⁵

¹⁹ *Decision on Jurisdiction I*, 27 November 1985, 3 ICSID Reports 112, 114/5. 16 ILM 1476, 1479 (1977). Law No. 43 of 1974 has since been replaced by the Investment Law of 1989.

²⁰ *At p. 126*. The provision continues by providing that disputes may also be settled by *ad hoc* arbitration under Egyptian law.

²¹ *At pp. 126/7*.

²² *Decision on Jurisdiction II*, 14 April 1988, 3 ICSID Reports 140, 147.

²³ *At pp. 152-156*.

²⁴ *At p. 161*.

²⁵ *At p. 161*.

Provisions in national laws foreseeing future agreement on consent

Not all references in national legislation amount to consent to jurisdiction or an offer to the investor to accept ICSID's jurisdiction. Therefore, the respective provisions in national laws must be studied carefully. Some legislative provisions referring to the settlement of disputes by ICSID make it clear that further action on the part of the host State is necessary to establish consent. For instance, the new Egyptian Investment Law of 1989 provides in Art. 55, after a reference to the role of domestic courts in the settlement of disputes under that law:

The parties concerned may also agree to settle such disputes within the framework of the agreements in force between the Arab Republic of Egypt and the investor's home country or within the framework of the [ICSID] Convention ...subject to the terms and conditions, and in the instances where such agreements do apply.

Similar clauses, providing for further agreement between the host State and the foreign investor, may be found in the investment legislation of El Salvador,²⁶ Madagascar,²⁷ Malawi,²⁸ Mozambique²⁹ and Yugoslavia.³⁰

Yet another type of legislative provision referring to ICSID dispute settlement foresees investment licences to be issued to foreign investors. Such a license may specify the modalities of dispute settlement, including ICSID arbitration. Clauses of this kind may be found in the investment legislation of Uganda,³¹ of Benin,³² Niger,³³ and Tanzania.³⁴

In the case of the last two types of clauses referring to ICSID, the legislative provisions as such do not amount to consent to ICSID's jurisdiction. They do not constitute an offer by the host State that may be accepted by the investor through a unilateral act. Rather, they require a specific agreement between the host State and the investor contained in an investment agreement, an investment licence or another document. Such an agreement may be withheld at the host State's discretion.

b) Acceptance by the Investor

While a host State may express its consent to ICSID's jurisdiction through legislation, the investor must perform some reciprocal act to perfect consent. Even where consent is based on the host State's legislation, it can only come into existence through an agreement between the parties. The provision in the host State's legislation can amount to no more than an offer that may be accepted by the investor. The Convention requires consent in writing. This would indicate a minimum of formality in accepting the host State's offer.

²⁶ Art. 21 of the *Foreign Investment Promotion and Guarantee Law, 1988*.

²⁷ Art. 33 of the *Investment Code, 1989*.

²⁸ Sec.18 of the *Investment Promotion Act, 1991*.

²⁹ Art. 25 of the *Law of Investment, 1993*.

³⁰ Art. 27 of the *Foreign Investments Law, 1988*.

³¹ Art. 30 of the *Investment Code, 1991*.

³² Art. 57 of the *Investment Code, 1982*.

³³ Art. 6 of the *Investment Code, 1989*.

³⁴ Art. 29 of the *National Investment (Promotion and Protection) Act, 1990*.

**Acceptance of offer
through instituting
proceedings**

The investor may accept the host State's offer by bringing a request for arbitration to the Centre:

In *Tradex v. Albania*, the Albanian law of 1993 contained an offer of consent by the host State (see above). The Tribunal said:

...it can now be considered as established and not requiring further reasoning that such consent can also be effected unilaterally by a Contracting State in its national laws the consent becoming effective at the latest if and when the foreign investor files its claim with ICSID making use of the respective national law.³⁵

While it is possible to perfect consent through the institution of proceedings, it is questionable whether it is wise for the investor to rely on the host State's offer contained in its legislation without accepting it at an earlier stage. Consent will be perfected only upon the acceptance of the offer and the time of consent triggers a number of legal consequences under the Convention. The most important of these is that consent becomes irrevocable. Therefore, once the investor has accepted consent based on legislation, the agreement on consent will stay in effect even if the legislation is repealed.

**Acceptance of offer
prior to instituting
proceedings**

The investor may express its acceptance in a variety of ways other than instituting proceedings. These include an investment agreement with the host State, a simple communication to the host State that consent to ICSID's jurisdiction in accordance with the legislation is accepted, a statement contained in an application for an investment licence or a mere application if under the law in question the successful applicant automatically gets specified benefits including access to ICSID.

The investor's acceptance of consent can be given only to the extent of the offer made in the legislation. But it is entirely possible for the investor's acceptance to be narrower than the offer and to extend only to certain matters or only to a particular investment operation.

In *SPP v. Egypt*, the Claimants had sent a letter to Egypt's Minister of Tourism on August 15, 1983, about one year before the institution of the arbitration, which said in relevant part:

...we hereby notify you that we accept and reserve the opportunity of availing ourselves of the uncontestable jurisdiction of the International Centre for the Settlement of Investment Disputes, under the auspices of the World Bank, which is open to us as a result of Law No. 43 of 1974, Article 8 of which provides that investment disputes may be settled by ICSID arbitration.³⁶

³⁵ *Tradex v. Albania, Decision on Jurisdiction, 24 December 1996, 14 ICSID Review–Foreign Investment Law Journal 161, 187 (1999).*

³⁶ *Decision on Jurisdiction I, 27 November 1985, 3 ICSID Reports 119.*

Before the Tribunal, the Claimants contended successfully that their own consent was expressed in the letter and again by the act of filing their request for arbitration with the Centre.³⁷

Conditions, time limits and formalities

The host State's legislation containing the offer of consent may prescribe certain conditions, time limits or formalities for the acceptance by the investor. In a number of investment laws, the investor's consent is linked to the process of obtaining an investment authorization. The choice of one of several methods for dispute settlement offered by the legislation must be stated expressly in the application for the investment authorization. Other investment laws require that the investor must accept the offer of consent to ICSID arbitration within certain time limits. In the absence of formal requirements in the host State's legislation for the investor's consent, a maximum of flexibility should be allowed. Any indication of acceptance on the part of the investor should be permissible. This may be effected by any written instrument by which the investor signifies its submission to the legal framework provided in the host State's legislation, including settlement under the ICSID Convention. Nevertheless, it is advisable to make an acceptance as clear as possible. Implicit acceptance, while not impossible, is liable to lead to jurisdictional disputes, to uncertainties concerning the exact date of consent and to difficulties once the host State changes its legislation.

Summary:

- **Some States offer ICSID arbitration to foreign investors by way of national legislation.**
- **Legislative provisions of this kind must be interpreted carefully: not all references to ICSID arbitration in national legislation amount to an offer of consent.**
- **Some provisions in national legislation merely hold out the prospect of future consent.**
- **In order to amount to a consent agreement, the offer contained in national legislation must be accepted by the investor.**
- **The investor may accept the offer simply by instituting proceedings. But it may be advisable to do so at an earlier stage.**
- **Offers of consent contained in national legislation may prescribe certain conditions, time limits or formalities for their acceptance.**

³⁷ At p. 120.

3. CONSENT THROUGH BILATERAL INVESTMENT TREATIES (BITS)

The technique employed in national legislation may also be employed with the help of treaties to which the host State is a party. The treaty on its own cannot amount to consent to ICSID's jurisdiction by the parties to the dispute, since ICSID arbitration is always between a host State and a foreign investor. But the treaty may contain the host State's offer. This offer may then be taken up by a national of the other State party to the treaty.

Consent through BITS has become accepted practice. Some capital exporting States have developed their own national practice in this regard, usually through the use of model BITS.³⁸ Over the years, ICSID clauses have been incorporated into hundreds of BITS. Today, they can be found in the overwhelming majority of new BITS.

a) Offer by the Host State

Offers of consent in BITS

The majority of ICSID clauses in modern BITS express consent on the part of the two Contracting States to submit to ICSID's jurisdiction, for the benefit of nationals of the other State party to the treaty. The treaty between the United Kingdom and Sri Lanka of 1980 offers an example of a simple ICSID clause in Art. 8:

*(1) Each Contracting Party hereby consents to submit to the International Centre for the Settlement of Investment Disputes (herein referred to as "the Centre") for settlement by conciliation or arbitration under the Convention ... any legal disputes arising between that Contracting Party and a national or company of the other Contracting Party concerning an investment of the latter in the territory of the former.*³⁹

Many BITS contain similar clauses. Clauses of this kind have been the basis of jurisdiction in several ICSID cases.⁴⁰

Some BITS do not specifically mention consent. But formulations to the effect that a dispute "shall be submitted" to the Centre or that the parties have the right to initiate proceedings leave no doubt as to the binding character of these clauses. For instance, the German Model Agreement in its Art. 11 (Model I) provides:

(2) If the divergency cannot be settled within six months of the date when it has been raised by one of the parties in dispute, it shall, at the request of the national or company of the other Contracting Party, be submitted for

³⁸ The most comprehensive study is Dolzer/Stevens, *Bilateral Investment Treaties* (1995).

³⁹ 19 ILM 886, 888 (1980).

⁴⁰ AAPL v. Sri Lanka, Award, 27 June 1990, 4 ICSID Reports 246, 250/1; AMT v. Zaire, Award, 21 February 1997, 36 ILM 1531, 1545 (1997); Fedax v. Venezuela, Decision on Jurisdiction, 11 June 1997, 37 ILM 1378, 1384 (1998).

arbitration. Unless the parties in dispute agree otherwise, the divergency shall be submitted for arbitration under the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States.⁴¹

ICSID as one of several alternatives

The dispute settlement clauses in many BITs refer to ICSID as one of several possibilities. The alternatives contemplated may include the domestic courts of the host State, procedures agreed to by the parties to the dispute, ICC arbitration, arbitration under the UNCITRAL rules, and *ad hoc* arbitration. Some of these composite settlement clauses require a subsequent agreement of the parties to select one of these procedures. Others contain the State's advance consent to all of them, thereby giving the parties a choice. A relatively simple example for this technique may be found in some Swiss BITs. For instance, the Switzerland-Ghana BIT of 1991 provides in its Art. 12:

- (2) *If such disputes cannot be settled according to the provisions of paragraph (1) of this article within a period of six months from the date either party to the dispute requested amicable settlement, the dispute shall be submitted to international arbitration or conciliation.*
- (3) *Where the dispute is referred to international arbitration or conciliation, the aggrieved party may refer the dispute either to:*
 - (a) *the International Centre for the Settlement of Investment Disputes ...; or*
 - (b) *an international arbitrator or an ad hoc arbitration tribunal to be appointed by a special agreement or established under the arbitration rules of the United Nations Commission on International Trade Law.*
- (4) *Each Contracting Party hereby consents to the submission of an investment dispute to international arbitration or conciliation.*

Some BITs offering several methods of settlement specify that the choice among them is with the investor.⁴²

BITs referring to future consent

Not all references to the ICSID Convention in BITs constitute binding offers of consent by the host State. Some clauses contain promises of future consent or hold out a general prospect of sympathetic consideration. Still others simply state that consent may be given by way of agreements with the investor.

Some clauses in BITs referring to ICSID's jurisdiction amount to an undertaking by the host State to give consent in the future. This may be achieved by providing that a future investment agreement between the host State and the investor shall, upon the investor's request, include a provision for the submission of disputes to ICSID.⁴³ More simply, the BIT may contain an undertaking to assent to any demand by the investor to submit to dispute settlement by the Centre. For instance, the Netherlands-Pakistan BIT of 1988 provides in its

⁴¹ Dolzer/Stevens, *Bilateral Investment Treaties*, p. 194.

⁴² See *Switzerland-Paraguay BIT (1993) Art. 9; Lithuania-Poland BIT (1992) Art. 7.*

⁴³ See *France-Malaysia BIT (1975) Art. 5.*

Art. 10:

*The Contracting Party in the territory of which a national of the other Contracting Party makes or intends to make an investment, shall assent to any demand on the part of such national to submit, for arbitration or conciliation, to the Centre ..., any dispute that may arise in connection with the investment.*⁴⁴

Clauses of this kind do not give the investor an immediate right of access to the Centre. If the host State refuses to give its consent, it would be in breach of its obligation under the BIT. But the Secretary-General of ICSID would presumably reject a request for arbitration under these circumstances. It is unlikely that a promise to give consent would be accepted as amounting to consent. Therefore, any remedy must, in the first place, lie with the treaty partner to the BIT. The investor's home State can demand that the host State give its consent and, if necessary, resort to such procedures as are available between the States parties to the BIT.

An even weaker reference to ICSID is contained in some BITs that provide for the host State's sympathetic consideration to a request for ICSID dispute settlement. It is obvious that a clause of this kind does not amount to consent by the host State. The most that can be read into it is that consent may not be withheld arbitrarily and that the States parties to the BIT must consider ICSID in good faith.

Some BITs merely foresee a future agreement between the host State and the investor containing consent to ICSID's jurisdiction. An example is Art. 6 of the Sweden-Yugoslavia BIT of 1978:

*In the event of a dispute arising between a national or a company of one Contracting State and the other Contracting State in connection with an investment on the territory of that other Contracting State, it shall upon the agreement by both parties to the dispute be submitted for arbitration to the International Centre for Settlement of Investment Disputes...*⁴⁵

In *CSOB v. Slovakia*, the Respondent contended that the dispute settlement clause in the BIT, which stated that the investor and the host State had the right to submit disputes to ICSID, meant that any submission had to be made jointly by both parties. The Tribunal rejected this argument. It pointed out that a holding that the parties must submit their dispute jointly would mean that the ICSID clause in the BIT was subject to an agreement by the parties after the dispute had arisen. The fact that some BITs contained provisions for joint submission of disputes to arbitration did not compel the conclusion that provisions whose

⁴⁴ See also Japan-Egypt BIT (1977) Art. 11; UK-Philippines BIT (1980) Art. X; Australia-CSFR BIT (1991) Art. 11. For further examples see Dolzer/Stevens, *Bilateral Investment Treaties*, p. 133; Broches, A., *Bilateral Investment Protection Treaties and Arbitration of Investment Disputes*, in: *The Art of Arbitration, Liber Amicorum Pieter Sanders* (Schultz, J./van den Berg, A. eds.) 63, 65/6 (1982).

⁴⁵ See also Sweden-Malaysia BIT (1979) Art. 6; Sweden-Egypt BIT (1978) Art. 6; Sri Lanka-Switzerland BIT (1981) Art. 9.

wording is at best ambiguous should be interpreted in this way. Moreover, the Tribunal noted that the BIT offered a choice between ICSID and UNCITRAL arbitration and that any dispute was to be resolved by the method that was chosen first. The Tribunal concluded that this provision made sense only on the assumption that each party to a dispute had the right separately to institute the arbitration proceedings.⁴⁶

b) Acceptance by the Investor

The Convention requires consent in writing by both parties to the dispute. Just as in the case of legislative provisions for the settlement of disputes by ICSID, a provision on consent in a BIT can be no more than an offer that requires acceptance. The treaty provision cannot replace the need for consent by the foreign investor. In addition, the BIT must be between the host State and the State of the investor's nationality.

Acceptance by instituting proceedings

It is established practice that an investor may accept an offer of consent contained in a BIT by instituting ICSID proceedings.

In *AMT v. Zaire*, the Tribunal said:

*In the present case, it happens that AMT (...) has opted for a proceeding before ICSID. AMT has expressed its choice without any equivocation; this willingness together with that of Zaire expressed in the Treaty, creates that consent necessary to validate the assumption of jurisdiction by the Centre.*⁴⁷

Acceptance of offer prior to instituting proceedings

Withdrawal of an offer of consent before its acceptance would appear to be less of a problem in the case of ICSID clauses contained in treaties than in the case of national legislation. Withdrawal of the host State's consent contained in a BIT would be a breach of the treaty and would presumably trigger some adverse reaction on the part of the other party to the treaty. Also, an ICSID clause in a treaty remains valid notwithstanding an attempt to terminate it, unless there is a basis for termination under the law of treaties. Nevertheless, in order to avoid complications early acceptance is advisable also in the case of offers of consent contained in treaties.

Some BITs require early acceptance

Some BITs specifically provide for the giving of consent by the investor. Under these clauses, once the investor has accepted the offer contained in the BIT, either party may start proceedings. Consent by the investor must be expressed

⁴⁶ *CSOB v. Slovakia, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review—Foreign Investment Law Journal 251, 271/2 (1999).*

⁴⁷ *AMT v. Zaire, Award, 21 February 1997, 36 ILM 1531, 1545/6 (1997). See also AAPL v. Sri Lanka, Award, 27 June 1990, 4 ICSID Reports 251; Fedax v. Venezuela, Decision on Jurisdiction, 11 June 1997, 37 ILM 1378, 1384 (1998); CSOB v. Slovakia, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review—Foreign Investment Law Journal 251, 264 (1999).*

in some positive way and cannot be substituted by the BIT or simply assumed.

There are ways by which an investor may be induced to give consent. Submission to ICSID or other methods of settlement may be made a condition for admission of investments in the host State and may form part of the licensing process. BITs may provide specifically that their benefits will extend only to investors that have consented to ICSID's jurisdiction.

Summary:

- **Many bilateral investment treaties (BITs) contain offers of consent to the nationals of the respective countries.**
- **Some of the dispute settlement clauses in BITs offer a choice of several methods including ICSID.**
- **Some references to ICSID in BITs do not amount to consent to jurisdiction, but merely hold out the prospect of future consent.**
- **In order to amount to a consent agreement the offer contained in a BIT must be accepted by the investor.**
- **The investor may accept the offer simply by instituting proceedings.**

4. CONSENT THROUGH MULTILATERAL TREATIES

Offers of consent in multilateral treaties

Since the early 1990s, a number of multilateral treaties that provide for ICSID's jurisdiction have come into existence. The underlying mechanism is similar to that in the BITs discussed above. The treaties contain offers by the States parties to them to consent to ICSID's jurisdiction. These offers may be taken up by investors who are nationals of other States parties to the treaties.

NAFTA

The North American Free Trade Agreement (NAFTA) of 1992 between Canada, Mexico and the United States⁴⁸ contains a Chapter Eleven on Investments. Art. 1122 bears the title "Consent to Arbitration" and provides in relevant part:

1. *Each Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement.*
2. *The consent given by paragraph 1 and the submission by a disputing investor of a claim to arbitration shall satisfy the requirement of:*
 - (a) *Chapter II of the ICSID Convention (Jurisdiction of the Centre) and the Additional Facility Rules for written consent of the parties;...*

As long as Canada and Mexico are not parties to the ICSID Convention, the NAFTA will not operate to confer jurisdiction under the Convention. But ICSID Additional Facility arbitration (see Module 2.4) is available between United States investors and Canada or Mexico and between Canadian or Mexican investors and the United States. In disputes between Canadian investors and Mexico or Mexican investors and Canada not even the ICSID Additional Facility may be used. In disputes of the latter kind only arbitration under the UNCITRAL Rules is available.

The NAFTA specifically provides that the investor must consent to arbitration (Art. 1121), thereby emphasizing the reciprocal nature of consent to arbitration. However, under the NAFTA, submission of a claim to arbitration is open only to an investor and not to a host State.

Energy Charter Treaty

The Energy Charter Treaty of 1994 between the European Communities and 49 mostly European States in its Art. 26 also provides consent to ICSID's jurisdiction by the States parties in relation to investors of all other States parties.⁴⁹ The Treaty contains an unconditional consent to ICSID and to the Additional Facility, whichever may be available. The Article specifically requires consent in writing also on the part of the investor. The Article only envisages the submission of a claim by the investor but not by the host State.

MERCOSUR

The 1994 Colonia and Buenos Aires Investment Protocols of the Common Market of the Southern Cone (MERCOSUR) contain similar provisions. Art. 9 of the Colonia Protocol gives the investor the option to institute one of several procedures including ICSID arbitration.

⁴⁸ 32 ILM 605 (1993).

⁴⁹ 34 ILM 360, 399 (1995).

**Cartagena Free
Trade Agreement**

The 1994 Free Trade Agreement between Mexico, Colombia and Venezuela offers yet another example of consent to ICSID arbitration by multilateral agreement. Under Art. 17-18, the investor is given the option to institute ICSID arbitration, Additional Facility arbitration or arbitration under the UNCITRAL Rules, depending on the ICSID Convention's state of ratification by the three States.

Summary:

- **Several regional multilateral treaties also offer consent to ICSID jurisdiction to nationals of participating countries investing in other participating countries.**
- **These offers must be accepted by eligible investors in the same way as in the case of BITs.**
- **Regional treaties containing offers of consent to ICSID arbitration include NAFTA, the Energy Charter Treaty, Mercosur and the Cartagena Free Trade Agreement.**

5. THE TIME OF CONSENT

Time of consent given by both parties

The time of consent is determined by the date at which both parties have agreed to ICSID's jurisdiction. If the consent clause is contained in an offer by one party, its acceptance by the other party will determine the time of consent.

If the host State makes a general offer to accept ICSID's jurisdiction in its legislation or in a treaty, the time of consent is determined by the investor's acceptance of the offer. At the latest, this offer may be accepted through bringing a request for conciliation or arbitration to the Centre. The investor is under no time constraints to accept the offer and thus to complete the consent unless the offer, by its own terms, provides for acceptance within a certain period of time. But it should be borne in mind that consent, once completed, has a number of legal consequences. Therefore, care should be taken to perfect consent at the appropriate time and not to rely on a standing offer without actually taking it up.

Additional requirements for consent

It may happen, that the conditions *ratione personae* for the Centre's jurisdiction have not yet been met when a document containing a consent clause is signed. For instance, the host State or the State of the investor's nationality may not yet have ratified the Convention. In such a case, the date of consent will be the date on which all the conditions have been met. If the host State ratifies the Convention after the signature of the consent agreement, the time of consent will be the entry into force of the Convention for the host State. The same applies to a ratification by the State of the investor's nationality subsequent to the signature of the agreement containing the consent clause.

In *Holiday Inns v. Morocco*, no fewer than three conditions for the full validity of consent were lacking at the time the agreement containing the consent clause was signed: (i) the host State had not yet ratified the Convention; (ii) the investor's home State had not yet ratified the Convention; and (iii) one of the corporate parties to the dispute had not yet been created. The Tribunal noted that all these defects had been cured before the institution of proceedings and stated that "... it is the date when the conditions are definitely satisfied ... which constitutes in the sense of the Convention the date of consent..."⁵⁰

Relevance of time of consent

Consent to the jurisdiction of the Centre triggers a number of legal consequences under the Convention. The most important one is that consent, once perfected, becomes irrevocable under the last sentence of Art. 25(1) (see Section 9. below). The nationality of the foreign investor under Art. 25(2) is determined by reference to the date of consent. Both, natural and juridical persons, must be nationals of another Contracting State on the date of consent.

⁵⁰ Lalive, *The First 'World Bank' Arbitration*, 51 *British Yearbook of International Law* 123, 146 (1980).

Consent to the jurisdiction of the Centre will, unless otherwise stated, exclude other remedies pursuant to Art. 26 of the Convention. Therefore, resort to domestic courts or to other forms of arbitration becomes unavailable, in principle, from the date of consent. Similarly, under Art. 27 (1) diplomatic protection by the investor's State of nationality is no longer permitted once the parties have consented to the jurisdiction of the Centre.

Art. 44 of the Convention provides that proceedings will be conducted in accordance with Arbitration Rules in effect on the date on which the parties have given their consent. The parties may agree otherwise. But if they do not, it is not the Rules in their latest version that apply but those in force on the date of consent. The idea is to protect the parties against amendments that might not suit them.

**Consent at time
of institution of
proceedings**

Consent by both parties must exist at the time of the institution of the proceedings. If the party wishing to institute proceedings cannot supply documentation of written consent to the jurisdiction of the Centre, the Secretary-General will find that the dispute is manifestly outside the jurisdiction of the Centre and will refuse to register it.

There are good practical reasons for not proceeding with a request that is unsupported by any documentation of consent by the other party. It does not make sense to go through the procedure of constituting a tribunal if it is likely that it will find that there is no jurisdiction. Therefore, manifest absence of consent is an absolute bar against a request ever reaching a tribunal.

The situation is somewhat different if the existence of a valid consent is unclear or if the precise scope of the consent is subject to doubt. These are questions that are to be decided by the tribunal under Art. 41, and it is in these proceedings that the position taken by the respondent may become relevant.

In *Tradex v. Albania*, the Claimants relied on the bilateral investment treaty between Albania and Greece as one of two bases for jurisdiction. The Tribunal noted that the Request for Arbitration was dated 17 October 1994 but that the BIT had come into force only on 4 January 1995. It found that jurisdiction must be established on the date of the filing of the claim and rejected the BIT as a basis for jurisdiction.⁵¹

Once the proceedings are instituted, the parties may confirm or even extend their consent to jurisdiction. A tribunal will examine the validity or scope of consent only if a party raises a jurisdictional objection. A party that has not challenged the existence of consent at an early stage in the proceedings, is precluded from doing so later on.

⁵¹ *Tradex v. Albania, Decision on Jurisdiction, 24 December 1996, 14 ICSID Review—Foreign Investment Law Journal 161, 178-180 (1999).*

A respondent's failure to appear before the tribunal cannot be interpreted as an admission of jurisdiction. Logic militates against interpreting absence from the proceedings as implicit consent to jurisdiction. Moreover, Art. 45 of the ICSID Convention expressly states that failure of a party to appear or to present his case shall not be deemed an admission of the other party's assertions.

Summary:

- **The time of consent is the date by which both parties have submitted to jurisdiction.**
- **If other conditions to ICSID's jurisdiction are not yet fulfilled by the time the parties have expressed their consent agreement, the time of consent will be the date by which these conditions are fulfilled.**
- **The time of consent carries a number of important consequences: these include the irrevocability of consent, the exclusion of other remedies, and the impermissibility of diplomatic protection.**
- **Consent must exist at the time of the institution of proceedings.**

6. LIMITATIONS ON CONSENT

Parties may limit consent

Art. 25 of the ICSID Convention merely defines the outer limits of the consent that the parties may give. There is nothing to stop them from circumscribing it in a narrower way. The parties are free to delimit their consent by defining it in abstract terms, by excluding certain types of disputes or by listing the questions they are submitting to ICSID's jurisdiction. The 1993 Model Clauses offer the following formula for this purpose:

Clause 4

*The consent to the jurisdiction of the Centre recorded in citation of basic clause above shall [only]/[not] extend to disputes related to the following matters: . . .*⁵²

In practice, broad inclusive consent clauses are the norm. They are also generally preferable. Narrow clauses, listing only certain questions or excluding certain questions, are liable to lead to difficulties in determining the tribunal's precise competence. Moreover, narrow clauses may inadvertently exclude essential aspects of the dispute.

Consent clauses contained in investment agreements typically refer to "any dispute" or "all disputes" under the respective agreements.

Limitations in investment legislation

References to ICSID contained in national investment legislation typically relate to the application and interpretation of the piece of legislation in question. Some national laws are more sweeping and simply refer to disputes "concerning foreign investment". Others describe the questions covered by consent clauses in narrower terms. These may include the requirement that "the dispute is fundamental to the investment itself" or that the dispute must be "in respect of any approved enterprise".

Some national laws circumscribe the issues that are subject to ICSID's jurisdiction narrowly.

The Albanian Law on Foreign Investment of 1993 offers consent to ICSID's jurisdiction but limits this consent in the following terms:

*... if the dispute arises out of or relates to expropriation, compensation for expropriation, or discrimination and also for the transfers in accordance with Article 7, ...*⁵³

In *Tradex v. Albania*, the Tribunal held that it had jurisdiction subject to joining to the merits the issue as to whether or not an expropriation had

⁵² 4 ICSID Reports 361.

⁵³ See *Tradex v. Albania*, *Decision on Jurisdiction*, 24 December 1996, 14 ICSID Review—Foreign Investment Law Journal 161, 174 (1999). Article 7 deals with the investor's right to transfer funds abroad.

been shown to exist.⁵⁴ In its Award it found, after a detailed examination of the facts, that the Claimant had not been able to prove that an expropriation had occurred.⁵⁵

Limitations in BITs

Clauses in bilateral investment treaties (BITs) are generally quite broad and refer to “any legal dispute . . . concerning an investment”.⁵⁶

Limitations in the acceptance by the investor

Where ICSID’s jurisdiction is based on an offer made by one party, subsequently accepted by the other, the parties’ consent exists only to the extent that offer and acceptance coincide. For instance, the host State’s investment legislation or its BIT with the investor’s home State may provide for the Centre’s jurisdiction in the most general terms. If the investor accepts ICSID jurisdiction only with regard to a particular dispute or in respect of certain investment operations, the consent between the parties will be thus limited. It is evident that the investor’s acceptance may not validly go beyond the limits of the host State’s offer. Therefore, any limitations contained in the legislation or treaty would apply irrespective of the terms of the investor’s acceptance. If the terms of acceptance do not correspond with the terms of the offer there is no perfected consent.

Summary:

- **Consent to jurisdiction may be limited to certain types of disputes.**
- **A Consent agreement exists only to the extent that the offer of consent and its acceptance coincide.**

⁵⁴ At pp. 185, 196.

⁵⁵ *Tradex v. Albania, Award, 29 April 1999, 14 ICSID Review—Foreign Investment Law Journal 197, 217, 223, 232-248 (1999).*

⁵⁶ *Great Britain Model Agreement, Art. 8, Dolzer/Stevens, Bilateral Investment Treaties, p. 234. Most of the other Model Agreements contain similarly sweeping clauses.*

7. CONDITIONS TO CONSENT

Parties may subject consent to conditions

Even if a dispute is clearly covered by the parties' consent to resort to ICSID arbitration, access to the Centre may be subject to conditions. The parties are free in the drafting of such conditions, provided they are not contrary to the Convention's mandatory provisions and are in compliance with the Centre's Rules and Regulations. In practice, such conditions always concern certain procedural steps that must be exhausted before proceedings can be instituted.

Exhaustion of local remedies

Under Art. 26 of the ICSID Convention, a State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under the Convention. In the absence of such a provision there is no requirement to exhaust local remedies. Only a few States have conditioned their consent to ICSID jurisdiction on the prior exhaustion of local remedies. A relatively small number of bilateral investment treaties and a few investment agreements with investors contain such a condition.

The condition that local remedies must be exhausted before ICSID arbitration can be instituted, may be expressed by a State party to the Convention only up to the time consent to arbitration is perfected but not later. This is a consequence of the principle that once consent to jurisdiction has been given, it may not be unilaterally withdrawn or restricted.

In the annulment proceedings to *Amco v. Indonesia*, Indonesia argued "that the Tribunal manifestly exceeded its powers by holding that Amco could bring its claim for compensation of damages based on the acts of the army and police personnel involved directly to an ICSID Tribunal without previously seeking redress before the Indonesian courts in conformity with the general international law rule on exhaustion of local remedies."⁵⁷ The *ad hoc* Committee had little problem to dispose of this argument:...

*By acceptance of ICSID jurisdiction without reserving under Article 26 of the Convention a right to require prior exhaustion of local remedies as a condition for obtaining access to an ICSID tribunal, Indonesia must be deemed to have waived such right ...*⁵⁸

It is questionable whether insistence by a host State on the exhaustion of local remedies prior to ICSID arbitration serves any useful purpose. Resort to local remedies before the institution of ICSID arbitration may be seen by the investor as a waste of time and money. The public proceedings in the host State's courts may further exacerbate the dispute between the parties and may affect the host State's investment climate. If the ICSID tribunal overturns a decision

⁵⁷ 1 ICSID Reports 526.

⁵⁸ 1 ICSID Reports 526.

by the host State's highest court, this may be a source of acute embarrassment. Therefore, it seems wisest to leave the Convention's basic rule of non-exhaustion in place and to follow the example of the vast majority of consent agreements in not requiring the exhaustion of local remedies.

Attempt at amicable settlement

A common condition for the institution of proceedings before ICSID is that an amicable settlement has been attempted through consultations or negotiations. Where this is the case, negotiations must be undertaken in good faith. Some national investment laws⁵⁹ and numerous BITs contain the condition that a negotiated settlement must be attempted before resort can be had to the Centre. In order to forestall dilatory tactics and in order to make it clear when the condition precedent for settlement under the Convention has been satisfied, the treaties typically lay down time limits for negotiations. If no settlement is reached within a certain period of time, access to ICSID is open.

In *Tradex v. Albania*, the consent clause in the Albanian Law was subject to the condition that the dispute "cannot be settled amicably".⁶⁰ The Tribunal noted that Tradex had sent five letters over four months to the competent Albanian Ministry but that none of these was answered or resulted in any relevant action. The Tribunal found these letters to be a sufficient good faith effort to reach an amicable settlement.⁶¹

Prior conciliation

Another procedural condition that may be inserted into a consent clause concerns conciliation. Since conciliation is one of two procedures under the ICSID Convention, provision for it is not, strictly, a condition for the Centre's jurisdiction. But arbitration can be made contingent upon prior unsuccessful conciliation under the Convention. Under the 1993 Model Clauses 1 and 2 (see section 1. above), consent can be given for conciliation followed, if the dispute remains unresolved within a certain period of time, by arbitration.

Summary:

- **Consent to ICSID arbitration may be subject to certain procedural conditions.**
- **The parties may agree to require the exhaustion of local remedies, or to attempt a negotiated settlement or to go through conciliation prior to the institution of arbitration proceedings.**

⁵⁹ *Albania Law on Foreign Investments, 1993, Art. 8(2); Cameroon Investment Code, 1990, Art. 45; Tanzania National Investment (Promotion and Protection) Act, 1990, sec. 29(1); Togo Investment Code, 1985, Art. 4; Uganda Investment Code, 1991, Art. 30(2).*

⁶⁰ *Tradex v. Albania, Decision on Jurisdiction, 24 December 1996, 14 ICSID Review—Foreign Investment Law Journal 161, 174 (1999).*

⁶¹ *At pp. 182-184.*

8. THE INTERPRETATION OF CONSENT

Restrictive or effective interpretation

A recurrent theme in the pleadings before ICSID tribunals is the argument that consent by the host State to the Centre's jurisdiction should be construed restrictively. Respondent Governments have insisted on the need for a restrictive interpretation of a State's undertaking to arbitrate which had to be seen as a derogation from its sovereignty. The Claimants have at times attempted to invoke an alleged principle of interpretation in the opposite sense: that of effective interpretation epitomized in the Latin phrase of *ut res magis valeat quam pereat*. ICSID tribunals have repeatedly refused to embrace either of the two principles.

In *Amco v. Indonesia*, the Tribunal was confronted with the argument that the consent given by a sovereign State to an arbitration convention amounting to a limitation of its sovereignty should be construed restrictively.⁶² The Tribunal rejected this contention categorically. It said:

*. . . like any other conventions, a convention to arbitrate is not to be construed restrictively, nor, as a matter of fact, broadly or liberally. It is to be construed in a way which leads to find out and to respect the common will of the parties: such a method of interpretation is but the application of the fundamental principle pacta sunt servanda, a principle common, indeed, to all systems of internal law and to international law. Moreover—and this is again a general principle of law—any convention, including conventions to arbitrate, should be construed in good faith, that is to say by taking into account the consequences of their commitments the parties may be considered as having reasonably and legitimately envisaged.*⁶³

In the Tribunal's view, the proper method for the interpretation of the consent agreement was to read it in the spirit of the ICSID Convention and in the light of its objectives. ICSID arbitration was in the interest of both parties, a thought that was expressed in the first paragraph of the Convention's Preamble. The investor's interest in submitting investment disputes to international arbitration was matched by a parallel interest of the host State: to protect investments is to protect the general interest of development and of developing countries.⁶⁴

In *SPP v. Egypt*, the argument of the restrictive interpretation of jurisdictional instruments was raised in relation to an ICSID clause in national legislation. The Tribunal found that there was no presumption of jurisdiction, particularly where a sovereign State was involved, and

⁶² *Decision on Jurisdiction*, 25 September 1983, 1 ICSID Reports 393, 397.

⁶³ At p. 394. *Emphases original*. See also remarks to the same effect at pp. 398 and 402. See also *Cable TV v. St. Kitts and Nevis, Award*, 13 January 1997, 13 ICSID Review—Foreign Investment Law Journal 328, 386 (1998); *CSOB v. Slovakia, Decision on Jurisdiction*, 24 May 1999, 14 ICSID Review—Foreign Investment Law Journal 251, 263 (1999).

⁶⁴ At p. 400.

that jurisdiction only existed insofar as consent thereto had been given by the parties. Equally, there was no presumption against the conferment of jurisdiction with respect to a sovereign State. After referring to a number of international judgements and awards, the Tribunal said:

*Thus, jurisdictional instruments are to be interpreted neither restrictively nor expansively, but rather objectively and in good faith, and jurisdiction will be found to exist if—but only if—the force of the arguments militating in favor of it is preponderant.*⁶⁵

Therefore, neither of the two presumptions or alleged principles of interpretation carry much weight when applied to expressions of consent to the jurisdiction of ICSID. Neither a principle of restrictive interpretation nor a doctrine of “*effet utile*” will do justice to a consent clause.

Successive legal instruments

A special problem of interpretation is the applicability of consent clauses to successive legal instruments. Investment operations often involve complex arrangements expressed in a number of successive agreements. Some such related agreements concern peripheral operations such as financing or arrangements with subcontractors. These agreements may be concluded in stages and over a period of time. Though economically interrelated, the agreements are legally distinct and often have different features. At times, ICSID clauses are included in some of these agreements but not in others. If ICSID clauses are neither repeated nor incorporated by reference in related agreements, the question arises whether the parties’ consent to ICSID’s jurisdiction extends to matters regulated by these related agreements.

ICSID tribunals have dealt with this question in a number of cases.⁶⁶ These cases suggest that ICSID tribunals are inclined to take a broad view of consent clauses where the agreement between the parties is reflected in several successive instruments. Expressions of consent are not applied narrowly to the specific document in which they appear but are read in the context of the parties’ overall relationship. Therefore, a series of interrelated contracts may be regarded, in functional terms, as representing the legal framework for one investment operation. ICSID clauses contained in some, though not all, of the different contracts may be interpreted to apply to the entire operation.

The need to settle an investment dispute finally and comprehensively would make any other solution impracticable. A situation in which an ICSID tribunal were to address only some of the issues between the parties but would leave other related ones to be litigated elsewhere would be highly unsatisfactory. Partial settlements are uneconomical and liable to delay resolution even further.

⁶⁵ *Decision on Jurisdiction*, 14 April 1988, 3 ICSID Reports 143/4.

⁶⁶ *Holiday Inns v. Morocco*, *Decision on Jurisdiction*, 12 May 1979; Lalive, *The First ‘World Bank’ Arbitration*, 51 *British Yearbook of International Law* 123, 156-159 (1980); Klöckner v. Cameroon, *Award*, 21 October 1983, *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 13-18, 65-69, 89-93, 97-117; SOABI v. Senegal, *Decision on Jurisdiction*, 1 August 1984, *Award*, 25 February 1988, 2 ICSID Reports 185-188, 204-208, 293-322.

Ideally, the parties might eliminate most problems of this nature through consistency in the drafting of their various documents. But experience tells that arbitration clauses often do not get the detailed attention they deserve. Therefore, the approach developed in the practice of ICSID tribunals would appear to be the only reasonable solution. But this approach can be maintained only to the extent that it reflects the parties' presumed intentions.

Summary:

- **Consent agreements are to be interpreted neither restrictively nor extensively but in accordance with good faith and with the object and purpose of the ICSID Convention.**
- **Where an investment operation is regulated in a number of successive legal instruments, consent expressed in one of these instruments may cover the entire investment operation.**

9. THE IRREVOCABILITY OF CONSENT

Article 25 (1), last sentence of the ICSID Convention provides:

When the parties have given their consent, no party may withdraw its consent unilaterally.

Consent agreements may not be revoked by one side

The binding and irrevocable nature of consent to the jurisdiction of ICSID is a manifestation of the maxim “*pacta sunt servanda*” and applies to undertakings to arbitrate in general. The applicability of this maxim is obvious where the consent is expressed in a compromissory clause contained in an agreement. It applies equally where an offer of consent is contained in national legislation or in a treaty which has been accepted by the investor. Consent to ICSID’s jurisdiction is always by agreement even if the elements of agreement are expressed in separate documents.

Irrevocability only after consent is perfected

The irrevocability of consent operates only after the consent has been perfected. A mere offer of consent to ICSID’s jurisdiction may be withdrawn at any time unless, of course, it is irrevocable by its own terms. In the case of national legislation and treaty clauses providing for ICSID jurisdiction, the investor must have accepted the consent in writing to make it irrevocable. Therefore, it is inadvisable for an investor, to rely on an ICSID consent clause contained in the host State’s domestic law or in a treaty without making a reciprocal declaration of consent. This may be done by a simple letter addressed to the host State. Alternatively, the investor may accept the offer of consent simply by instituting proceedings before the Centre but in doing so runs the risk that the offer may be withdrawn at any time before then.

The irrevocability of consent only applies to unilateral attempts at withdrawal. It is clear that the parties may terminate consent to jurisdiction by mutual agreement either before or after the institution of proceedings.

Non-frustration of ICSID proceedings

The ICSID Convention not only declares the unilateral withdrawal of consent inadmissible but also makes provision for the institution and continuance of proceedings despite the refusal of a party to cooperate. The provisions on the constitution of arbitral tribunals (Arts. 37-38) on *ex parte* procedure (Art. 45) and on the enforcement of awards (Art. 54) are designed to secure the successful conclusion of proceedings even in the face of a recalcitrant party.

The parties are free to subject their consent to limitations and conditions (see sections 6 and 7. above) However, once consent has been given, its irrevocability extends to the introduction of new limitations and conditions. In other words, the prohibition of withdrawal covers the full extent of the consent to jurisdiction.

No indirect revocation of consent

Consent, once it is perfected, may not be withdrawn indirectly through an attempt to remove one of the other jurisdictional requirements under the Convention. To this end Art. 72 of the ICSID Convention provides that the Convention’s denunciation by the host State or the investor’s home State shall

not affect consent to jurisdiction given previously.

Similarly, if the consent to ICSID's jurisdiction was given by way of an investment licence or similar authorization, the withdrawal of the licence will not defeat jurisdiction.

Repeal of national legislation

A host State is free to change its investment legislation including the provision concerning consent to ICSID's jurisdiction. An offer of consent contained in national legislation that has not been taken up by the investor will lapse when the legislation is repealed. The situation is different if the investor has accepted the offer in writing while the legislation was still in force. The consent agreed to by the parties then becomes insulated from the validity of the legislation containing the offer. It assumes a contractual existence independent of the legislative instrument that helped to bring it about. Therefore, repeal of investment legislation providing for ICSID's jurisdiction will not effect a withdrawal of consent if the investor has accepted the offer during the legislation's lifetime.

Termination of treaties

Bilateral investment treaties (BITs) and multilateral international instruments providing for consent to ICSID's jurisdiction are more difficult to terminate than national legislation. The fact remains that consent based on treaties is only perfected once it is accepted by the investor. It is only after its acceptance by the investor that an offer of consent contained in a BIT or other international instrument becomes irrevocable and hence insulated from attempts by the host State to terminate the treaty.

In *CSOB v. Slovakia*, the Tribunal found that the BIT had never entered into force despite the fact that it was published in Slovakia's Official Gazette together with a notice announcing its entry into force. After the institution of ICSID proceedings, Slovakia published a corrective notice in its Official Gazette asserting the BIT's invalidity. The Tribunal said:

In this connection, it should be noted that if the Notice were to be held to constitute a valid offer by the Slovak State to submit to international arbitration, the corrective notice published by the Slovak Ministry of Foreign Affairs in the Official Gazette on November 20, 1997, asserting the invalidity of the BIT, would be of no avail to Respondent, since Claimant accepted the offer in the Request for Arbitration filed prior to the publication of the corrective notice.⁶⁷

Severability of arbitration agreement

If an investment agreement between the host State and the investor containing a clause providing for ICSID's jurisdiction is alleged to be invalid or is terminated, it may be argued that the consent clause is also invalidated or ceases to operate. But a unilateral invocation of invalidity or termination of the investment agreement will not defeat the consent clause. A tribunal must

⁶⁷ *CSOB v. Slovakia, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review—Foreign Investment Law Journal 251, 267 (1999).*

have the power to decide on disputes concerning the alleged invalidity of investment agreements even if the tribunal's very existence depends on the agreement's validity. Under the doctrine of the severability or separability of the arbitration agreement, the agreement providing for arbitration assumes a separate existence, which is autonomous and legally independent of the agreement containing it. This principle of severability of the arbitration agreement is supported by the weight of international arbitral codifications⁶⁸ as well as by national and international arbitral practice.⁶⁹

Invalidity of State's consent

The argument that a State's own expression of consent was defective under its law and hence invalid is unlikely to succeed. There are weighty arguments to dismiss a plea of incapacity as vitiating a State's consent. It is the primary duty of the Contracting State to ensure the observance of its own law. Alternatively, good faith requires that any incapacities or procedural requirements must be divulged to the other side. A party may not avail itself of its own violation of legal rules.

Summary:

- **As soon as all requirements for jurisdiction, including consent by both parties, are met a party may not withdraw consent unilaterally.**
- **Consent, once it is perfected, constitutes a binding agreement.**
- **An attempt by a party to revoke consent indirectly by removing one of its prerequisites, will not be successful.**

⁶⁸ See ICC Rules of Arbitration (1998), Art. 6(4), 36 ILM 1604, 1609 (1997); UNCITRAL Arbitration Rules (1976), Art. 21(2), 15 ILM 701, 709 (1976); UNCITRAL Model Law on International Commercial Arbitration (1985), Art. 16(1), 24 ILM 1302, 1306 (1985); Institut de Droit International, Resolution on Arbitration between States, State Enterprises or State Entities, and Foreign Enterprises, Art. 3(a), 63 *Annuaire II* 324, 326 (1989).

⁶⁹ Schwebel, *International Arbitration: Three Salient Problems*, 24-59 (1987).

10. CONSENT BY A CONSTITUENT SUBDIVISION OR AGENCY

Constituent Subdivision or Agency In many States investment agreements are entered into not by the government itself but by statutory corporations and public companies that exercise public functions but are legally distinct from the State. Also, in some States it is not the central government but a smaller entity, such as a province or even a municipality, that deals with foreign investors. The Convention provides that such entities may become parties in ICSID proceedings instead of or in addition to the host State itself.

Two requirements for party status Party status for a constituent subdivision or agency depends on two requirements:

- (a) The constituent subdivision or agency must have been designated to the Centre (see Module 2.4).
- (b) The consent of the constituent subdivision or agency must have been approved by the State to which it belongs.

Consent must be approved by government Consent by a constituent subdivision or agency is regulated in Art. 25 (3) of the ICSID Convention in the following terms:

(3) Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.

No withdrawal of approval Once approval of consent by a constituent subdivision or agency has been given, such approval is protected by the prohibition to withdraw consent contained in the last sentence of Art. 25 (1) (see section 9 above). In other words, consent, once approved, may not be invalidated through a retraction of the approval.

Form of approval The Convention does not require any particular form for the approval of consent. In particular, unlike designation of the constituent subdivision or agency and unlike waiver of approval, the approval need not be communicated to the Centre. In principle, approval is a unilateral act of the host State that need not be formally communicated to anyone. For practical reasons, it is desirable that the foreign investor and the constituent subdivision or agency are informed of the approval so that they may rely on the validity of consent. An investor will be well-advised to insist on approval by the State prior to or simultaneously with the consent agreement.

Approval may be contained in a separate agreement between the host State and the investor. Or the approval may be contained in an instrument of designation communicated to the Centre.⁷⁰ It may be practical to obtain approval

⁷⁰ For a combined designation and approval clause see Art. 7.10 of the 1982 participation agreement between New Zealand and Mobil Oil NZ Ltd., cited in *Attorney General v. Mobil Oil NZ Ltd.*, New Zealand High Court, 1 July 1987, 4 ICSID Reports 123/4.

by way of making the host State a party to the consent agreement. Alternatively, written approval by the host State may be affixed directly to the agreement between the constituent subdivision or agency and the investor. In addition, the consent clause may confirm that the investor's partner is indeed a designated subdivision or agency. The Model Clauses of 1993 offer the following choices in regard to a constituent subdivision or agency:

Clause 5

The name of constituent subdivision or agency is [a constituent subdivision]/[an agency] of the Host State, which has been designated to the Centre by the Government of that State in accordance with Article 25(1) of the Convention. In accordance with Article 25(3) of the Convention, the Host State [hereby gives its approval to this consent agreement]/[has given its approval to this consent agreement in citation of instrument in which approval is expressed]/[has notified the Centre that no approval of [this type of consent agreement]/[of consent agreements by the name of constituent subdivision or agency] is required].⁷¹

As noted in the Model Clauses, it is clear that the direct expression of approval of consent can only be used if the Government is also a party to the agreement.

Time of approval

The Convention does not specify at what time the host State's approval of consent, given by one of its constituent subdivisions or agencies, must be obtained. Approval may be given in advance of consent or thereafter. But it should be kept in mind that the validity of consent by a constituent subdivision or agency depends on its approval. Therefore, the actual date of consent is not before its approval. The date of consent triggers a number of consequences under the Convention (see section 5 above).

Approval of consent must be obtained by the time ICSID proceedings are instituted. A request for arbitration relating to a constituent subdivision or agency must contain information on its designation to the Centre and on the approval of its consent. Failure to provide this information in the request may lead to its rejection by the Secretary-General in accordance with his screening power under Art. 36 (3) of the Convention.

Waiver of approval

The possibility of a notification to the Centre that no approval of a consent to jurisdiction by a constituent subdivision or agency is required has its reason in the constitutions of some States. If the matter is within the exclusive competence of a constituent subdivision it may be unconstitutional to require the approval by the central government.

The notification that no approval is required would normally be made in general terms for the future in respect of a particular constituent subdivision or agency. It may be limited to certain types of consent agreements. A notification by the host State that no approval of a particular consent agreement is required is also possible. This is barely distinguishable from actual approval. But it may satisfy constitutional requirements in the host State if the subdivision or agency

⁷¹ 4 ICSID Reports 361.

has exclusive competence under domestic law and if no advance notice has been given that approval is not required.

The Centre has published a list of designated constituent subdivisions and agencies as document ICSID/8-C. This document also indicates in respect of which subdivisions or agencies Contracting States have notified the Centre that approval of consent is not required. This document is available on ICSID's website at <http://www.worldbank.org/icsid/pubs/icsid-8/icsid-8-c.htm> .

**Effect of approval
on host State**

Approval by the host State of consent to ICSID jurisdiction by a constituent subdivision or agency does not amount to consent to jurisdiction by the host State itself. Even if the host State has interfered in the investment activity, it would be impossible to bring it before the Centre without independent consent. The host State's obligation would be limited to ensuring the enforcement of an award against its constituent subdivision or agency.

The situation may be different if the host State abolishes or otherwise eliminates the procedural capacity under the ICSID Convention of a constituent subdivision or agency after having given approval of consent. In such a case an argument may be made that the host State is substituted for its constituent subdivision or agency for purposes of ICSID's jurisdiction. This would follow from the principle, contained in Art. 25 (1) of the ICSID Convention, that consent once given may not be withdrawn even indirectly (see section 9 above).

Summary:

- **In some countries investment agreements are entered into by constituent subdivisions or agencies that are legally distinct from the State.**
- **Constituent subdivisions or agencies may become parties to ICSID proceedings.**
- **Party status for constituent subdivisions or agencies requires their designation to the Centre and the approval of their consent by the State.**
- **Approval of consent may be given informally.**
- **A State may notify the Centre that the approval of the consent of certain constituent subdivisions or agencies is not required.**

TEST MY UNDERSTANDING

After having studied this Module the reader should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. Can ICSID's jurisdiction be established through a unilateral act of the host State?
2. Is it possible to give consent to ICSID's jurisdiction with respect to disputes that may arise in the future?
3. Does every reference to ICSID arbitration in national legislation amount to an expression of consent to jurisdiction?
4. Is it possible for a host State to withdraw its expression of consent to ICSID's jurisdiction contained in national legislation by repealing the legislation? Can the investor forestall such an attempt to withdraw consent?
5. Is it possible to establish ICSID's jurisdiction merely through a provision in a treaty between the host State and the investor's State of nationality?
6. Who are the beneficiaries of consent to ICSID's jurisdiction expressed in a treaty?
7. What factors determine the time of consent?
8. Why is the time of consent important?
9. Is it possible to give consent to jurisdiction after the institution of arbitration proceedings?
10. Is it possible to give consent to ICSID's jurisdiction not in general terms but only in respect of certain types of issues?
11. Is it necessary to exhaust local remedies before instituting ICSID arbitration?
12. Is it plausible to argue that consent to ICSID's jurisdiction given by a State must be interpreted restrictively since such a consent constitutes a derogation from that State's sovereignty?
13. Can a State terminate consent to the jurisdiction of ICSID by cancelling an investment licence that contained the consent clause?
14. Is it possible for a province or municipality of a host State to become a party to ICSID arbitration?
15. If the answer to question 14 is affirmative, in what way does a host State control the giving of consent by constituent subdivisions or agencies?

HYPOTHETICAL CASES

Extraction Corp. v. Tadistan

In May 1993 Extraction Corp., a company established under the law of Capitalia, started investing in an oil and gas mining enterprise in the State of Tadistan. The investment is governed by an agreement of the same year between Tadistan and Extraction Corp. containing a stabilization clause which exempts the investor from future legislation “unless such future legislation shall be accepted specifically by the investor”. The agreement does not contain any reference to ICSID.

In 1997, Tadistan issued Government Decree 77, having the force of law, which sets out the legal framework for foreign investors. The Decree offers national treatment and constant protection and security to foreign investors. Art. 7 of Government Decree 77 provides:

“All foreign nationals engaged in lawful investment activity in the Republic of Tadistan shall have the right to utilize the settlement machinery of the International Centre for Settlement of Investment Disputes”.

In June 1998 Extraction Corp. addressed a letter to the government of Tadistan expressing its willingness to have its investment governed by Government Decree 77 of 1997.

In 1999 Tadistan introduced a new tax code which provides for a substantial increase of corporation tax for foreign corporations doing business in Tadistan. Extraction Corp. immediately contested the application of the new tax code to itself arguing that this would violate the stabilization clause contained in the agreement of 1993 and the principle of national treatment contained in Decree 77 of 1997.

In June 2000 Capitalia and Tadistan entered into a Bilateral Investment Treaty (BIT). Art. 8 of this BIT provides:

“The Contracting Parties shall assent to a demand for arbitration or conciliation under the auspices of the International Centre for Settlement of Investment Disputes by investors of the other Contracting Party in respect of any investment made after the entry into force of this agreement.”

In the course of 2001 the dispute between Extraction Corp. and Tadistan escalated and Extraction Corp. threatened to institute arbitration. In December 2001 Tadistan, through Government Decree 136, repealed Article 7 of Government Decree 77 of 1997.

In February 2002 Extraction Corp. is ready to file a Request for Arbitration with ICSID.

Please advise Extraction Corp. on its chances to obtain a favourable decision on jurisdiction and help in the drafting of a Request for Arbitration.

Alternatively:

Advise Tadistan on its chances to obtain a decision declining jurisdiction and help in the drafting of a memorial containing relevant objections to the jurisdiction of ICSID.

Capitalia and Tadistan have been parties to the ICSID Convention since 1972 and 1986 respectively. They are also parties to the Energy Charter Treaty since 1994.

Mark & Frank Inc. v. Radia

Mark & Frank Inc.(M&F) is a garment business incorporated in the State of Eureka. In October 1989 M&F applied for an investment licence in the Republic of Radia. The investment was directed at the setting up of a production facility in order to take advantage of low labour costs in Radia.

The application for the licence relied on Radia's Investment Code of 1982. The Investment Code contains the following Article 9:

“Investors of foreign nationality holding a valid investment licence may submit a dispute with the Republic of Radia and the Republic of Radia hereby consents to the submission thereof, alternatively to the domestic courts of Radia, to the International Centre for Settlement of Investment Disputes or to arbitration in accordance with the UNCITRAL Rules if the dispute arises out of or relates to expropriation or compensation for expropriation of the investment. In the case of international arbitration, the accepted principles of international law shall apply.”

Upon M&F's application, the Radia National Investment Board (RNIB) issued the investment licence in January 1990. The licence states that it “is issued under and is controlled by the Investment Code of 1982”.

At the time the licence was issued, Radia had signed but not yet ratified the ICSID Convention. After ratification, the ICSID Convention entered into force for Radia on 1 October 1990. Soon after ratification, Radia designated RNIB to ICSID as a constituent subdivision or agency in accordance with Article 25(1) of the ICSID Convention. In making the designation, Radia did not make a notification under Article 25(3) of the ICSID Convention that no approval of any consent to jurisdiction by RNIB would be required. Eureka has been a party to the ICSID Convention since 1986.

In 2001 a dispute arose between M&F and the RNIB concerning the employment practices of M&F. RNIB charged that M&F routinely recruited local labour for low paying menial jobs but reserved better paid managerial positions to nationals of Eureka. As a consequence of the dispute, RNIB

cancelled the investment licence in November 2001. All nationals of Eureka who were present in Radia in connection with the activities of M&F were given 48 hours to leave the country. The premises of M&F in Radia were put under the administration of a commissioner appointed by RNIB. In June 2002 M&F filed a Request for Arbitration with ICSID against Radia and RNIB. The Request was duly registered and the Tribunal constituted.

Before the ICSID Tribunal, Radia and RNIB present the following objections to ICSID's Jurisdiction:

1. The consent to ICSID's jurisdiction contained in Art. 9 of the Investment Code of 1982 only applies to foreign investors holding a valid investment licence. As a consequence of the cancellation of the licence in November 2001, M&F is no longer entitled to institute ICSID proceedings.
2. Art. 9 of the Investment Code provides, alternatively for dispute settlement by domestic courts, ICSID and under the UNCITRAL Rules. Before instituting proceedings, the parties must reach agreement on one of the three methods.
3. Art. 9 of the Investment Code only relates to disputes arising out of an expropriation. The measures of November 2001 did not constitute an expropriation.
4. At the time of the purported consent to ICSID's jurisdiction, Radia had not yet ratified the ICSID Convention. Any consent expressed prior to the Convention's entry into force for Radia was premature and is invalid.
5. M&F has failed to exhaust local remedies in Radia. In referring to "accepted principles of international law", Art. 9 of the Investment Code preserved the requirement to exhaust local remedies.
6. In filing a Request for Arbitration against Radia, M&F chose the wrong respondent. The complaint is really directed against RNIB an independent agency under the law of Radia with separate legal personality.
7. The Request for Arbitration against RNIB must fail because RNIB has never consented to ICSID arbitration. Even if such consent could be construed, it has never been approved by Radia in accordance with Art. 25(3) of the ICSID Convention.

Please discuss these objections to ICSID's jurisdiction. Try to make arguments in favour and against each of them. Try to anticipate the likely decision of the Tribunal.

FURTHER READING

Books

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- **Tupman, W. M.**, Case Studies in the Jurisdiction of the International Centre for Settlement of Investment Disputes, 35 International and Comparative Law Quarterly 813 (1986).

Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- List of Contracting States and other Signatories of the Convention:
<http://www.worldbank.org/icsid/constate/c-states-en.htm>
- Contracting States and Measures Taken by them for the Purpose of the Convention:
<http://www.worldbank.org/icsid/pubs/icsid-8/main-eng.htm>
- Bilateral Investment Treaties, 1959-1996, Chronological and Country Data
<http://www.worldbank.org/icsid/treaties/treaties.htm>
- ICSID Model Clauses:
<http://www.worldbank.org/icsid/model-clauses-en/main.htm>
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<http://www.worldbank.org/icsid/cases/cases.htm>

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.4 REQUIREMENTS RATIONE PERSONAE



UNITED NATIONS
New York and Geneva, 2003

NOTE

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OVERVIEW

This Module deals with the question of who may be a party to proceedings under the Convention on the Settlement of Investment Disputes between States and Nationals of other States. These are called the requirements *ratione personae*. Most prominent among these are issues of nationality.

The Convention is designed for the settlement of investment disputes between host States and foreign investors. The Convention allows nationals of Contracting States (i.e. States Parties to the ICSID Convention) to bring claims against other Contracting States. It also allows Contracting States to bring claims against nationals of other Contracting States.

The requirements *ratione personae* are critical for ICSID's jurisdiction. If these requirements are not met there is no jurisdiction. Compliance with these requirements is initially screened by the Secretary-General of ICSID in the process of registering a request for arbitration or conciliation. The final determination of whether these requirements are met is with the tribunal. In actual practice the requirements *ratione personae* have repeatedly led to detailed discussions before the tribunals.

To further encourage settlement of investment disputes, the Additional Facility was created in 1978. It allows the settlement of a dispute between a State and a foreign national even if only the State that is a party to the dispute or the State of the private party's nationality is a Contracting State.

OBJECTIVES

Upon completion of this booklet the reader should be able to:

- Describe the parties to ICSID arbitration.
- Tell who may institute ICSID arbitration.
- Define the role of constituent subdivisions and agencies in ICSID arbitration.
- Compare the nationality requirements for individuals and for corporations.
- Identify the consequences of host State nationality.
- Analyse the situation of a locally incorporated company that is under foreign control.
- Discuss the requirement of ratification of the ICSID Convention for jurisdiction.
- Appreciate the importance of the Additional Facility.

INTRODUCTION

Contracting State and national of another Contracting State

The settlement of investment disputes at ICSID is available to Contracting States of the Convention and to their nationals. Art. 25(1), first sentence, of the ICSID Convention¹ provides in relevant part:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State,...

Therefore, the Convention allows only Contracting States or their nationals to institute proceedings. Also, proceedings may only be brought against Contracting States or their nationals. Proceedings are always mixed, that is between a State and a foreign investor. Therefore, under the Convention, proceedings are always between a Contracting State and a national of another Contracting State.

Constituent subdivision or agency

Some States authorize constituent subdivisions or agencies to deal with foreign investors. The Convention allows these constituent subdivisions or agencies to be parties in ICSID proceedings, provided certain procedural requirements are met.

Nationality

Article 25(2) prescribes the nationality requirements for natural and juridical persons. In both cases, the Convention follows the traditional definitions of nationality which are accepted under both international and most domestic laws.

Local companies under foreign control

In many countries, foreign investments are required to be channeled through locally incorporated companies. This requirement has important implications for foreign investors. If the investment is carried out through a locally incorporated company, a national of the host State, the investor would not normally be eligible to be a party to proceedings before the Centre. The drafters of the Convention recognized this problem and adopted Article 25(2)(b). This provision allows locally incorporated but foreign controlled companies to have access to ICSID provided certain procedural requirements are met.

Additional Facility

Non-Contracting States or their nationals may become parties to proceedings under the Additional Facility. Under the Additional Facility, only one party has to fulfill the Convention's requirements *ratione personae*. The purpose of the Additional Facility is to facilitate the settlement of disputes by expanding the reach of the Convention to non-Contracting States and their nationals.

¹ *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 18 March 1965, in force: 14 October 1966; 575 UNTS 159; 4 ILM 532 (1965); 1 ICSID Reports 3 (1993).

1. CONTRACTING STATES

Participation in ICSID Convention

A State becomes a Contracting State by ratification, acceptance or approval of the ICSID Convention. Under Article 68 of the Convention, this status is attained 30 days after depositing the instrument of ratification. Under Article 71, a State may withdraw from the Convention by a written notice to the Centre. A withdrawal becomes effective six months after the written notice. During that period the State remains subject to the Convention. Withdrawal does not affect consent to the Centre's jurisdiction if the State has given its consent prior to its withdrawal.

The Secretary-General of ICSID has to determine whether a State is, in fact, a Contracting Party as part of his screening function under Articles 28(3) and 36(3). This task is easy. A List of Contracting States and Other Signatories of the Convention is maintained and regularly updated by the Centre. It is available as document ICSID/3 and on the Centre's website:

<http://www.worldbank.org/icsid>.

Critical time for participation

The critical time for the status of a State as a Contracting State is the date of the registration of the request for arbitration or conciliation by the Secretary-General of ICSID. A State has to qualify as a Contracting Party at that date if a request for arbitration/conciliation is to be accepted.

A State may give its consent to submit to the Centre's jurisdiction before becoming a Contracting State. This consent becomes effective only once the State satisfies the requirements of a Contracting State.

This point is illustrated by the decision on jurisdiction in the case *Holiday Inns v. Morocco*. Neither Morocco, the host State, nor the investor's State of nationality, Switzerland, was a Contracting State at the time the two parties agreed to consent to the Centre's jurisdiction. Subsequently, both countries ratified the Convention prior to the investor's Request for Arbitration. The Tribunal stated that the consent of Morocco and of the investor became effective when both Morocco and Switzerland had become Contracting Parties and hence met the requirements of the Convention *ratione personae*.²

A State that is not a Contracting State of the Convention, at the time of a request for arbitration or conciliation, will not be subject to the Centre's jurisdiction even if it has given its consent to jurisdiction. If the State party named in the request is not a Contracting State, the Secretary-General of

² *Holiday Inns v. Morocco, Decision on Jurisdiction, 12 May 1974. The Decision is unpublished. A detailed description of the Decision is provided by Lalive, P., The First 'World Bank' Arbitration (Holiday Inns v. Morocco) – Some Legal Problems, 51 British Year Book of International Law 123 at 142/3 (1980).*

ICSID will refuse to register the request since the dispute is manifestly outside the jurisdiction of the Centre.

Summary:

- **A Contracting State or a national thereof may institute proceedings before the Centre. Proceedings may be instituted against a Contracting State or a national thereof.**
- **A State becomes a Contracting State of the ICSID Convention by depositing an instrument of ratification with the Centre.**
- **The critical time for the status of a party as a Contracting State is the date a request for arbitration or conciliation is considered for registration by the Secretary-General of ICSID.**
- **Proceedings are always mixed, that is, between a State and a foreign investor.**

2. CONSTITUENT SUBDIVISION OR AGENCY OF A CONTRACTING STATE

State entities

A State may conduct matters of foreign investment itself through a central organ or through a separate entity. A separate entity may be territorial, such as a province, or may be a governmental agency, such as an investment agency. Foreign investors may conclude investment agreements, often called concession agreements, with any of these, depending on the host State's internal legal system. Not infrequently, these agreements will contain ICSID consent clauses.

If an investment dispute arises, the investor will, typically, only be able to bring a claim against the State entity with which it has concluded the investment agreement containing the ICSID consent clause. The investor will not normally be in a position to bring claims against State entities that are not identified in the agreement. For example, if the ICSID clause is in an agreement with a province, the investor will not normally be able to bring claims against the central government.

Constituent subdivision or agency

The distinction between the State party in the form of the central government and that of a governmental agency or territorial entity is reflected in Article 25(1) of the Convention. In addition to the term "Contracting State", Article 25(1) also refers to "any constituent subdivision or agency of a Contracting State." The precise meaning of the term "constituent subdivision or agency" is not explained in the Convention. It is generally accepted that the term "constituent subdivisions" includes any territorial entity below the State such as a state, province, canton or municipality.³

The term "agency" is determined functionally rather than structurally. This allows for flexibility in ascertaining the status of an agency by looking into the nature of its work rather than being limited to its form. Whether the "agency" is a corporation, whether and to what extent it is government-owned and whether it has separate legal personality are of secondary importance. What matters is that it performs public functions on behalf of the Contracting State.⁴

Designation to the Centre

The ICSID Convention requires that States designate their governmental agencies and constituent subdivisions to the Centre, that is the ICSID Secretariat. Designation of a constituent subdivision or agency is a requirement for ICSID's jurisdiction over it. The Secretary-General of ICSID will refuse to register a request for arbitration or conciliation against a constituent subdivision or agency if the State to which it belongs has failed to make the designation to the Centre. Designation assures investors that the particular agency or entity with which they are dealing has been authorized by the State. In addition, designation to the Centre creates a presumption that the designated entity is a constituent subdivision or agency of the Contracting State in the

³ C. Schreuer, *The ICSID Convention: A Commentary*, Article 25, paras. 145-149, pp. 150-152 (2001).

⁴ Loc. cit.

sense of Article 25(1) of the Convention.

Approval of consent

In addition, Article 25(3) of the ICSID Convention requires that the constituent subdivision or agency's consent to the Centre's jurisdiction be approved by the State to which it belongs.⁵ These two distinct steps, namely designation to the Centre and approval of the constituent subdivision's or agency's consent, are separate but critical to the Centre's jurisdiction to hear disputes involving constituent subdivisions or agencies.

Form of designation

Designation of a constituent subdivision or agency to the Centre need not be made in any particular form. A State may designate its constituent subdivisions or agencies through domestic legislation, bilateral agreement or by directly informing the Centre. Any such designation should always be communicated to the Centre in writing.

The Centre keeps a register of designations. The list is published as document ICSID/8–C. The list is also available on the Centre's website:

<http://www.worldbank.org/icsid/pubs/icsid-8/icsid-8-c.htm>. This list shows that the designations fall into two categories. Some countries have designated territorial entities, in other words, constituent subdivisions. Other countries have designated entities of a non-territorial nature, in other words, agencies.

Time of designation

A Contracting State may designate a constituent subdivision or agency at any time before or after the dispute has arisen, provided such designation exists on the day a request for arbitration or conciliation is made to the Centre. It is open to States to make designations not only in general terms for the future but also on the occasion of specific investment projects or after an investment dispute has arisen. Such an *ad hoc* designation too, must be communicated to the Centre.

Withdrawal of designation

The Convention is silent on whether a State may withdraw the designation of a constituent subdivision or agency to the Centre. Such withdrawal is believed to be possible subject to the last sentence of Article 25(1).⁶ That provision precludes the unilateral withdrawal of consent. This means that once a State has designated a constituent subdivision or agency and has approved its consent to jurisdiction, such consent cannot be terminated by simply withdrawing the designation.

The importance of designation is illustrated by the case *Cable Television v. St. Kitts and Nevis*.⁷ The Claimant entered into an agreement with the Nevis Island Administration (NIA) containing consent to ICSID arbitration. The Tribunal found that the NIA was a constituent subdivision of the Federation of St. Kitts & Nevis. But NIA had not been designated

⁵ This requirement is covered in Module 2.3 dealing with Consent to Arbitration.

⁶ Schreuer, *Commentary, Article 25, para. 164, p. 158.*

⁷ *Cable Television v. St. Kitts and Nevis, Award, 13 January 1997, 13 ICSID Review-Foreign Investment Law Journal 328 (1998).*

to the Centre as a constituent subdivision or agency in accordance with Article 25(1) of the ICSID Convention nor had its consent been approved by the Federation in accordance with Article 25(3). The Tribunal held that in the absence of a designation of the NIA under Art. 25(1) it had no jurisdiction. The Tribunal also rejected the attempted substitution of the Federation for NIA as a party to ICSID proceedings.

Summary:

- **A distinction exists between a State in the form of its central government and a State's territorial entities (constituent subdivisions) or governmental agencies. Territorial entities and governmental agencies can become parties to proceedings before the Centre only if they have been designated by the host State.**
- **Designation to the Centre gives a strong presumption that the entity is a "constituent subdivision or agency of a Contracting State."**
- **In addition to designation, the consent to jurisdiction given by a constituent subdivision or agency is subject to the approval of the State to which it belongs.**
- **A Contracting State may designate its governmental agencies or territorial entities at any time before or after the dispute has arisen. Once the constituent subdivision or agency has given its consent to the Centre's jurisdiction, and this consent has been approved, the State's ability to withdraw a designation will be subject to the last sentence of Article 25(1).**

3. NATIONAL OF ANOTHER CONTRACTING STATE

Positive and negative nationality requirements

In order to gain access to dispute settlement under the ICSID Convention, an investor is required to be a “national of another Contracting State”. Article 25(2) contains the following definition of this term:

(2) “National of another Contracting State” means: (a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

Therefore, Article 25(2) defines the term “national of another Contracting State” by distinguishing between a natural person and a juridical person. Investors are required to meet a positive and a negative nationality requirement. To satisfy the positive requirement, investors are required to be nationals of a Contracting State. To satisfy the negative requirement, investors must not have the nationality of the host State. Juridical persons will qualify as nationals of Contracting States through their place of incorporation or seat of business. A juridical person may, however, possess the host State’s nationality and still qualify as a national of another Contracting State under an exception contained in Article 25(2)(b) discussed below.

Critical dates

Article 25(2)(a) states that the nationality requirements for a natural person have to be satisfied at two separate dates. An individual investor has to be a national of a Contracting State at the time the parties consent to submit to the Centre’s jurisdiction and also on the date the request for arbitration or conciliation is registered by the Centre. In addition, the individual investor must not be a national of the host State on these two dates. The individual investor’s possession of other nationalities is irrelevant in the interim period between the date of consent and the date of registration. The Convention does not speak of a requirement for the investor to continuously hold its nationality between these two dates. By contrast, a juridical person has to satisfy the nationality requirements only on the date the parties consented to submit to the Centre’s jurisdiction.

a) Natural Person

Nationality of individuals An individual’s nationality is determined by the domestic legislation of the

State whose nationality is claimed. Two criteria are generally accepted under international and domestic laws in determining the nationality of individuals. The first criterion confers nationality on the individual on the basis of descent from a national of a particular State (*ius sanguinis*). The second criterion emphasizes the territoriality principle under which the nationality is conferred according to the place of birth (*ius soli*). The domestic legislation of most countries adheres to one of or both these criteria in regulating the concept of nationality.⁸ In addition, there are other accepted criteria for the acquisition of a nationality, such as a grant of nationality on the basis of long residence or other ties linking the individual to a State. However, there are instances where a State's rules on nationality may be ignored. This would be the case where a nationality is conferred without regard to any effective link between the State conferring the nationality and the individual.⁹ This is often referred to as "nationality of convenience" which may be obtained from certain countries by the mere compliance with certain procedural steps. These kinds of nationalities may be challenged by host States.

Objective determination of nationality

An agreement between a host State and an investor may specifically state the investor's nationality. Such an agreement creates a presumption that the nationality in question exists. However, if the facts demonstrate that the investor does not qualify as a national under the law of the State whose nationality has been claimed, the agreement will be of little use. An investor's nationality has to be objectively determined irrespective of agreements between the host State and the investor. To that end, an investor must show the possession of the nationality of a Contracting State.

No host State nationality

The purpose of ICSID is to encourage the settlement of disputes that involve States and private foreign investors who are often reluctant to settle disputes in host States' courts. Investors who hold the nationality of the host State are barred from bringing claims before the Centre. The motive behind this prohibition is to exclude disputes that are normally settled locally. This also applies to investors with dual nationality, one of which is that of the host State. This exclusion applies to investors with dual nationality even if the host State's nationality is not the effective one.¹⁰

Only under extreme circumstances may an individual investor with the host State's nationality be allowed to institute proceedings at the Centre. This would be the case if the host State conferred its nationality on an investor involuntarily for the sole purpose of undermining the Centre's jurisdiction. Under these circumstances, the prohibition against the unilateral withdrawal of consent¹¹ would override the negative nationality requirement.

Summary:

- **A natural person must satisfy both a positive and a negative**

⁸ A. Randelzhofer, *Nationality*, *Encyclopedia of Public International Law*, Vol. III, 501 (1997).

⁹ See in general the *Nottebohm Case*, 1955 ICJ Reports 23.

¹⁰ Schreuer, *Commentary*, Article 25, paras. 440-444.

¹¹ Article 25(1), last sentence.

nationality requirement: the investor must be a national of a Contracting State. In addition, the investor must not be a national of the host State.

- **A natural person must comply with these requirements at two critical dates: on the date when both parties consent to submit the dispute to arbitration or conciliation and also on the date the request for arbitration or conciliation is registered by the Centre.**
- **An agreement between the parties stipulating the nationality of the investor creates a presumption of compliance with the nationality requirements of Article 25(2)(a). However, this presumption is rebuttable.**

b) Juridical Person

Nationality of corporations

Two criteria are decisive in determining the nationality of a corporation. First, the place of incorporation, i.e., the law under which the corporation is formed. Second, the place of its seat (*siège social*), i.e., the State where the headquarters or the centre of its management is located.

Another relevant criterion in determining the nationality of a company is that of foreign control. A foreign investor may exercise control through the holding of equity shares in the company, through managerial control or by having the necessary voting power to affect the decision-making process in the investment. The concept of foreign control is relevant in situations where a company is locally incorporated under the host State's law.

ICSID tribunals have consistently adopted the traditional test of incorporation or seat in determining the nationality of a corporation.¹² The Centre's practice reflects a reluctance to adopt the control test in defining the nationality of a juridical person outside the narrowly defined exception in Article 25(2)(b).

Nationality of a Contracting State

A juridical person must be a national of a Contracting State. A corporation that has the nationality of a non-Contracting State will not be able to institute proceedings before the Centre. A corporation may, however, have more than one nationality. If all nationalities are those of Contracting States, the Centre will have jurisdiction. If one of the nationalities belongs to a non-Contracting State, the juridical person has to demonstrate that it holds the nationality of a Contracting State on the basis of incorporation or seat. The concurrent possession of the nationality of a non-Contracting State, established on the basis of these same criteria, would not exclude jurisdiction.

Agreement on nationality

An agreement on the nationality of the investor between the host State and a corporate investor strongly indicates that the nationality requirement has been fulfilled. Such an agreement will carry much weight, but it cannot create a nationality that does not exist. Therefore, the existence of such an agreement will not preclude the tribunal from examining the compliance with this requirement.

¹² Schreuer, *Commentary, Article 25, paras. 465-468.*

An agreement on an investor's nationality where the juridical person is registered in a non-Contracting State but controlled by a national of a Contracting State may allow for the Centre's jurisdiction. The validity of this agreement would depend on the host State's knowledge of the circumstances underlying the investor's nationality combined with the State's consent to submit to the Centre's jurisdiction. This situation differs from the one where the juridical person is a national of the host State. In the latter case, the agreement is subject to the explicit exception of Article 25(2)(b).¹³

In *MINE v. Guinea*¹⁴, there was an agreement on the nationality of the investor. MINE had concluded an agreement with the Government of Guinea which contained the parties' consent to settle disputes through ICSID. This agreement also stipulated that the investor, MINE, was a Swiss national. Switzerland was (and is) a Contracting State. But MINE was incorporated in Liechtenstein which had not ratified the ICSID Convention. But the company was controlled by a Swiss national. When MINE instituted proceedings with ICSID it argued that it had complied with the nationality requirement since the real interest in the corporation was Swiss. Guinea did not object to the Centre's jurisdiction and the Tribunal did not explicitly refer to the investor's nationality. The Tribunal's assumption of jurisdiction over the case implied that it had accepted MINE's nationality as Swiss. The Tribunal's position seems to have been based on two elements. First, the agreement between the parties stipulated the investor's nationality to be Swiss. Second, Guinea was aware of the circumstances underlying the investor's nationality when it agreed to submit to ICSID's jurisdiction.

Private nature of investor

In principle, investors must be private corporations. The Convention's Preamble refers to private international investment. But this does not necessarily exclude wholly or partly government-controlled companies acting as investors. The decisive criterion is whether the company is acting in a commercial capacity or is discharging governmental functions.¹⁵

In *CSOB v. Slovakia*,¹⁶ the Respondent contested the Tribunal's competence charging that the Claimant was a State agency of the Czech Republic rather than an independent commercial entity and that it was discharging essentially governmental activities. The Tribunal rejected this contention. It held that the concept of "national" under the Convention was not limited to privately owned companies and did not

¹³ Ibid. at paras. 485-489.

¹⁴ *MINE v. Guinea, Award, 6 January 1988, 4 ICSID Reports 61.*

¹⁵ Broches, A., *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 136 *Recueil des Cours* 331, 354/5 (1972-II).

¹⁶ *CSOB v. Slovakia, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review – Foreign Investment Law Journal 251, 257-261 (1999).*

depend upon whether or not the company was partially or wholly owned by the Government. The decisive test was whether the company was discharging an essentially governmental function. CSOB's activities in executing international banking transactions under the State's control had to be judged by their nature and not by their purpose and were hence commercial.

Summary:

- **The Convention is silent on the definition of the nationality of a juridical person. The Centre's practice demonstrates the acceptance of the traditional criteria for the nationality of corporations under international and domestic laws, namely the place of incorporation or seat of business.**
- **A juridical person must be a national of a Contracting State in order to have access to ICSID.**
- **An agreement on the nationality of an investor between a host State and an investor creates a strong presumption of compliance with the nationality requirements.**
- **If the juridical person is a national of a non-Contracting State but is controlled by a national of a Contracting State, an agreement on the nationality of an investor may suffice if the host State is fully aware of the situation.**
- **A State-owned corporation will qualify as an investor if it acts in a commercial rather than in a governmental function.**

4. LOCALLY INCORPORATED COMPANIES UNDER FOREIGN CONTROL

Purpose of Art. 25(2)(b)

The purpose of the Convention is the settlement of investment disputes between States and foreign investors. Disputes between States and their own nationals are to be settled locally. Many host States require that foreign investors operate through locally incorporated companies. The consequence of incorporating under the host State's law is that these companies have the nationality of the host State. In principle, these companies would be excluded from proceedings against the host State since the Convention requires the nationality of an investor to be that of a Contracting State other than the State party to the dispute. However, the drafters of the Convention realized that a sizeable portion of foreign investments would thus be excluded from the Centre's jurisdiction. Therefore, they included the following category among "National of another Contracting State" in Article 25(2)(b):

...any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

Article 25(2)(b) applies the principle of foreign control to locally incorporated companies. This guarantees access to ICSID to foreign investors even if they operate through locally incorporated companies. To achieve this result, the Convention requires two elements. There must be an agreement with the host State that reflects its undertaking to treat the locally incorporated company as foreign. In addition, the objective element of foreign control must be present.

a) Agreement to Treat the Investor as a National of Another Contracting State

A request for arbitration or conciliation involving a company having the nationality of the host State must be supported by information concerning an agreement of the parties that it should be treated as a national of another Contracting State for the purposes of the Convention.¹⁷

Explicit agreement

The agreement to treat an investor as a national of another Contracting State may be reached in different ways. Such an agreement may be contained in the instrument recording the consent of the parties to submit to the Centre's jurisdiction. The Model Clauses provided by the Centre suggest the following formula:

Clause 7

It is hereby agreed that, although the Investor is a national of the Host State, it is controlled by nationals of name(s) of other Contracting State(s) and

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¹⁷ Institution Rule 2(1)(d)(iii).

*shall be treated as a national of [that]/[those] State[s] for the purposes of the Convention.*¹⁸

Implicit agreement

The Convention does not prescribe a particular form for an agreement to treat the investor as a national of another Contracting State. Whereas a consent agreement is required to be in writing, no formality is attached to agreements on the nationality of locally incorporated companies that are foreign controlled. The practice of ICSID's tribunals shows flexibility in the determination of whether such an agreement exists.

In *Amco v. Indonesia*,¹⁹ PT Amco, a locally incorporated company, was controlled by its parent foreign company, Amco Asia. The arbitration clause nominated PT Amco as a potential party in any ICSID proceeding. In contesting the Centre's jurisdiction over PT Amco, Indonesia argued that it had not expressed its agreement to treat PT Amco as a foreign corporation. The Tribunal acknowledged the lack of formal requirements for these agreements. This allowed the Tribunal to determine whether an implicit agreement existed between the parties. This was found to be the case. The Tribunal referred to the consent agreement which indicated the Indonesian Government's acknowledgment of PT Amco's status as a locally incorporated but foreign controlled corporation. PT Amco was, in fact, referred to as a "foreign business" in the agreement. In addition, the agreement contained provisions that would normally apply to foreign businesses. Therefore, the Tribunal found an implied agreement between the parties to treat PT Amco as a national of another Contracting State for purposes of the Convention.

Subsequent cases demonstrate that ICSID Tribunals have inferred an agreement to treat the locally incorporated company as a foreign national from the mere existence of an ICSID clause.

In *Klöckner v. Cameroon*,²⁰ the foreign investor had participated in the establishment of a joint venture company, SOCAME, in Cameroon. An agreement between SOCAME and Cameroon (the "Establishment Agreement") contained an ICSID clause. Before the Tribunal, Cameroon sought to challenge the validity of the ICSID clause because SOCAME was a Cameroonian company. The Tribunal held that the mere existence of an ICSID arbitration clause indicated an agreement on foreign nationality: The insertion of an ICSID arbitration clause by itself presupposes and implies that the parties were agreed to consider SOCAME at the time to be a company under foreign control, thus having the capacity to act in ICSID arbitration. This is an acknowledgment

¹⁸ 4 ICSID Reports 362.

¹⁹ *Amco v. Indonesia, Decision on Jurisdiction*, 25 September 1983, 1 ICSID Reports 392-397.

²⁰ *Klöckner v. Cameroon, Award*, 21 October 1983, 2 ICSID Reports 14-18.

which completely excludes a different interpretation of the parties' intent. Inserting this clause in the Establishment Agreement would be nonsense if the parties had not agreed that, by reason of the control then exercised by foreign interests over SOCAME, said Agreement could be made subject to ICSID jurisdiction.²¹

Presumption of agreement

Other decisions of ICSID Tribunals have also demonstrated flexibility in determining the existence of an agreement on nationality.²² In instances where an agreement containing the host State's consent to submit to ICSID's jurisdiction existed with a locally incorporated but foreign controlled company, Tribunals found an implicit agreement to treat that company as foreign. Since consent agreements are only valid if the Convention's nationality requirements are satisfied, such agreements create a presumption that a host State has, in fact, accepted to treat the local corporation as foreign.

Legislation and treaties

Such inferences can only be drawn from consent agreements concluded directly with host States which relate to a particular local company. In cases where a host State's consent to ICSID's jurisdiction is offered in general terms in national legislation or through a bilateral investment treaty (BIT), such a presumption that the host State has agreed to regard a particular local company as foreign cannot be made. But an offer to treat locally incorporated companies as foreign because of foreign control may also be stipulated in national legislation and/or in bilateral investment treaties. This offer becomes part of the general consent offer to submit to the Centre's jurisdiction and becomes binding upon the investor's acceptance of the offer.

The second clause of Art. 25(2)(b) requires an agreement between the parties to the dispute. A clause in national legislation or in a treaty providing for ICSID's jurisdiction is an offer to the investor, which may be accepted by the latter.²³ The proviso that a local company, because of foreign control, would be treated as a national of another Contracting State is part of the terms of the offer made by the host State. When the offer to submit disputes to ICSID is accepted by the investor, that proviso becomes part of the consent agreement between the parties to the dispute.²⁴

Legislation

Some national investment laws providing for ICSID's jurisdiction do, in fact, grant access also to local companies that are under foreign control. Some laws simply extend the right to institute ICSID proceedings to corporations with a majority of foreign capital. Other investment laws contain definitions of foreign investors that include locally established legal persons that are controlled by a majority of foreign capital.²⁵

²¹ At p 16.

²² See also *LETCO v. Liberia, Decision on Jurisdiction, 24 October 1984, 2 ICSID Reports 351-354.*

²³ Generally, see *Module 2.3 on Consent to Arbitration.*

²⁴ Schreuer, *Commentary, Article 25, para. 536.*

²⁵ Schreuer, *Commentary, Article 25, para. 531.*

Treaties

In a similar way, many bilateral investment treaties provide that companies established in one State but controlled by nationals of the other State shall be treated as nationals of the other State for purposes of Art. 25(2)(b).²⁶ For instance, the BITs of the United Kingdom typically include the following clause:

*A company which is incorporated or constituted under the law in force in the territory of one Contracting Party and in which before such a dispute arises the majority of shares are owned by nationals or companies of the other Contracting Party shall in accordance with Article 25(2)(b) of the Convention be treated for the purposes of the Convention as a company of the other Contracting Party.*²⁷

Multilateral treaties providing for ICSID jurisdiction also contain provisions to the same effect.²⁸

b) Foreign Control**Control by nationals of other Contracting States**

The Convention does not define the term “foreign control”, but the drafting history indicates that control must be exercised by nationals of other Contracting States.²⁹ This interpretation excludes control by nationals of non-Contracting States or by nationals of the host State. This interpretation is in line with the objective of the Convention to promote the settlement of disputes between host States and nationals of other Contracting States.

Objective requirement of control

An agreement on an investor’s nationality under Article 25(2)(b) “because of foreign control” implies that such control is an objective requirement that has to be determined by Tribunal. In other words, an agreement on the nationality of an investor creates no more than a presumption that there is “foreign control”. Whereas an agreement on foreign nationality can be inferred from the existence of a consent agreement, no such an inference can be made in respect of foreign control.

ICSID tribunals have invariably examined the actual existence of foreign control over the local company.³⁰ In situations where the element of control is lacking, the Tribunal will find that it has no jurisdiction.

²⁶ Dolzer/Stevens, *Bilateral Investment Treaties* (1995) pp. 142-144; Parra, A. R., *Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment*, 12 *ICSID Review – Foreign Investment Law Journal* 287, 324 (1997); Peters, P., *Dispute Settlement Arrangements in Investment Treaties*, 22 *Netherlands Yearbook of International Law* 91, 144 (1991).

²⁷ Dolzer/Stevens, *Bilateral Investment Treaties*, p. 234. See also the *United States Model Agreement*, loc. cit. at 248/9.

²⁸ See *Energy Charter Treaty 1994, Article 26(7)*, 34 *ILM* 360, 400 (1995). But contrast *Article 1117 of NAFTA*, 32 *ILM* 605, 643 (1993). For a broader discussion see Schreuer, *Commentary, Article 25, para. 535*.

²⁹ Schreuer, *Commentary, Art. 25, para. 551*.

³⁰ *Amco v. Indonesia, Decision on Jurisdiction*, 25 September 1983, 1 *ICSID Reports* 396/7; *Klöckner v. Cameroon, Award*, 21 October 1983, 2 *ICSID Reports* 15/16; *SOABI v. Senegal, Decision on Jurisdiction*, 1 August 1984, 2 *ICSID Reports* 182/3; *LETCO v. Liberia, Decision on Jurisdiction*, 24 October 1984, 2 *ICSID Reports* 352.

In *Vacuum Salt Products Ltd. v. Ghana*,³¹ there was an agreement between the Ghanaian Government and Vacuum Salt containing an ICSID clause. Vacuum Salt was organized under the law of Ghana. When Vacuum Salt initiated arbitration proceedings before ICSID, the Ghanaian Government objected to the Centre's jurisdiction arguing that Vacuum Salt was its own national and was not controlled by foreign nationals. In addition, the government stated that no agreement had been concluded with the investor to treat Vacuum Salt as a national of another Contracting State.³² The Tribunal noted the practice of previous tribunals to infer an agreement on nationality from the existence of a consent to ICSID's jurisdiction. But it insisted that it had to determine whether foreign control did, in fact, exist:

*... the parties' agreement to treat Claimant as a foreign national "because of foreign control" does not ipso jure confer jurisdiction. The reference in Article 25(2)(b) to "foreign control" necessarily sets an objective Convention limit beyond which ICSID jurisdiction cannot exist and parties therefore lack power to invoke same no matter how devoutly they may have desired to do so.*³³

The Tribunal examined whether Vacuum Salt was effectively controlled by foreign nationals and found that the foreign investor only held 20 per cent of the shares, whereas 80 per cent were in Ghanaian hands. Under these circumstances, the local company did not objectively meet the requirement of foreign control under the Convention. The Tribunal also looked at other elements of control besides shareholding, such as the foreign investor's management role, but was not, in the end, satisfied of the existence of foreign control.³⁴

Elements of control

The consideration of elements other than shareholding demonstrates a differentiated approach to the concept of foreign control. In addition to shareholding, indirect control, voting powers or managerial control were taken into account by ICSID Tribunals.³⁵ The Convention's methodology on this issue has been summarized as follows:

*On the basis of the Convention's preparatory works as well as the published cases, it can be said that the existence of foreign control is a complex question requiring the examination of several factors such as equity participation, voting rights and management. In order to obtain a reliable picture, all these aspects must be looked at in conjunction. There is no simple mathematical formula based on shareholding or votes alone.*³⁶

³¹ *Vacuum Salt v. Ghana*, Award, 16 February 1994, 4 ICSID Reports 329.

³² At p. 331.

³³ At pp. 342/3.

³⁴ At pp. 342-351.

³⁵ *Amco v. Indonesia*, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 396; *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 15/16; *SOABI v. Senegal*; Decision on Jurisdiction, 1 August 1984, 2 ICSID Reports 182/3; *LETCO v. Liberia*, Decision on Jurisdiction, 24 October 1984, 2 ICSID Reports 349, 351; *Vacuum Salt v. Ghana*, Award, 16 February 1994, 4 ICSID Reports 342-351; *Cable TV v. St. Kitts and Nevis*, Award, 13 January 1997, 13 ICSID Review—Foreign Investment Law Journal 366-370 (1998).

Indirect control

The complexity inherent in the concept of foreign control is most evident in connection with indirect control. Indirect control refers to instances where a foreign corporation, controlling the local company in the host State, is itself controlled by nationals of other States. In that situation, the question arises whether a Tribunal should concern itself only with those who directly control the local company or whether it should look beyond the first layer and search for the chain of control that may be exercised by multiple investors. ICSID practice on this point is not uniform.

In *Amco v. Indonesia*, the Tribunal discussed the possibility of examining control beyond the first level. The Indonesian Government argued that PT Amco, the local company, was not controlled by Amco Asia, a company owned by a national of the United States of America, since Amco Asia was, in turn, controlled by a Hong Kong company owned by a Dutch citizen. The Tribunal refused to search for indirect control beyond the first level of control and found that it was restricted to the immediate control exercised by the parent company of the local company.³⁷

The Tribunal in *SOABI v. Senegal* took a different approach. SOABI, a company incorporated in Senegal, was controlled by a Panamanian company, Flexa, which in turn was controlled by Belgian nationals. In this case, it was critical for SOABI to convince the Tribunal to go beyond the first level of control since Panama was not a Contracting State, whereas Belgium was (and is) a Contracting State. The Senegalese Government disputed jurisdiction arguing that Panama was not a Contracting State, hence, the nationality requirements of Article 25 were not met. The Tribunal stated that the Convention was not only concerned with direct control over a locally incorporated company. The Tribunal referred to the purpose of Article 25(2)(b) of the Convention in facilitating foreign investments through locally incorporated companies while still retaining their standing before ICSID. In that spirit, the Tribunal went beyond the direct control exercised by the Panamanian company and found that SOABI was, in fact, controlled by Belgian nationals.³⁸

There is no definitive legal position on the issue of indirect control as ICSID Tribunals have taken differing approaches. Scholarly opinion is also divided. One view is that the correct approach would be to allow a Tribunal to search for control by a national of a Contracting State until jurisdiction can be established.³⁹ Under another view, a Tribunal should look at the true controllers thereby excluding access to the Centre to juridical persons controlled directly

³⁶ Schreuer, *Commentary, Article 25, para. 573*.

³⁷ *Amco v. Indonesia, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 396. It should be noted that this finding was an obiter dictum: even if the Tribunal had decided to probe beyond the first level of control, it would have been able to assert jurisdiction because all the relevant nationalities were those of Contracting States.*

³⁸ *SOABI v. Senegal, Decision on Jurisdiction, 1 August 1984, 2 ICSID Reports 182/3.*

or indirectly by nationals of non-Contracting States or nationals of the host State.⁴⁰

Summary:

- **Foreign investments are often channeled through companies incorporated in the host State. Such companies may be parties to ICSID proceedings if the host State has agreed to treat them as foreign nationals because of foreign control.**
- **An agreement on the nationality of a locally incorporated but foreign controlled company may be achieved by different methods. It may be contained in a direct consent agreement to submit to ICSID's jurisdiction. It may also be contained in a host State's national legislation or in a bilateral investment treaty.**
- **A consent agreement to submit to ICSID's jurisdiction in respect of a specific locally incorporated company, implies that the host State has also agreed to treat that company as a foreign national.**
- **A consent to jurisdiction offered by a host State through its national legislation or a BIT in general terms cannot create this effect. Some national investment laws and treaties offer to treat locally incorporated but foreign controlled companies as foreign investors for purposes of jurisdiction.**
- **Foreign control must be exercised by nationals of Contracting States.**
- **Control must be objectively determined and cannot be inferred from an agreement. There is no specific method for ascertaining the existence of foreign control. The Convention allows for a comprehensive approach taking into account factors such as management, voting rights, control by shareholders, etc.**

³⁹ Amerasinghe, C. F., *Interpretation of Article 25(2)(b) of the ICSID Convention*, in: *International Arbitration in the 21st Century: Towards Judicialization and Uniformity?* (Lillich, R. B./Brower, Ch. N. eds.) 223, 240 (1994).

⁴⁰ Schreuer, *Commentary, Article 25, para. 563.*

5. THE ADDITIONAL FACILITY

Nationality requirements under the Additional Facility

Under Article 25(1) of the ICSID Convention the host State and the investor's State of nationality must be Contracting States. If either of these States is not a party to the Convention, the requirements *ratione personae* are not fulfilled and there is no jurisdiction. If only one party fulfills the requirements *ratione personae* the Additional Facility offers a method of dispute settlement. The Administrative Council of ICSID adopted the Additional Facility Rules in September 1978.⁴¹ The Additional Facility provides for dispute settlement in certain situations where ICSID's jurisdiction does not exist because some requirements under the Convention have not been met.

The conditions for access to the Centre under the Additional Facility are described in Art. 2 of its Rules:

Article 2

Additional Facility

*The Secretariat of the Centre is hereby authorized to administer, subject to and in accordance with these Rules, proceedings between a State (or a constituent subdivision or agency of a State) and a national of another State, falling within the following categories: (a) conciliation and arbitration proceedings for the settlement of legal disputes arising directly out of an investment which are not within the jurisdiction of the Centre because either the State party to the dispute or the State whose national is a party to the dispute is not a Contracting State; ...*⁴²

Therefore, the Additional Facility enables a non-Contracting State or a national of a non-Contracting State to the ICSID Convention to participate in dispute settlement proceedings administered by ICSID. Under the Additional Facility, only one party must fulfill the requirements *ratione personae*. In other words, either the host State or the State of the investor's nationality must be a Contracting Party to the Convention. If neither State is a party to the ICSID Convention not even the Additional Facility is available. If both States are parties to the Convention, the parties must use the procedure under the Convention and may not use the Additional Facility. Also, there must be a separate submission to dispute settlement under the Additional Facility.

⁴¹ The Additional Facility Rules together with four schedules are reproduced in 1 ICSID Reports 213-280. Generally on the Additional Facility see Broches, A., *The 'Additional Facility' of the International Centre for Settlement of Investment Disputes (ICSID)*, 4 Yearbook Commercial Arbitration 373 (1979); Toriello, P., *The Additional Facility of the International Centre for Settlement of Investment Disputes*, 4 Italian Yearbook of International Law 59 (1978/79); Schreuer, *Commentary*, Art. 6, para. 25; Art. 11, para. 15; Art. 25, paras. 10-14, 29-33, 69, 111-118, 124, 133-138, 188-189, 270, 294, 310-315, 411; Art. 26, paras. 17, 18, 52, 86, 87; Art. 36, paras. 7, 47, 61; Art. 42, paras. 86, 169; Art. 43, para. 3; Art. 47, para. 6; Art. 52, para. 5; Art. 53, paras. 5-8; Art. 54, paras. 12-22; Art. 62, paras. 7-10.

⁴² 1 ICSID Reports 218. Additionally, the Additional Facility is also available for the settlement of legal disputes that are not subject to the ICSID Convention because they do not arise directly out of an investment and for fact-finding proceedings. These matters relate to jurisdiction *ratione materiae* and are not discussed in this context.

Additional Facility not governed by ICSID Convention

It should be noted that the Additional Facility Rules are not part of the ICSID Convention. Therefore, arbitration proceedings under the Additional Facility are not subject to the Convention's rules not all of which are reflected in the Additional Facility Rules. This applies, for instance, to the Convention's provisions on annulment (Article 52) and on enforcement (Article 54).

NAFTA

The Additional Facility has attained importance in the context of the North American Free Trade Agreement (NAFTA) between Canada, Mexico and the United States of America. The NAFTA contains the consent of the Contracting Parties to submit to ICSID or its Additional Facility.⁴³ The United States is a Contracting State of the ICSID Convention but Canada and Mexico are not. Therefore, the Additional Facility Rules allow a national of the United States to bring claims against Canada or Mexico. The Additional Facility also permits nationals of Canada and Mexico to seek settlement of disputes that arise with the United States. But if a dispute arises between Canada and a Mexican national, or vice versa, the parties cannot even submit the dispute to the Additional Facility. A number of cases have been brought under the Additional Facility on the basis of the NAFTA.

Summary:

- **The Additional Facility is available if only one of the parties meets the *ratione personae* requirements of the ICSID Convention. If both the host State and the investor's State of nationality are not Contracting States, the Additional Facility will not be available.**

⁴³ Article 1122, 32 ILM 644 (1993).

TEST MY UNDERSTANDING

After having studied this Module the reader should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation:

1. Can any State or a national of any State bring a dispute before ICSID?
2. What is the relevant factor in becoming a Contracting State of the Convention?
3. Is it possible for a national of a Contracting State to bring a dispute against the host State if s/he is also a national of the host State?
4. Can a State's constituent subdivision or agency be a party to proceedings before an ICSID Tribunal? If so, what are the requirements for a State's constituent subdivision or agency becoming a party?
5. What effects, if any, does an agreement on the nationality of an investor between the host State and the investor have?
6. What factors are relevant for the nationality of a juridical person?
7. Can a company incorporated in the host State be a party before an ICSID Tribunal?
8. If the answer to question 7 is affirmative, what requirements need to be satisfied for a Tribunal to assert jurisdiction?
9. Under Article 25(2)(b) the parties may agree to treat a locally incorporated company as a national of another Contracting State. Must such an agreement always be explicit? Under what circumstances can it be implied?
10. Under Article 25(2)(b), what elements does a Tribunal look at in determining the existence of foreign control over a locally incorporated company?
11. Is the ICSID mechanism for dispute settlement limited to parties that meet the *ratione personae* requirements under the Convention?
12. If the answer to question 11 is negative, discuss any alternative facility and the requirements to institute proceedings at that facility.

HYPOTHETICAL CASES

Munaco Inc. v. Kotoland

In June 1998, Munaco Inc., a company established under the law of the Republic of Somakistan entered into an investment agreement with the State of Kotoland. In the agreement, both Munaco and Kotoland agreed to submit their dispute to ICSID. In December 2000, Munaco instituted proceedings before an ICSID Tribunal. Somakistan ratified the ICSID Convention in May 1999. Kotoland ratified the ICSID Convention in January 2001.

1. Please advise Munaco of its chances of obtaining a favourable decision on jurisdiction. Alternatively, advise Kotoland on its chances of prevailing in its attempt to have the Tribunal decline jurisdiction.
2. Should Munaco fail in persuading the Tribunal to assert jurisdiction, what advice can you give Munaco to gain access to ICSID for the settlement of this dispute?

Tonoco Inc. v. Republic of Nari

Tonoco Inc., was established under the law of the Republic of Nari in 1995. In the same year, Tonoco concluded an agreement with the Republic of Nari in which the government consented to submit any disputes arising from and relating to Tonoco's investment to be settled at ICSID. The agreement did not make any reference to Tonoco's foreign control. In the agreement, however, the Narian Government offered Tonoco tax incentives that are usually given to foreign investors.

Chris Nice, a national of Airtsua, owns 25 per cent of Tonoco's shares. Roberto Puccini, a national of Ylati, also owns 25 per cent of the shares while the Narian Government owns the remaining 50 per cent. Airtsua is not a Party to the Convention while Ylati ratified the Convention in 1985. Chris Nice is Tonoco's CEO (chief executive officer) and makes all operational and managerial decisions relating to Tonoco.

In 1992 the Republic of Nari adopted Law No. 11 in which the government agreed to treat locally incorporated but foreign controlled companies as foreign. The government, however, did not offer consent to submit to ICSID's jurisdiction as part of Law No. 11. Nari ratified the ICSID Convention in 1994.

In 2002 a dispute arose between Tonoco and the Narian Government and Tonoco instituted arbitration proceedings before ICSID. The Narian Government made the following objections:

1. Tonoco is a national of the Republic of Nari and as such cannot bring a claim against the host State;
2. The Narian Government owns the majority of the shares in Tonoco, therefore, control rests with the host State and not with foreign nationals;
3. The Narian Government has not agreed to treat Tonoco as a locally incorporated but foreign controlled company;
4. The Republic of Nari rejects the contention that Chris Nice exercised effective control. In addition, the Narian Government argues that even if the Tribunal found Chris Nice to have exercised control, the Tribunal should dismiss the case because Chris Nice is a national of a non-Contracting State.

Please discuss the various objections or arguments made by the Republic of Nari. Try to make arguments in favor and against each of them. Try to anticipate the likely decision of the Tribunal.

FURTHER READING

Books

- **Dolzer, R., Stevens, M.**, *Bilateral Investment Treaties* (1995).
- **Schreuer, C.**, *The ICSID Convention: A Commentary* (2001).

Articles

- **Amerasinghe, C. F.**, Jurisdiction Ratione Personae under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 47 *British Year Book of International Law* 227 (1974/75).
- **Amerasinghe, C. F.**, Interpretation of Article 25(2)(b) of the ICSID Convention, *in: International Arbitration in the 21st Century: Towards Judicialization and Uniformity?* (Lillich, R. B./Brower, Ch. N. eds.) 223 (1994).
- **Broches, A.**, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 136 *Recueil des Cours* 331, 351-364 (1972-II).
- **Broches, A.**, The ‘Additional Facility’ of the International Centre for Settlement of Investment Disputes (ICSID), 4 *Yearbook Commercial Arbitration* 373 (1979).
- **Broches, A.**, Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965, Explanatory Notes and Survey of its Application, 18 *Yearbook Commercial Arbitration* 627, 641-647 (1993).
- **Lalive, P.**, The First ‘World Bank’ Arbitration (Holiday Inns v. Morocco)—Some Legal Problems, 51 *British Year Book of International Law* 123 (1980).
- **Parra, A. R.**, Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment, 12 *ICSID Review—Foreign Investment Law Journal* 287 (1997).
- **Peters, P.**, Dispute Settlement Arrangements in Investment Treaties, 22 *Netherlands Yearbook of International Law* 91 (1991).
- **Schreuer, C.**, Access to ICSID Dispute Settlement for Locally Incorporated Companies, *in: International Economic Law with a Human Face* (Weiss, F. ed.) 497 (1998).
- **Toriello, P.**, The Additional Facility of the International Centre for Settlement of Investment Disputes, 4 *Italian Yearbook of International Law* 59 (1978/79).

Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- List of Contracting States and other Signatories of the Convention:
<http://www.worldbank.org/icsid/constate/c-states-en.htm>
- Designations by Contracting States Regarding Constituent Subdivisions or Agencies:
<http://www.worldbank.org/icsid/pubs/icsid-8/icsid-8-c.htm>
- Bilateral Investment Treaties, 1959-1996, Chronological and Country Data:
<http://www.worldbank.org/icsid/treaties/treaties.htm>
- ICSID Model Clauses :
<http://www.worldbank.org/icsid/model-clauses-en/main.htm>
- ICSID Cases:
<http://www.worldbank.org/icsid/cases/cases.htm>
- ICSID Additional Facility:
<http://www.worldbank.org/icsid/facility/facility.htm>

Cases

- *Amco v. Indonesia*, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 389, 392-397.
- *Cable TV v. St. Kitts and Nevis*, Award, 13 January 1997, 13 ICSID Review–Foreign Investment Law Journal 328 (1998).
- *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review – Foreign Investment Law Journal 251, 257-261 (1999).
- *Holiday Inns v. Morocco*, Decision on Jurisdiction, 12 May 1974. Unpublished. For a detailed description see *Lalive, P.*, The First ‘World Bank’ Arbitration (*Holiday Inns v. Morocco*) – Some Legal Problems 51 *British Year Book of International Law* 123 (1980) and 1 ICSID Reports 645.
- *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 9, 14-18.
- *MINE v. Guinea*, Award, 6 January 1988, 4 ICSID Reports 61.
- *SOABI v. Senegal*, Decision on Jurisdiction, 1 August 1984, 2 ICSID Reports 175, 182/3.
- *Vacuum Salt v. Ghana*, Award, 16 February 1994, 4 ICSID Reports 329.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.5 REQUIREMENTS RATIONE MATERIAE



UNITED NATIONS
New York and Geneva, 2003

NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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OVERVIEW

This Module deals with the subject-matter for which ICSID was designed. It discusses how the phrase “investment disputes” in the Convention’s title is reflected in the provisions of the ICSID Convention. The key provision is Article 25 which speaks of “any legal dispute arising directly out of an investment”.

This Module looks at the characteristics a dispute must have in order to be subject to ICSID’s jurisdiction. In particular, this it examines what types of transactions may be understood as investments for purposes of the Convention. In addition, it looks at the concept of a legal dispute and at the requirement that it arise directly from an investment. The combination of these elements circumscribe the scope of application of the ICSID Convention as far as its subject-matter is concerned. In other words, they determine the extent of ICSID’s jurisdiction *ratione materiae*.

As in the other Modules on ICSID, the starting point is the text of the Convention. In addition, this Module looks at how the relevant provision was prepared, how it was explained to States at the time of its adoption, how it was relevant to the work of the ICSID Secretariat, and how it has been interpreted by arbitral tribunals in ICSID cases.

This Module will also point out some connections with other aspects of the ICSID Convention and with other instances of international dispute settlement dealing with investment. These include the consent to jurisdiction (see Module 2.3) and the Additional Facility (see Module 2.2).

OBJECTIVES

Upon completion of this Module the reader should be able to:

- Understand the concept of jurisdiction *ratione materiae* or subject-matter jurisdiction.
- Delineate ICSID's subject-matter jurisdiction.
- Describe the concept of investment as used in the context of ICSID's jurisdiction.
- Appreciate the limits of a party agreement concerning the existence of an investment.
- Analyse the significance of definitions of "investment" in BITs and other treaties for ICSID's jurisdiction.
- Identify who makes a decision on jurisdiction *ratione materiae* in ICSID proceedings.
- List typical examples of uncontested instances of investments.
- Explain under what circumstances other activities may qualify as investments.

INTRODUCTION

The World Bank and ICSID

ICSID is one of the few arbitration institutions with a specialized subject-matter jurisdiction. The focus of ICSID's jurisdiction is exclusively on disputes arising from international investment. The reason for this lies in the origin of ICSID under the auspices of the International Bank for Reconstruction and Development (IBRD, the World Bank). Article I of the IBRD's Articles of Agreement provides that its purposes include the facilitation of investment of capital for productive purposes, the promotion of private foreign investment and the encouragement of international investment for the development of the productive resources of its members.

Investment and international law

International investment has been a central subject in the development of public international law concerning state responsibility and, more generally, in international economic law. Important disagreement on the substantive international rules governing the treatment of investment has resulted in the absence of a general multilateral treaty embodying such rules (see Module 2.6). One of the few international instruments addressing substantive rules on investment to attract a general consensus among States was U.N. General Assembly Resolution 1803, on Permanent Sovereignty over Natural Wealth and Resources, of 1962. At about the same time, the ICSID Convention was being devised as the procedural dimension of a set of international rules dealing with investment issues.

ICSID arbitration and conciliation

The requirements of subject-matter jurisdiction apply both to arbitration and conciliation proceedings before ICSID. But ICSID conciliation has turned out to be very rare (see Module 2.2). Therefore, this paper refers only to arbitration and to arbitral tribunals.

Summary:

- **ICSID's jurisdiction is limited to investment disputes.**
- **ICSID was created under the auspices of the World Bank in connexion with its concern for the promotion of private investment as a factor for development.**

1. ICSID'S SUBJECT-MATTER JURISDICTION

Article 25

Article 25(1) of the ICSID Convention provides in relevant part:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.

Three elements

The jurisdiction *ratione materiae*, or subject-matter jurisdiction, of the Centre under Article 25(1) is thus defined as “any legal dispute arising directly out of an investment.” Therefore, ICSID’s subject-matter jurisdiction, as defined in Article 25(1), has three components:

- (a) the requirement of a legal dispute;
- (b) the requirement that the legal dispute arise directly out of the underlying transaction; and
- (c) that such underlying transaction qualify as an investment. These three elements will be covered in separate sections of this Module.

Articles 41, 36

ICSID practice under Article 25 of the Convention derives primarily from the power of an arbitral tribunal to decide on its own jurisdiction (Article 41), and also from the screening function of ICSID’s Secretary-General (Article 36) (see Module 2.7).

Additional Facility

The 1978 Additional Facility Rules of ICSID (see Module 2.2) authorize the Centre to administer arbitration and conciliation proceedings for certain disputes that fall outside the jurisdiction of the Centre. These include legal disputes between a State (or a constituent subdivision or agency of a State) and a national of another State “which are not within the jurisdiction of the Centre because they do not arise directly out of an investment, provided that either the State party to the dispute or the State whose national is a party to the dispute is a Contracting State.”¹ The significance of the Additional Facility in the context of subject-matter jurisdiction is discussed below in a separate section.

Summary:

- **Subject-matter jurisdiction under the ICSID Convention is defined in terms of a legal dispute arising directly out of an investment.**
- **The Additional Facility provides for the settlement of certain disputes that fall outside this definition.**

¹ See *Additional Facility Rules Article 2(b)*, 1 ICSID Reports 218.

2. LEGAL DISPUTE

Dispute

The existence of a dispute is a basic premise for the jurisdiction of any international judicial or arbitral institution. A dispute requires a minimum of communication between the parties. This communication must have revealed a disagreement on a point of law or fact. A failure to respond to demands by the other side may also signify a dispute. In addition, a disagreement between the parties should have some practical relevance and should not be merely theoretical.

Legal

The requirement that there is a legal dispute is an absolute requirement for ICSID's jurisdiction. It is independent of the chosen method of dispute settlement under the Convention and applies even if a tribunal is authorized to decide on the basis of equity rather than law (see Module 2.6). Therefore, the requirement that there is a legal dispute needs to be met irrespective of whether the parties have agreed to submit a dispute to arbitration or to conciliation, and even if they have agreed under Article 42(3) that the dispute may be decided *ex aequo et bono*.

Political and commercial disputes

At the time of the Convention's drafting, developing countries expressed a desire to avoid creating an international mechanism to which "merely" political or commercial disputes could be submitted. In order to be submitted to ICSID, disputes would have to be of a legal character. The Report of the Executive Directors spells this out by explaining that the disputes "must concern the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation."

Legal nature of dispute

This is not a difficult requirement to meet. Most economic disputes can be formulated also in terms of a legal right or obligation. But the requirement that the dispute be a legal one underlines the function of ICSID dispute settlement as a means of providing a legal remedy. Findings of fact are often a necessary corollary to this function. In practice, the requirement of a legal dispute has not presented difficulties for arbitral tribunals.

Legal basis

The Centre once received a request for arbitration that did not clearly indicate the legal basis of the dispute it sought to submit to the Centre. The request alleged that the respondent State had increased logging levies, thereby upsetting the claimant's expectations under a logging concession. The request did not cite a relevant legal provision. In fact, the concession contract attached to the request specifically provided that logging levies could be increased. The Secretariat asked the requesting party for clarification on this point, but the request was not pursued and was eventually withdrawn.² In this situation, it might have been argued that there was an implied clause under which levies should

² Unpublished.

not be increased unreasonably so as to upset the economic balance of the concession.

Claims for renegotiation

A similar situation could present itself if a request were to seek the renegotiation of an investment contract. The request would need to argue that there was a legal right or obligation to renegotiate.

Summary:

- **There must be a concrete dispute between the parties on a point of law or fact.**
- **A claim must be formulated in terms of a legal right or obligation.**
- **A claim presented in terms of a commercial or political dispute is not admissible.**

3. ARISING DIRECTLY

Directness

The ICSID Convention requires that disputes submitted under its provisions be disputes “arising directly” out of an underlying transaction which qualifies as an investment. Therefore, transactions and claims that are only peripherally or indirectly linked to an investment operation will be outside ICSID’s jurisdiction. This requirement may be seen as reflecting the focus of the Convention on investment disputes and its establishment of a specialized dispute settlement mechanism for the purpose of encouraging international investment.

Links with other requirements

The requirement of directness is thus linked with other elements of ICSID jurisdiction. It is linked to the existence of an investment from which the dispute must arise directly. This requirement is additional to the parties’ consent to submit disputes to ICSID.³ It has been correctly observed that the requirement of directness is analytically distinct from such other jurisdictional elements.⁴ Nevertheless, the treatment of this requirement by ICSID tribunals has been undertaken mostly in conjunction with the requirements of the existence of an investment and/or consent to jurisdiction.

General obligation

In *Amco v. Indonesia*, the Tribunal had to deal with a counter-claim by the respondent State alleging liability of the claimant for tax fraud. It found that it had to

...distinguish between rights and obligations that are applicable to legal or natural persons who are within the reach of a host State’s jurisdiction, as a matter of general law; and rights and obligations that are applicable to an investor as a consequence of an investment agreement entered into with that host state. Legal disputes relating to the latter will fall under Article 25(1) of the Convention. Legal disputes concerning the former, in principle fall to be decided by the appropriate procedures in the relevant jurisdiction unless the general law generates an investment dispute under the Convention.

The obligation not to engage in tax fraud is clearly a general obligation of law in Indonesia. It was not specially contracted for in the investment agreement and does not arise directly out of the investment.

For these reasons the Tribunal finds the claim of tax fraud beyond its competence ratione materiae.⁵

Direct investment

Another ICSID tribunal has observed that the expression “directly” relates to the connexion between the dispute and the investment out of which it arises,

³ Clause 1 of the ICSID Model Clauses, which is the basic submission clause in regard to future disputes, refers to “any dispute arising out of or relating to this agreement.” The ICSID Model Clauses may be consulted on ICSID’s website at www.worldbank.org/icsid; see also 4 ICSID Reports 357 at 359/60.

⁴ Schreuer, C., *The ICSID Convention: A Commentary*, Article 25, para. 67.

⁵ *Amco Asia et al. v. Indonesia, Resubmitted Case, Decision on Jurisdiction, 10 May 1988, 1 ICSID Reports 543, 565.*

and not to the character of the underlying investment. That is to say, the expression “directly” does not mean that the investment must be a direct foreign investment.⁶

**Reasonable
proximity to
investment**

The Commentary on the Convention has usefully pointed out that the requirement of directness means that a dispute must be “reasonably closely connected” to an investment.⁷ This approach has been confirmed by at least one recent decision examining a complex transaction.⁸ It would suggest that a dispute “arising directly” out of an investment is not necessarily the same as a dispute arising “immediately” out of an investment.

Summary:

- **The legal dispute must be reasonably closely connected to the underlying investment transaction.**
- **Issues arising from generally applicable rules of the host State’s law may not meet this requirement.**
- **The investment need not be a foreign direct investment.**

⁶ Fedax N.V. v. Republic of Venezuela, *Decision on Jurisdiction*, 11 July 1997, 37 ILM 1378 (1998), at 1383, para. 24.

⁷ Schreuer, *Commentary, Article 25, para. 67*.

⁸ Ceskoslovenska Obchodni Banka, A. S. v. Slovak Republic, *Decision on Jurisdiction*, 24 May 1999, 14 ICSID Review – FILJ 251 (1999) at 275-76.

4. INVESTMENT

a) Definition of Investment

Absence of definition

The concept of investment is central to the ICSID Convention's subject-matter jurisdiction. Therefore, it may seem surprising that the Convention does not offer any definition or even description of this basic term.

Drafting history

The Documents Concerning the Origin and the Formulation of the Convention⁹ record the background of this omission. The chairman of the sessions in which the Convention was prepared, Aron Broches, was reluctant to include a definition of "investment" since the parties' agreement to submit disputes to ICSID would in any event always be required. Nevertheless, a series of proposals led to the following definition of investment in Article 30 of the Convention's First Draft: "[A]ny contribution of money or other assets of economic value for an indefinite period, or, if the period be defined, for not less than five years."¹⁰

Decision to omit a definition

This definition was not satisfactory to all participants. Some found it too imprecise, while others wished to introduce qualifications addressing elements such as profit and risk or the host State's development interests. Yet others found that the definition could be unnecessarily restrictive. A more detailed definition was drafted, but a proposal that omitted any definition of the term eventually prevailed.

What kinds of investment to include

One of the main reasons for resisting a definition of investment in the Convention was the fear that it could give rise to lengthy jurisdictional discussions even if the parties' consent to submit a dispute to ICSID was well established. The concerns did not necessarily involve the notion of investment itself, but rather what kind of investment would be a suitable subject-matter for the ICSID system. Proposals were made for minimum amounts, or for the exclusion of investment that pre-dated the Convention. Mr. Broches felt that this aspect of the Centre's jurisdiction was appropriately left to be controlled by the requirement of consent. He subsequently remarked "that the requirement that the dispute must have arisen out of an 'investment' may be merged into the requirement of consent to jurisdiction."¹¹

Report of the World Bank Executive Directors

The relevant passage of the World Bank Executive Directors' Report accompanying the Convention reads as follows:

27. No attempt was made to define the term 'investment' given the essential requirement of consent by the parties, and the mechanism through which Contracting States can make known in advance, if they so desire, the classes

⁹ See *History of the Convention and the description in Schreuer, Commentary, Article 25, paras. 80-86.*

¹⁰ *History, Vol. I, p. 116.*

¹¹ Broches, A., *The Convention on the Settlement of Investment Disputes: Some Observations on Jurisdiction*, 5 *Columbia Journal of Transnational Law* 263 at 268 (1966).

of dispute which they would or would not consider submitting to the Centre (Article 25(4)).¹²

In fact, a number of attempts were made in the preparation of the Convention to include a definition of “investment” but they all failed.¹³

Objective requirement

Therefore, the approach adopted in the Convention gives potential parties to ICSID arbitration wide discretion to describe a particular transaction, or a category of transactions, as investment. Ultimately, however, the requirement of an investment is an objective one.¹⁴ The parties’ discretion results from the fact that the notion of investment is broad and that its contours are not entirely clear. But the parties do not have unlimited freedom in determining what constitutes an investment.¹⁵ Any such determination, while important, is not conclusive for a tribunal deciding on its competence. Under Article 41 of the Convention, a tribunal may examine on its own motion whether the requirements of jurisdiction are met.

Typical features of investment

While it is not possible to give a precise definition of “investment” it is possible to identify certain typical features.¹⁶

- The project should have a certain duration.
- There should be a certain regularity of profit and return.
- There is typically an element of risk for both sides.
- The commitment involved would have to be substantial.
- The operation should be significant for the host State’s development.

These features should not necessarily be understood as jurisdictional requirements but merely as typical characteristics of investments under the Convention.

Summary:

- **The ICSID Convention does not contain a definition of the term “investment”.**
- **During the Convention’s drafting such a definition was attempted but eventually abandoned.**
- **The absence of a definition gives the parties a certain discretion to characterize their transaction as an investment.**
- **Nevertheless, the requirement that there is an investment is an objective one and the parties are not free to bring just any dispute to ICSID.**
- **Even without a precise definition, the concept of investment may be described with the help of a few typical criteria.**

¹² 1 ICSID Reports 23, 28.

¹³ Schreuer, *Commentary, Article 25, para. 86.*

¹⁴ *Ibid. at para. 90.*

¹⁵ *Ibid. at para. 89.*

¹⁶ *Ibid. at para. 122.*

b) Party Agreement

Explicit agreement

As pointed out above, the parties have a certain discretion in describing their transaction as an investment although this discretion is not unlimited. Clause 3 of the ICSID Model Clauses (see Module 2.3) contemplates an express stipulation in the parties' arbitration agreement to the effect that the transaction to which the agreement relates is an investment:

Clause 3

It is hereby stipulated that the transaction to which this agreement relates is an investment.¹⁷

Such an express provision may help to dispel doubts especially in the case of complex transactions and will preclude a later argument that there was no investment.

Implicit agreement

Alternatively, a standard ICSID arbitration clause in a contract can be regarded as an understanding that the transaction to which the agreement relates is an investment. Otherwise the ICSID clause would not make any sense.

BITs

A large number of bilateral investment treaties (BITs) contain advance consents by States to submit disputes with covered investors to ICSID (see Module 2.3). Usually these BITs also contain a provision explaining what is to be understood as investment. Most bilateral investment treaties contain a general statement or definition followed by a non-exhaustive list of categories of covered investments. A typical provision in a BIT on the concept of investment would read as follows:

For the purposes of this Agreement:

- (a) *“investment” means every kind of asset and in particular, though not exclusively, includes:*
- (i) *movable and immovable property and any other property rights such as mortgages, liens or pledges;*
 - (ii) *shares in and stock and debentures of a company and any other form of participation in a company;*
 - (iii) *claims to money or to any performance under contract having a financial value;*
 - (iv) *intellectual property rights, goodwill, technical processes and know-how;*
 - (v) *business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.¹⁸*

Multilateral treaties

Other treaties, such as Article 1139 of the North American Free Trade Agreement (NAFTA), define investment by means of an exhaustive, although broad, list of categories.¹⁹ The Energy Charter Treaty in Article 1(6) follows

¹⁷ 4 ICSID Reports 360.

¹⁸ Dolzer, R./Stevens, M., *Bilateral Investment Treaties* 229 (1995). See also *Asian-African Consultative Committee: Model Bilateral Agreements on Promotion and Protection of Investments, Art. 1*, 23 ILM 237, 242 (1984).

¹⁹ 32 ILM 605, 647 (1993).

the model of BITs in defining investments.²⁰

**Two requirements
ratione materiae**

An investor wishing to avail herself of the offer of ICSID arbitration in an investment treaty will have to show that two distinct requirements *ratione materiae* are met: the transaction out of which the dispute arises must be an investment under the ICSID Convention. In addition, it must be an investment as defined by the applicable investment treaty.

**Limited usefulness of
treaty definitions**

Unlike a description of a particular transaction as an investment in a contract between the parties, treaty definitions cannot provide an assurance that they cover a given transaction. They are drafted in general terms and use general categories. In addition, the treaty terms are sometimes circular, using phrases such as “investment means every type of investment” or “every type of asset invested.” Provisions such as these merely illustrate the forms that an investment may take. For purposes of the ICSID Convention, the existence of the investment may have to be ascertained by other criteria. The categories of investment treaties and the scope of the Convention do not always coincide. For instance, some BITs grant a right of admission to covered investors. By contrast, the ICSID Convention does not cover investments that are merely prospective or planned.

**Limitation to certain
investment disputes**

An agreement between the parties concerning the subject-matter of their submission to ICSID’s jurisdiction may be narrower than the Convention would allow. For instance, a treaty may offer consent to jurisdiction only for approved projects. Some BITs provide for dispute settlement by ICSID only for certain categories of investment disputes like questions concerning the amount of compensation in case of an expropriation.

Summary:

- **The parties may describe their transaction as an investment in an agreement.**
- **Where jurisdiction is based on a treaty, it is not possible to assure that the parties agreed to regard the particular transaction as an investment.**
- **The definition of “investment” in a BIT does not necessarily coincide with the meaning of that term under the ICSID Convention.**
- **The parties’ consent to jurisdiction may relate to only certain categories of investment disputes.**

c) Article 25(4)

Article 24(4)

Article 25(4) of the ICSID Convention provides:

Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider

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²⁰ 34 ILM 360, 383 (1995).

submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1).

Information purposes only

The Report of the World Bank Executive Directors explains that the notification foreseen in Article 25(4) of the Convention is for information purposes only. There might be classes of investment disputes that governments might consider unsuitable for submission to ICSID. Article 25(4) is designed to avoid the risk of misunderstanding as to what types of investment disputes a Contracting State might be expected to submit to ICSID. The Report says in relevant part:

31. ...The provision makes clear that a statement by a Contracting State that it would consider submitting a certain class of dispute to the Centre would serve for purposes of information only and would not constitute the consent required to give the Centre jurisdiction. Of course, a statement excluding certain classes of disputes from consideration would not constitute a reservation to the Convention.²¹

No effect on jurisdiction

Therefore, notifications under Article 25(4) of the Convention by themselves neither restrict nor expand the jurisdiction *ratione materiae* of the Centre. In case of a conflict between a declaration under Article 25(4) and an expression of consent by the parties, the latter would prevail.

Summary:

- **Notifications by Contracting States under Article 25(4) concerning classes of disputes that they would consider submitting to ICSID's jurisdiction are for information purposes only.**
- **Such notifications do not constitute consent. Neither would such a notification affect consent validly given.**

d) Decision on Subject-Matter Jurisdiction

Secretary-General's screening power

Under Article 36(3) of the Convention, the Secretary General shall register a request for arbitration unless he finds that the dispute is manifestly outside ICSID's jurisdiction. This screening power includes the possibility of a finding that there is manifestly no investment.

In 1999, the ICSID Secretary-General refused registration of a request for arbitration in respect of a dispute arising out of a supply contract for the sale of goods. The Secretary-General found that the transaction manifestly could not be considered an investment and, therefore, that the dispute was manifestly outside the jurisdiction of the Centre. The dispute did not arise directly out of any other transaction that could be regarded as an investment (e.g., ownership of equity in the company party to the contract).²²

²¹ Report of the Executive Directors, 1 ICSID Reports 29.

²² Shihata, I.F.I./Parra, A., *The Experience of the International Centre for Settlement of Investment Disputes*, 14 ICSID Review – FILJ 299 at 308 and note 27 (1999).

Tribunal's decision on jurisdiction

Under Article 41 of the ICSID Convention, the tribunal is competent to decide on its own jurisdiction. Despite the seemingly simple wording of the Convention's Article 25 on jurisdiction, ICSID tribunals have repeatedly had the opportunity to deal with issues of subject-matter jurisdiction. Tribunals have examined the central issue of the concept of investment under the ICSID Convention in the context of ICSID arbitration clauses contained in contracts as well as in cases brought on the basis of investment treaties.

The claim as presented

ICSID tribunals have addressed questions concerning the classification of the dispute as presented by the parties, in order to determine whether they are within ICSID's subject-matter jurisdiction.

In *Amco v. Indonesia*²³, the respondent objected to ICSID's jurisdiction arguing that the tribunal was being asked to decide a lease dispute between two private parties. The tribunal upheld its jurisdiction over a claim for expropriation of a hotel lease carried out through armed military action. The tribunal held that,

*...in order for it to make a [preliminary] judgement ... as to the substantial nature of the dispute before it, it must look firstly and only at the claim itself as presented...*²⁴

Initiative

A tribunal may examine its competence not only in reaction to an objection to jurisdiction by a party but also on its own initiative.²⁵ In contested proceedings this will rarely be necessary. But if the respondent fails to appear and plead, the tribunal may have to actively look into its subject-matter jurisdiction.

In two uncontested cases, the tribunals on their own motion stated their understanding that the dispute arose directly out of an investment. In the first case, the dispute concerned a taxation measure which was inconsistent with the provisions of a mining concession, under which a foreign company had "invested substantial amounts."²⁶ In the second case, the tribunal had no doubt that amounts paid out to develop a timber concession and related undertakings could serve as a basis for a dispute arising directly out of an investment.²⁷

Summary:

- **The Secretary-General, as part of his screening function, will look at the question whether a request for arbitration is manifestly**

²³ *Amco Asia et al. v. Indonesia, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 389 at 404-05.*

²⁴ *At p. 405.*

²⁵ *Arbitration Rule 41(2), 1 ICSID Reports 172.*

²⁶ *Kaiser Bauxite Company v. Jamaica, Decision on Jurisdiction, 6 July 1975, 1 ICSID Reports 296 at 303.*

²⁷ *Liberian Eastern Timber Corporation v. Republic of Liberia, Award, 31 March 1986, 2 ICSID Reports 346 at 350.*

outside the Centre’s jurisdiction because it does not relate to an investment.

- **A tribunal making a decision on its jurisdiction will look at the question whether the dispute arises from an investment.**
- **A tribunal may look at this question not only in reaction to a jurisdictional objection by a party but also on its own motion.**

e) Non-Contentious Instances of Investment

Implicit confirmation

As mentioned before, ICSID tribunals have the power to consider on their own motion whether a dispute arises directly out of an investment, even without an objection by the respondent. Therefore, cases in which the question of subject-matter jurisdiction did not arise as an issue may be regarded as confirming that the dispute before the tribunal did indeed concern an investment.

Readily recognizable types of investment in ICSID cases have consisted in mining and petroleum concessions. These account for just over 15 per cent of all cases. Power generation and distribution enterprises have been another frequent category. Another, though less numerous category, has been industrial manufacturing ventures. Food production and processing has been the subject of a handful of ICSID cases.

The services sector has provided another group of categories, including shipping, port and transport services, waste management and disposal, hotel and resort management, exportation and duty free enterprises, funeral services, and banking. Civil construction, involving roads, buildings and other infrastructure projects (such as property development), has been similarly accepted as investment activity. Finally, financial transactions have also been the subject-matter of ICSID cases. This last category will be further described below.

Summary:

- **In a considerable group of cases the existence of an investment was beyond doubt.**

f) Service-Related Investment and Construction Works

Services and construction

The establishment of an investment abroad, for example by constituting an enterprise and transferring capital to it, may serve the purpose of providing services, for instance in the banking sector. Parties have argued repeatedly that this may lead to a legal dispute arising out of an investment. Parties have argued similarly that contracts for the provision of construction works may be regarded as investments for the purpose of ICSID jurisdiction.

In *SOABI v. Senegal*, the tribunal had to determine the scope of an



ICSID clause contained in one of several instruments governing the investment operation. The Tribunal found that the ICSID clause covered the entire investment operation. A dispute settlement clause in a subsequent agreement between the same parties relating to the construction of a building provided for dispute settlement by domestic courts. The tribunal upheld its jurisdiction, finding that the clause in the subsequent agreement only covered a narrow category of disputes. It added that the subsequent agreement “was limited to construction of a building to be paid for by the client as work progressed, and could thus not be said to be an agreement concerning investments.”²⁸

Construction contracts

Despite some debate as to whether construction works can qualify as investment for the purpose of the Convention, the issue was not raised by the parties in two cases involving road construction projects.²⁹ The tribunals confirmed their jurisdiction.

Investment under BIT and ICSID Convention

In *Salini v. Morocco*,³⁰ two objections to subject-matter-jurisdiction were raised. The first was that construction contracts did not fall under the definition of investment contained in the bilateral treaty which formed the basis for consent. The second objection was that construction contracts did not qualify as investment under the ICSID Convention.

As regards the first objection, the tribunal rejected an interpretation of the BIT based on the host State’s domestic law. It held that the contract fell within the categories listed in the treaty.

The tribunal then turned to the second objection, i.e. that the contract did not qualify as an investment under the ICSID Convention. It considered the criteria generally identified by commentators for defining investment under the Convention. These were: a contribution, a certain duration, participation in the risks of the operation, and (based on the preamble of the ICSID Convention) that the operation should contribute to the development of the host state. The tribunal found that each of these criteria were met by the construction contract.

Risk element

As regards the element of risk, the tribunal added the following observation:

²⁸ *Société Ouest Africaine des Bétons Industriels v. Senegal, Award, 25 February 1988, 2 ICSID Reports 190 at 219.*

²⁹ *Astaldi S.p.A. & Columbus Latinoamericana de Construcciones S.A. v. Republic of Honduras, Award, 19 October 2000 (unpublished); and Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela, Decision on Jurisdiction, 27 September 2001, 16 ICSID Review – FILJ 469 (2001). A significant feature of the project in the latter case was that it included a concession for the operation of the highway by the claimant.*

³⁰ *Salini Costruttori SpA. & Italstrade SpA. v. Kingdom of Morocco, Decision on Jurisdiction, 23 July 2001, Journal de Droit International 196 (2002).*

It matters little in this respect that the risks have been freely agreed to. It similarly matters little that the contractor's remuneration is not tied to the exploitation of the work being constructed. A construction project that spans several years and whose cost cannot be established with certainty beforehand creates a manifest risk for the contractor.³¹

Summary:

- **Investments may be made in the services sector.**
- **Construction activities may qualify as investment if they meet the usual criteria, especially risk.**

g) Trade-Related Investment

Investment in foreign trade

International economic law has acknowledged the links between trade and investment, but has developed different regimes for each. A company or individual may establish a foreign investment in a country in order to conduct international trade, that is, to import and export goods into and from that country. If a given dispute concerns a measure affecting that activity, it may be argued that the dispute arises out of an investment.

Relevance of non-ICSID cases

Issues of this kind have been discussed in cases brought under the investment chapter of NAFTA. These have not been ICSID cases, but rather cases conducted under the UNCITRAL Arbitration Rules. Although they do not involve an interpretation of the ICSID Convention, these cases would indicate that measures that regulate international trade can lead to a dispute arising out of an investment. Therefore, these decisions will be important if similar issues are submitted to ICSID.

In the case of *Pope & Talbot, Inc. v. Canada*,³² Canada argued that there was no investment dispute. Such a dispute would arise only when a measure is “primarily aimed” at investors or investments. In Canada’s view, the NAFTA investment chapter made a sharp distinction between trade in goods issues and investment issues. Canada acknowledged, however, that the claimant did in fact have an investment in Canada. The tribunal held that its subject-matter jurisdiction could be established on the basis of the claims as presented to it. The tribunal added that there was

...no provision to the express effect that investment and trade in goods are to be treated as wholly divorced from each other.

Canada also argued that the measures complained of did not, for the

³¹ para. 56 at p. 208.

³² *Pope & Talbot, Inc. v. Canada, Award On Motion to Dismiss Re Existence of an Investment*, 26 January 2000, <http://www.naftaclaims.com>

same reasons, “relate to” an investment or investor as required by NAFTA. The tribunal held that, first, trade measures could directly affect and be applied to a particular enterprise; and, secondly

...the fact that a measure may primarily be concerned with trade in goods does not necessarily mean that it does not also relate to investment or investors.

In *S.D. Myers, Inc. v. Canada*,³³ Canada argued that the claim was barred because the measures complained of were controlled by the NAFTA chapters dealing with trade in goods and cross-border services. The tribunal, citing a similar doctrine in WTO decisions, held that

*different chapters of NAFTA can overlap and that the rights it provides can be cumulative except in cases of conflict,*³⁴

As regards trade in goods, the tribunal held that a

*measure that relates to goods can relate to those who are involved in the trade of those goods and who have made investments concerning them.*³⁵

The tribunal saw a clear link between the measure complained of and the claimant’s investment plans.

Summary:

- **An investment may be made in order to conduct international trade.**
- **Under these circumstances, a measure primarily directed at trading activities may lead to an investment dispute.**

h) Financial Instruments

Loans as investments

Commentators on the Convention have, on the whole, agreed that loans can qualify as investments. Two decisions on jurisdiction by ICSID tribunals have discussed the circumstances under which financial transactions can be regarded as investments under the Convention.

In *Fedax v. Venezuela*,³⁶ the claimant initiated proceedings on the basis of the 1991 Netherlands-Venezuela bilateral investment treaty, alleging that Venezuela had failed to pay amounts due on promissory notes which had been endorsed to the claimant. Venezuela objected that the promissory notes, held by the claimant, did not constitute an investment,

³³ *S.D. Myers, Inc. v. Canada, Partial Award, 12 November 2000, 40 ILM 1408 (2001).*

³⁴ *At p. 1441.*

³⁵ *Loc. cit.*

³⁶ *Fedax N.V. v. The Republic of Venezuela, Decision on Jurisdiction, 11 July 1977, 37 ILM 1378 (1998).*

either under the terms of the ICSID Convention or under the terms of the bilateral investment treaty.

Venezuela argued that the purchase by Fedax of the promissory notes did not qualify as an investment because it did not amount either to direct foreign investment or to portfolio investment carried out through approved stock market transactions. Venezuela argued that the meaning of investment as an economic term entailed “the laying out of money or property in business ventures, so that it may produce a revenue or income.” (para. 19)

The tribunal reviewed the relevant drafting history of the Convention, cases and commentary. It further observed that the Operational Regulations of the Multilateral Investment Guarantee Agency (MIGA), also a World Bank Group organization, applied to medium or long-term loans.

The tribunal concluded that, in principle, loans can be covered as investments under the ICSID Convention:

Since promissory notes are evidence of a loan and a rather typical financial and credit instrument, there is nothing to prevent their purchase from qualifying as an investment under the Convention in the circumstances of a particular case such as this. (para. 29)

The tribunal noted that the capital involved was “relatively substantial,” was committed for a certain duration, entailed regular returns in the way of interest payments, and involved risk as evidenced by the fact that payments on them were outstanding. (para. 43)

In *CSOB v. Slovakia*,³⁷ the respondent objected that the dispute did not arise out of an investment in the sense of the ICSID Convention. The Czech and the Slovak Republics, which are both shareholders in CSOB (a Czech bank), concluded a Consolidation Agreement as part of its privatization. Under this agreement, CSOB transferred its non-performing loans in Slovakia to a specially constituted Slovak collection agency, and at the same time extended a loan to that agency for the price of the transfer. The Slovak Republic undertook to cover the agency’s losses so that it would be able to repay the loan extended to it by CSOB. CSOB alleged that the Slovak Republic had failed to abide by this undertaking.

The Slovak Republic argued that CSOB’s loan to the Slovak collection agency did not involve a transfer of resources into the Slovak Republic and, therefore, did not constitute an investment. (para. 76)

³⁷ *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic, Decision on Jurisdiction, 24 May, 1999, 14 ICSID Review-FILJ 251 (1999).*

The Tribunal first observed that the Slovak Republic's undertaking, viewed in isolation, did not constitute an investment because it did not "involve any spending, outlays or expenditure of resources by CSOB in the Slovak Republic" (para. 69), although an investment did not require "a physical transfer of funds." (para. 78) The tribunal offered the following guidance for identifying an investment:

[A] dispute that is brought before the Centre must be deemed to arise directly out of an investment even when it is based on a transaction which, standing alone, would not qualify as an investment under the Convention, provided that the particular transaction forms an integral part of an overall operation that qualifies as an investment. (para. 72)

The Tribunal examined the terms of the Consolidation Agreement and concluded that there was a "close link" between the Slovak Republic's undertaking and CSOB's loan to the Slovak collection agency. (para. 75) The Tribunal found that loans were not, in principle, excluded from the broad notion of investment under the Convention, but that this did not mean that any loan could therefore qualify as an investment. (paras. 76-77) The Tribunal found that CSOB's loan to the Slovak collection agency constituted a working asset which enabled CSOB to develop its business there. (para. 87) The Tribunal concluded that

the basic and ultimate goal of the Consolidation Agreement was to ensure a continuing and expanding activity of CSOB in both Republics. This undertaking involved a significant contribution by CSOB to the economic development of the Slovak Republic; it qualified CSOB as an investor and the entire process as an investment in the Slovak Republic within the meaning of the Convention. This is evident from the fact that CSOB's undertakings include the spending or outlays of resources in the Slovak Republic in response to the need for the development of the Republic's banking infrastructure. (para. 88)

The tribunal concluded that CSOB's claim and the related loan facility made available to the Slovak collection agency were closely connected to that goal and qualified as an investment under the Convention. (para. 91)

Summary:

- **Loans and similar transactions may qualify as investment if they meet certain criteria.**
- **These criteria include substantial expenditure, risk, duration and relevance to economic development.**

i) Pre-Establishment and Admission Disputes

Pre-contract expenditures

Prospective investors may expend significant sums in the negotiation phase leading up to the conclusion of an investment agreement or a concession contract. If a dispute arises before the agreement materializes and negotiations are interrupted, will the project expenditures qualify as an investment for the purpose of ICSID jurisdiction?

Denial of admission

The problem is highlighted by the fact that some treaties grant potential investors a right to establishment under certain circumstances.³⁸ This raises the question whether these entry rights are covered by the concept of investment under the ICSID Convention.

In *Mihaly v. Sri Lanka*,³⁹ the two parties had been engaged in negotiations concerning a project for the construction of a power generation plant in Sri Lanka. These negotiations had matured to a point where Sri Lanka issued letters to grant exclusivity to the claimants for the negotiation of the relevant contracts. Each of those letters, however, contained a caveat stating that its terms did not constitute an obligation binding on any party and that they were subject to the conclusion of the respective contracts. Negotiations were protracted and ultimately terminated by Sri Lanka. Mihaly argued that Sri Lanka had breached its obligations under the United States – Sri Lanka BIT and claimed its expenditures for the preparation of the project as an investment. Sri Lanka objected that Mihaly's alleged expenditures did not qualify as an investment either under the ICSID Convention or under the United States–Sri Lanka BIT.

The tribunal found that a crucial and essential feature of the transaction was the care taken to point out that none of the documents granting exclusivity created contractual obligations, combined with the fact that the grant of exclusivity never matured into a contract. The tribunal concluded that this was a clear indication that the expenditure of moneys would not be considered to be an investment admitted in Sri Lanka. It added that, had a contract been concluded, it could well be that expenses incurred during negotiations could be capitalized as part of the investment. In this case, however, they did not constitute an investment in the context of the specific obligations assumed by the parties.

Summary:

- **Expenses arising from merely prospective or planned investments are not within ICSID's subject-matter jurisdiction.**
- **A project must have been formalized or actually started in order to qualify as an investment.**

³⁸ See Dolzer/Stevens, *Bilateral Investment Treaties*, 50-57. See also Arts. 1102 and 1103 of the NAFTA..

³⁹ *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, Award, 15 March 2002, 17 ICSID Review – FILJ 142 (2002).

5. ADDITIONAL FACILITY

Scope ratione materiae

In 1978 the Administrative Council of ICSID adopted the Additional Facility Rules (see Modules 2.2 and 2.4). These Rules authorize the Centre to administer arbitration and conciliation proceedings for certain categories of disputes that are not covered by the ICSID Convention. One category of such disputes relates to the absence of ICSID's jurisdiction *ratione materiae*. Under Article 2(b) of the Additional Facility Rules these are legal disputes between a State (or a constituent subdivision or agency of a State) and a national of another State

*which are not within the jurisdiction of the Centre because they do not arise directly out of an investment, provided that either the State party to the dispute or the State whose national is a party to the dispute is a Contracting State.*⁴⁰

No cases

So far, cases under the Additional Facility have not addressed disputes that fall outside the ICSID Convention's scope because they do not meet the requirements for jurisdiction *ratione materiae*.

Approval of access

Access to the Additional Facility requires the approval of ICSID's Secretary-General. Article 4(3) of the Additional Facility Rules states that the Secretary-General shall give this approval only if he is satisfied (a) that the above conditions have been met, and (b) "that the underlying transaction has features which distinguish it from an ordinary commercial transaction."

More than ordinary commercial transaction

Therefore, under this provision the Additional Facility will be available only for a dispute that arises from activity that is more than an ordinary commercial transaction even if that activity does not qualify as an investment. It follows that an investment, for purposes of the ICSID Convention, should at least be distinguishable from ordinary commercial transactions, since not even the Additional Facility Rules are available for these.

Summary:

- **The Additional Facility provides for a dispute settlement mechanism for cases that are outside ICSID's jurisdiction *ratione materiae*.**
- **Even these disputes must arise from transactions that are distinguishable from ordinary commercial transactions.**

⁴⁰ 1 ICSID Reports 218.

6. ANCILLARY CLAIMS

Article 46

ICSID tribunals have the power to deal with ancillary claims. These include incidental and additional claims and counter-claims. The relevant provision is Article 46 of the ICSID Convention:

Except as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counter-claims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre.

Purpose

The purpose of this provision is to allow an ICSID tribunal to consider closely related aspects of a dispute and thus avoid the need to institute separate proceedings. This provision does not in any way extend ICSID's jurisdiction. It merely delineates the competence of a tribunal in regard to the scope of a particular dispute submitted to it.⁴¹ Even a closely related ancillary claim must be within ICSID's jurisdiction.

Article 25 governs

Therefore, jurisdiction *ratione materiae* of the Centre under Article 25 of the Convention, must exist to enable a tribunal to consider ancillary claims. The incidental or additional claim or a counter-claim must arise directly out of an investment. In addition, under Article 46 of the Convention, it must arise directly out of the subject-matter of the particular dispute as submitted to the tribunal.

Types of ancillary claims

Examples of ancillary claims that arise directly out of the subject-matter of the dispute would be expenses from third party contracts serving the purpose of the investment operation, interest on the amount claimed and procedural costs.

Summary:

- **An ICSID tribunal will deal with an ancillary claim that is closely related to the original dispute.**
- **The ancillary claim must be within ICSID's subject-matter jurisdiction.**

⁴¹ Schreuer, *Commentary, Article 46, para. 4.*

TEST MY UNDERSTANDING

After having studied this Module the reader should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. How is the subject-matter jurisdiction of ICSID defined?
2. How do you identify the existence of a dispute?
3. What distinguishes a legal dispute from other types of disputes?
4. What is the difference between a dispute arising directly out of an investment and a dispute arising from a direct foreign investment?
5. Does the ICSID Convention define the concept of “investment”?
6. Can you describe an investment for purposes of the ICSID Convention?
7. Do the parties have an unlimited discretion in agreeing that a particular transaction is an investment?
8. Are definitions of “investment” in a BIT or other treaty determinative of the concept under the ICSID Convention?
9. Is it conceivable that a particular transaction is covered by the definition of “investment” in a BIT but is still outside ICSID’s subject-matter jurisdiction?
10. What is the effect of notifications under Article 25(4) of the ICSID Convention?
11. Who makes a decision regarding ICSID’s jurisdiction *ratione materiae*?
12. Will an ICSID tribunal only examine its competence *ratione materiae* if prompted by a jurisdictional objection?
13. Give examples of transactions that are undoubtedly investments.
14. Can construction activities constitute investments? If so, under what circumstances?
15. Can one always clearly distinguish between trade-related disputes and investment disputes?
16. Can financial operations like loans constitute investments? If so, under what circumstances?
17. Can operations preparatory to investments be regarded as investments under the ICSID Convention?
18. Does the Additional Facility offer procedures for the settlement of disputes that are outside ICSID’s jurisdiction *ratione materiae*? If so, under what circumstances?
19. Does an ICSID tribunal have the power to deal with claims that are closely related to the principal claim submitted to it?
20. If so, does this power constitute an extension of subject matter jurisdiction?

HYPOTHETICAL CASE

Tiport v. Arcadia

Tionesia and Arcadia are both ICSID Contracting States. While both are developing countries, Tionesia has enjoyed high economic growth over the past fifteen years, whereas Arcadia in the same period has seen lapses into negative growth, high debt and political instability. Since 1996, a Bilateral Investment Treaty has been in force between Arcadia and Tionesia, providing for the submission of investment disputes to arbitration under the ICSID Convention.

For the past seven years, Tiport, a Tionesian multinational company, has been providing technical and management consultancy services to the Arcadian Port Agency (APA), under a 1995 Cooperation Agreement. In early 2001, the Government of Arcadia invited Tiport to acquire a 35 per cent share in APA, as part of the first steps of a privatisation programme. Tiport began negotiations with the Arcadian Government for an arrangement whereby Tiport would appoint the majority of APA's Board of Directors while acquiring only 35 per cent of APA's shares. These negotiations were ultimately unsuccessful and Tiport desisted from acquiring shares in APA, which remained owned entirely by the Government of Arcadia.

Following the negotiations, in June 2001, Tiport and APA concluded a Credit Facility Agreement, under which Tiport made available up to US\$100 million. The Credit Facility was to have multiple uses, including the payment of any sums due to Tiport by APA. The Government of Arcadia was a guarantor under the Agreement.

In July 2001, APA and the Arcadian Government awarded to Tiport a public contract for the construction of a pier and port terminal in Arcadia. Construction was completed, and the pier and port terminal were delivered to APA, in August 2002. At that time, APA owed Tiport an amount of US\$7 million in outstanding fees under the 1995 Cooperation Agreement, and US\$50 million under the construction contract. APA had drawn from the Credit Facility to make an initial payment under the construction contract and to pay two invoices under the Cooperation Agreement, but the Government had very promptly repaid Tiport the amounts drawn.

In September 2002, following political upheaval and a change of government in Arcadia, the new Arcadian administration informed Tiport that it would not pay, and would challenge its obligation to pay, any outstanding amounts under the Cooperation Agreement or the construction contract. Tiport initiated ICSID arbitration proceedings against the Government of Arcadia under the Bilateral Investment Treaty. In the proceedings, Arcadia argued that ICSID lacked jurisdiction because the dispute did not arise directly out of an investment.

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What arguments could each party make in support of its position on subject-matter jurisdiction?

FURTHER READING

Books

- **Dolzer, R./Stevens, M.**, *Bilateral Investment Treaties* (1991).
- **Schreuer, C.**, *The ICSID Convention: A Commentary* (2001).

Articles

- **Amerasinghe, C. F.**, The Jurisdiction of the International Centre for the Settlement of Investment Disputes, 19 *Indian Journal of International Law* 166 (1979);
- **Broches, A.**, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 136 *Recueil des Cours* 331 (1972-II);
- **Delaume G R.**, Le Centre International pour le règlement des Différends relatifs aux Investissements (CIRDI), 109 *Journal du Droit International* 775 (1982);
- **Delaume, G R.**, ICSID Arbitration: Practical Considerations, 1 *Journal of International Arbitration* 101 (1984);
- **Parra, A. R.**, Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment, 12 *ICSID Review—Foreign Investment Law Journal* 287 (1997);
- **Shihata, I. F. I./Parra, A. R.**, The Experience of the International Centre for Settlement of Investment Disputes, 14 *ICSID Review—Foreign Investment Law Journal* 299 (1999).

Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- ICSID Cases:
<http://www.worldbank.org/icsid/cases/cases.htm>
- ICSID Model Clauses:
<http://www.worldbank.org/icsid/model-clauses-en/main.htm>
- ICSID Additional Facility:
<http://www.worldbank.org/icsid/facility/facility.htm>

Cases

- *Amco Asia et al. v. Indonesia*, Decision on Jurisdiction, September 25, 1983, 1 ICSID Reports 389.
- *Amco Asia et al. v. Indonesia*, Resubmitted Case, Decision on Jurisdiction, 10 May 1988, 1 ICSID Reports 543, 565.
- *Astaldi S.p.A. & Columbus Latinoamericana de Construcciones S.A. v. Republic of Honduras* (ICSID Case No. ARB/99/8), Award, 19 October 2000 (unpublished).
- *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, Decision on Jurisdiction, 27 September 2001, 16 ICSID Review – FILJ 469 (2001).
- *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review – Foreign Investment Law Journal 251 (1999).
- *Fedax N.V. v. Republic of Venezuela*, Decision on Jurisdiction, 11 July 1997, 37 ILM 1378 (1998).
- *Kaiser Bauxite Company v. Jamaica*, Decision on Jurisdiction, 6 July 1975, 1 ICSID Reports 296.
- *Liberian Eastern Timber Corporation v. Republic of Liberia*, Award, 31 March 1986, 2 ICSID Reports 346.
- *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, Award, 15 March 2002, 17 ICSID Review – Foreign Investment Law Journal 142 (2002).
- *Pope & Talbot, Inc. v. Canada*, Award On Motion to Dismiss Re Existence of an Investment, 26 January 2000, <http://www.naftaclaims.com/>.
- *S.D. Myers, Inc. v. Canada*, Partial Award, 12 November 2000, 40 ILM 1408 (2001).
- *Salini Costruttori S.p.A. & Italstrade S.p.A. v. Kingdom of Morocco*, Decision on Jurisdiction, 23 July 2001, Journal de Droit International 189 at 196 (2002).
- *Société Ouest Africaine des Bétons Industriels v. Senegal*, Award, 25 February 1988, 2 ICSID Reports 190.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.6 APPLICABLE LAW



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NOTE

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OVERVIEW

This Module gives an overview of the most important legal questions that arise in connection with the applicable law under the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention).

The substantive rules of law for solving a dispute are not provided by the ICSID Convention. The Convention grants autonomy to the parties in choosing the law that ought to be applied to solve their dispute. The parties can also allow the tribunal to decide *ex aequo et bono*. In the absence of an agreement, the ICSID Convention designates the host State's law in conjunction with international law as the applicable law. The tribunal may not return a finding of *non liquet* if it is unable to discover appropriate rules of law.

Sometimes, difficulties have arisen in identifying the parties' agreement on choice of law. Questions have also been raised concerning the relationship between international law and domestic law.

The ICSID Convention provides the possibility of annulling awards that do not apply the proper law.

OBJECTIVES

Upon completion of this booklet the reader should be able to:

- Understand the significance of the applicable law in ICSID arbitration.
- Discuss the principle of party autonomy in the choice of law.
- Describe the ways in which the parties may agree on the proper law.
- Define the ICSID Convention's rule on applicable law in the absence of party agreement.
- Analyse the relationship of international and domestic law in ICSID practice.
- Explain the prohibition of *non liquet*.
- Identify the requirements for a decision based on equity rather than law.
- Appreciate the possible consequences of a non-application of the proper law.

1. APPLICABLE LAW: GENERAL APPROACH

Introduction

Arbitration awards are always based on substantive rules of law, applicable to the relationship between the parties. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (hereinafter the Convention or the ICSID Convention) does not provide those substantive rules. It just establishes a procedural framework for the settlement of disputes.

However, Article 42 of the Convention sets forth a mechanism in accordance with which the tribunal is to select the appropriate rules of law for the particular dispute.

This mechanism combines flexibility with certainty. Flexibility is provided by granting the parties the freedom to choose the applicable law. Certainty is provided by ensuring that, if the parties fail to make that choice, the tribunal will find appropriate rules in order to solve the dispute (the host State's law in conjunction with international law). A finding of *non liquet* by the tribunal is prohibited.

Article 42

Article 42 of ICSID Convention provides:

- (1) *The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.*
- (2) *The Tribunal may not bring in a finding of non liquet on the ground of silence or obscurity of the law.*
- (3) *The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute ex aequo et bono if the parties so agree.*

Scope

Article 42 of the Convention only addresses the substantive law to be applied. Matters of procedure are not governed by Article 42.

In fact, Article 44 of the Convention states that the arbitration procedure is regulated exhaustively by the Convention itself and by the rules adopted under it, subject to any agreement by the parties. (see Module 2.7)

Likewise, matters relating to the tribunal's jurisdiction under Article 25 are not governed by Article 42.

In *CSOB v. Slovakia*, jurisdiction was based on an agreement between the parties. The Tribunal held:

The question of whether the parties have effectively expressed their consent to ICSID jurisdiction is not to be answered by reference to national law. It is governed by international law as set out in Article 25(1) of the ICSID Convention¹.

The rule of Article 42 also does not govern the nationality of the investor. The nationality of a natural person is settled primarily by the law of the State whose nationality is claimed. The nationality of a juridical person is established by the principle of incorporation or seat of the corporation in question. The law of the investor's nationality also rules the investor's status and legal capacity.²

In the Decision on Jurisdiction in the Resubmitted Case *Amco v. Indonesia*³, Amco Asia, a company registered in Delaware, was dissolved under the laws of Delaware one month after the rendering of the first Award. Indonesia held that under Indonesian law, which was applicable in accordance with Article 42(1) second sentence, once a limited liability corporation was dissolved, it ceased to exist for any purpose.⁴ The Tribunal disagreed with Indonesia's argument on applicable law stating that:

When a company enters into an agreement with a foreign legal person, the legal status and capacity of that company is determined by the law of the state of incorporation. Similarly, one should apply the law of the State of incorporation to determine whether such a company, though dissolved, is still an existing legal entity for any specified legal purpose⁵.

Methodology

First of all, the tribunal should verify whether the parties have chosen a system of law or individual rules of law or principles of law, in accordance with Article 42(1) first sentence. Only if the parties have not agreed on applicable rules of law, the tribunal will fall back on the residual rule referring it to the law of the host State and to international law (Article 42(1) second sentence). The method described is designed to avoid any uncertainty of law, in order to leave no place for silence or obscurity of the law making a decision impossible (Article 42(2)).

Summary:

- **The substantive rules of law for solving the dispute between the parties are not provided by the ICSID Convention.**
- **The parties are free to choose the applicable substantive law that the tribunal should apply to solve the dispute.**
- **If the parties have not agreed on a choice of law, the tribunal will apply the host State's law and international law.**

¹ CSOB v. Slovakia, *Decision on Jurisdiction*, 24 May 1999, 14 ICSID Review—Foreign Investment Law Journal 251, 263/4 (1999).

² Schreuer, C., *The ICSID Convention: A Commentary*, p. 554 (2001).

³ Resubmitted Case: *Decision on Jurisdiction*, 10 May 1988, 1 ICSID Reports 543.

⁴ At p. 561.

⁵ At p. 562.

2. GENERAL RULE: THE AUTONOMY OF THE PARTIES

Freedom of choice

The principle of autonomy of the parties granted by the ICSID Convention implies the freedom of the parties to choose the applicable law by agreement. Like any other arbitral tribunal, ICSID tribunals are bound by the parties' agreement in this matter.

In accordance with Article 42(1) first sentence, an ICSID tribunal

shall decide a dispute in accordance with such rules of law as may be agreed by the parties.

The parties are free to decide on the substantive law that the tribunal should apply to settle their dispute. They can also leave the matter to the residual rule of Article 42(1) second sentence⁶.

Law of the host State

The law of the host State is the typical choice for a contractual relationship concerning an investment.

*In Mobil Oil v. New Zealand*⁷, the parties had agreed that
an arbitral Tribunal shall apply the law of New Zealand

Law of the investor's home country or of a third State

The selection of the law of the investor's home country or of a third State is unusual. Such choices would create difficulties if the investment involves activities that are closely related to the host State's legal system like administrative law, labour law and tax law.

An exception to this observation is the well-known practice to submit loan contracts to the law of the lender's State or to the law of a third State that has an important financial centre.

A stipulation for the application of the law of the investor's home country appeared in *Colt Industries v. The Republic of Korea*⁸. In that singular case, the investment involved technical and licensing agreements that seemed most closely connected with the licensor's home country.

Investment agreement as a self-contained legal system

An inadvisable method to choose the applicable law is to consider the agreement as a self-contained legal system isolated from any extraneous system of law. This choice may cause significant practical problems when the tribunal is unable to find any guidance on a particular issue in the agreement itself. In such case,

⁶ Shihata, I. F. and Parra, A. R., *Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention*, 9 *ICSID Review—Foreign Investment Law Journal* 183, p. 189 (1994).

⁷ *Attorney-General v. Mobil Oil NZ Ltd., New Zealand, High Court, 1 July 1987*, 4 *ICSID Reports* 123.

⁸ *This case was settled and discontinued with no published record of the proceedings.*

it may resort to the second sentence of Article 42(1) and apply the law of the Contracting State and such rules of international law as may be applicable.

Rules of law

Article 42(1) first sentence refers to “rules of law” rather than systems of law. Consequently, it is generally accepted that the parties are not restricted to accepting a complete legal system of law *tel quel* but are free to combine rules of diverse origin.

Therefore, choice of law clauses may refer to various legal systems cumulatively, or subject different parts of the agreement to different systems of law, a process called “*dépeçage*”. The parties are also allowed to set aside certain aspects of a chosen system of law from its application to the relationship, or to declare applicable rules derived from a treaty not yet in force or another non-binding instrument.

Renvoi under Article 42(1) first sentence

“*Renvoi*” is a process by which a selected system of law in turn includes rules on the conflict of laws that make reference to another legal system. Since the first sentence of Article 42(1) makes no reference to rules on the conflict of laws, as is the case in its second sentence, it stands to reason that an explicit choice of law only applies to the substantive rules of the selected law, but not to the conflict of laws rules included therein.

Choice of international law

In order to protect the investor's interests in view of the uncertainties of the host State's law, the parties sometimes decide to internationalize their agreement. This purpose is accomplished by making a reference to international law or to general principles of law, jointly with the host State's law.

Referring only to international law and excluding any reference to a domestic law is not advisable. The law thus chosen may lack in clarity and technical detail. Nevertheless, many multilateral treaties providing for ICSID arbitration, including NAFTA and the Energy Charter Treaty, contain clauses on applicable law that only mention the corresponding treaty and rules of international law.

For example, the Energy Charter Treaty establishes in its Article 26:

*(6) A Tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law*⁹.

In *AGIP v. Congo*, the parties had agreed on the application of Congolese law supplemented by the principles of international law. After establishing that the Congolese ordinance, which had nationalized the Claimant's property, was in breach of Congolese law, the Tribunal turned to international law:

⁹ 34 ILM 400 (1995). See also Wälde, T. W., *International Investment under the 1994 Energy Charter Treaty—Legal, Negotiating and Policy Implications for International Investors within Western and Commonwealth of Independent States/Eastern European Countries*, 29 *Journal of World Trade* 5, 60 et seq. (1995).

82. In the present case, it must be recalled, that according to Article 15 of the Agreement, Congolese law can be “supplemented” when the occasion arises by principles of international law.⁸³ It has been maintained by AGIP that the qualification of “supplemented” must be interpreted as implying the subordination of Congolese law to international law. Whatever the merits of this argument it suffices for the Tribunal to note that the use of the word “supplemented” signifies at the very least that recourse to principles of international law can be made either to fill a lacuna in Congolese law, or to make any necessary additions to it¹⁰.

International law as part of domestic law

International law is frequently incorporated into domestic law through a variety of techniques¹¹. To the extent that it thereby becomes applicable internally, it may be seen as part of a system of domestic law chosen by the parties and may be relied upon before an ICSID tribunal.

But it would not be wise just to rely on the incorporation of international law into a domestic law chosen by the parties. The status of international law under domestic constitutions is by no means uniform. Subsequent domestic enactments may take precedence over international law. Certain parts of international law may be regarded as non-self-executing. Therefore, an investor looking for protection in international law should not simply rely on references to international law in the law of the host State. The investor should insist either on a choice of law clause that includes international law or on the application of the second sentence of Article 42(1).

International law in the absence of its choice

The question remains, whether international law will be taken into account by an ICSID tribunal if it is not mentioned in an agreement on choice of law. There are good reasons for the proposition that there is at least some place for international law even in the presence of an agreement on choice of law which does not mention it.

In *SPP v. Egypt*¹², there was disagreement as to whether a choice of Egyptian law had been made by the Parties and, consequently, as to whether international law was applicable in conformity with the second sentence of Article 42(1). The Tribunal declared this disagreement immaterial, holding that international law was applicable either way:

80. Finally, even accepting the Respondent's view that the Parties have implicitly agreed to apply Egyptian law, such an agreement cannot entirely exclude the direct applicability of international law in certain situations. The law of the ARE, like all municipal legal systems, is not complete or exhaustive, and where a lacuna occurs it cannot be said that there is agreement as to the application of a rule of law which ex hypothesi, does not exist. In such case, it must be said that there is “absence of agreement” and, consequently, the second sentence of Article 42(1) would come into play.¹³

¹⁰ Award, 30 November 1979, 1 ICSID Reports 323.

¹¹ Oppenheim's International Law, 9th edition, 54 et seq. (1992).

¹² Award, 20 May 1992, 3 ICSID Reports 189.

¹³ At p. 207.

The Tribunal proceeded to apply international law to defeat an Egyptian argument that certain acts of its officials were invalid under Egyptian law. It held that these acts created expectations protected by the application of the principle of international law establishing the international responsibility of States for unauthorized or ultra vires acts of officials having an official character:

84. When municipal law contains a lacuna, or international law is violated by the exclusive application of municipal law, the Tribunal is bound in accordance with Article 42 of the Washington Convention to apply directly the relevant principles and rules of international law.¹⁴

This decision shows a reluctance to abandon international law in favour of the host State's domestic law. The complete exclusion of international law as a consequence of an agreed choice of law containing only a domestic legal system would lead to undesirable consequences. It would mean that an ICSID tribunal would have to uphold discriminatory and arbitrary actions by the host State, breaches of its undertakings which are evidently in bad faith or amount to a denial of justice as long as they conform to the applicable domestic law. It would mean that a foreign investor, by assenting to a choice of law, could sign away the minimum standards for the protection of aliens and their property developed in customary international law. Such a solution would be contrary to the goal of the Convention to stimulate investment through the creation of a favourable investment climate.¹⁵

International minimum standard

Therefore, international minimum standards should be preserved, even in the absence of a reference to international law in a choice of law clause. The mandatory rules of international law which provide an international minimum standard of protection for aliens, exist independently of any choice of law. Their obligatory nature is not open to the disposition of the parties.

The transaction remains governed by the domestic legal system chosen by the parties. However, this choice is checked by the application of a number of mandatory international rules such as the prohibition of denial of justice, the discriminatory taking of property or the arbitrary repudiation of contractual undertakings.

Summary:

- **The principle of autonomy of the parties implies the freedom to choose the substantive law to settle their disputes.**
- **The parties may combine provisions from different domestic or international legal systems.**
- **Even if the parties do not include international law in their agreement on applicable law, the tribunal will preserve the application of international minimum standards.**

¹⁴ At p. 208.

¹⁵ Report of the Executive Directors, para. 9, 1 ICSID Reports 25.

3. WAYS OF CHOOSING THE APPLICABLE LAW

The choice of law open to the parties may be exercised in one of several ways.

Direct agreement

One is a direct agreement between the parties, which may be reached before or after the institution of proceedings. The normal way to agree on a choice of law is through a clause in the initial investment agreement between the host State and the investor.

The 1993 ICSID Model Clauses offers the following sample for a direct agreement on choice of law:

Clause 10

Any Arbitral Tribunal constituted pursuant to this agreement shall apply specification of system of law [as in force on the date on which this agreement is signed]/[subject to the following modifications: . . .].¹⁶

In their agreement the parties may refer to domestic law, international law, a combination of domestic and international law, or a law frozen in time or subject to certain modifications. They are free to agree on rules of law defined as they choose.

Applicable law chosen in legislation or treaty

In some cases, the legislation or treaty providing for ICSID jurisdiction (see Module 2.3, Sections 3.-5.) includes a provision on applicable law. Such a provision is transformed into an agreement on choice of law by the parties upon the acceptance of jurisdiction by the investor.

Choice of law in BITs

Many bilateral investment treaties (BITs) contain choice of law clauses. These commonly include references to the BIT itself, the law of the Contracting State, the rules and principles of international law, and sometimes the provisions of a particular investment contract.

For example, article 10 of the Argentina/Netherlands BIT concluded in 1992, after providing for ICSID arbitration, established:

7. The Arbitration Tribunal addressed in accordance with paragraph (5) of this Article shall decide on the basis of the law of the Contracting Party which is a party to the dispute (including its rules on the conflict of law), the provisions of the present Agreement, special Agreements concluded in relation to the investment concerned as well as such rules of international law as may be applicable.¹⁷

Time of agreement

Under the ICSID Convention, the parties' freedom to choose the applicable rules of law is not limited to the time of the conclusion of an investment agreement or even to the time that the dispute arises. The choice of law may

¹⁶ 4 ICSID Reports 364.

¹⁷ Argentina/Netherlands BIT, 20 October 1992, Investment Promotion and Protection Treaties, looseleaf, ICSID. Many BITs, especially of Latin American countries, contain similar clauses. See Fedax v. Venezuela, Award, 9 March 1998, 37 ILM 1391, 1396 (1998).

also be made by the parties in the course of the arbitration proceeding¹⁸. If no choice of law has been made by direct agreement, by legislation or by treaty by the time the arbitration is instituted, nothing precludes a subsequent agreement by the parties on applicable law.

In *Benvenuti & Bonfant v. Congo*, the parties reached an agreement in the course of the arbitration proceedings to authorize the Tribunal to rule *ex aequo et bono*¹⁹, a power which was accepted by the Tribunal²⁰. While this agreement did not strictly relate to rules of law as provided in Article 42(1) first sentence, such an agreement reached in the course of the proceedings would be equally acceptable.

Implied choice of law

It is an open question whether, for purposes of Article 42(1) first sentence, the parties' agreement on applicable law must be expressed or may be implied from the facts and circumstances of the relationship²¹.

Article 42(1) of the ICSID Convention does not require that the parties' agreement must be in writing or even that it should be stated expressly.

But the choice of law, if implied, must be evidenced “with reasonable certainty” by the terms of the parties' contract or the circumstances of the case²².

Choice of law by reference to domestic legislation

For instance, the mere fact that jurisdiction is derived from a provision of the host State's law cannot be construed as a choice of law of the host State's law.

Also, the mere recital in a particular agreement of a provision of domestic law or even of a complete piece of legislation is not a reliable indication of a general choice of the domestic law concerned.

Choice of law derived from parties' submissions

Sometimes, the reliance by the parties on certain sources of law in their submissions before the tribunal is taken as an argument to support an implicit agreement on choice of law.

In *AAPL v. Sri Lanka*²³, the Tribunal observed that the parties, not having concluded an arbitration agreement directly negotiated between them, had not had an opportunity to choose the applicable law in advance of the arbitration proceedings. Therefore, the choice of law process would materialize through the conduct of the Parties in the arbitration proceedings. An observation of this conduct led the Tribunal to conclude that: →

¹⁸ Shihata and Parra, *Applicable Substantive Law*, p. 201.

¹⁹ *Award*, 15 August 1980, 1 ICSID Reports 342. The suggestion was originally put forward by the Claimants at the Tribunal's first session on 14/15 June 1978 but rejected by the Respondent (p. 338). An agreement to this effect was formally reached by the Parties on 5 June 1979 and communicated to the Tribunal (p. 342).

²⁰ At pp. 349, 357 et seq.

²¹ Schreuer, *Commentary*, p. 573.

²² Shihata and Parra, *Applicable Substantive Law*, p. 190.

²³ *Award*, 27 June 1990, 4 ICSID Reports 250 at p. 256.

...both Parties acted in a manner that demonstrates their mutual agreement to consider the provisions of the Sri Lanka/United Kingdom Bilateral Investment Treaty as being the primary source of the applicable legal rules.

Parties' submissions as confirmation of the chosen law

In other situations the tribunal may reach an independent conclusion on choice of law but may take the parties' submissions as a confirmation of its own determination.

In *Amco v. Indonesia*²⁴ the Tribunal found that, since the Parties had not expressed an agreement as to rules of applicable law, Indonesian law and rules of international law were to be applied. The Tribunal found confirmation for this finding in the fact that both parties had not just failed to deny the applicability of these two systems of law but had, in fact, constantly referred to both of them.

Summary:

- **The parties can choose the applicable law through a direct agreement or through the operation of a choice of law clause in a treaty or legislation providing for ICSID arbitration.**
- **The choice of law may be exercised also after the institution of the arbitration proceedings.**
- **ICSID tribunals may recognize an implied choice of law. But the intention of the parties to exercise such choice should be clear.**

²⁴ 20 November 1984, 1 ICSID Reports 413.

4. STABILIZATION CLAUSES

Risk of subsequent changes of law

When the parties choose the host State's domestic legal system, the foreign investor runs the risk of subsequent changes in that law. These changes may adversely affect the legal terms of the relationship.

Subsequent changes in the applicable law may have a severe impact on the investment. These may go as far as the termination of the contract and the expropriation of the investor's property.

Other changes in domestic laws are less dramatic but may still have a strong impact on the investment relationship. Changes in taxation, environmental standards, minimum wages and any other aspect of the regulatory structure in the investor's activities are typical examples of these situations.

Stabilization clauses

One way to prevent the effect of subsequent changes is to introduce a stabilization clause into the investment agreement. Such a clause protects the investor from subsequent changes of the local law.

The State may still change its law, but a stabilization clause establishes a promise not to apply any adverse changes to the investor's operations or a promise to compensate the investor for any adverse consequences of such a change. In other words, from the investor's perspective, the law becomes frozen at the time of the contract.

In order to shield stabilization clauses against their unilateral abrogation through host State legislation, they are governed by international law, even if otherwise the chosen law is domestic law.

ICSID Model Clause 10 of 1993

ICSID Model Clause 10 of 1993,²⁵ dealing with applicable law, suggests a possibility to stabilize the chosen law. It suggests the insertion of the words "as in force on the date on which this agreement is signed".²⁶ Stabilization clauses are used frequently in contracts providing for ICSID arbitration.

Non-comprehensive stabilization clauses

Stabilization clauses need not to be comprehensive, but may be employed selectively. It is perfectly conceivable to apply them to specific areas only. For example, in *Kaiser Bauxite v. Jamaica*, the principal agreement between the parties included a "no further tax" clause.²⁷

Absence of stabilization clauses

In the absence of a stabilization clause the chosen law will normally be applied as it evolves over time. Normal changes to the host State's legal system, which constitute adaptations to changing social, economic and technological conditions, will apply to existing investment relationships. These will usually

²⁵ 4 ICSID Reports 364.

²⁶ Earlier versions of the Model Clauses also offered formulas for stabilization. See the 1981 Model Clause XVII, 1 ICSID Reports 206 and the 1968 Model Clauses XIX and XX, 7 ILM 1176 (1968).

²⁷ ICSID Reports 297. The Tribunal did not reach the question of the clause's relevance.

involve changes of labour law, reasonable adjustments of tax law and the updating of technical safety and environmental standards.

The situation is different if the change in the legislation serves the purpose of defeating undertakings which have been made by the host State. Action taken through changes in the domestic law which is aimed at abrogating the contractual relationship or at establishing a framework under which the investor can no longer operate will not have to be accepted. The repudiation of the agreement or the confiscatory expropriation of the investor's property through subsequent law changes are clear examples of such a situation. The host State's freedom to legislate is limited by the minimum standards of protection mandated by international law.

Summary:

- **The parties can introduce stabilization clauses into their contract in order to avoid the adverse effects of subsequent changes in domestic legislation.**
- **Changes in domestic legislation that evidence the will of defeating previous undertakings are contrary to international law.**

5. ABSENCE OF AGREEMENT ON THE APPLICABLE LAW

Residual rule of Article 42(1) second sentence

If the tribunal cannot find an agreement between the parties on the rules of law to be applied to the dispute, it should turn to the residual rule contained in the second sentence of Article 42(1). This provision says:

... *In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.*

Absence of choice of law

In *Benvenuti & Bonfant v. Congo*²⁸ the determination that the parties had not reached an agreement on the applicable law was made by way of a search of the contractual documents which ruled the relationship. These documents did not contain an explicit choice of law clause.

Another method is to look for an implicit or indirect choice of law in the agreements or in the parties' later behavior as, for example, their submissions to the tribunal in the course of the proceedings.

Incomplete agreement on choice of law

The provision of Article 42(1) second sentence may be applicable even if the parties have made an agreement on choice of law. If the parties have not made a complete agreement on the applicable law, leaving some aspects of the relationship without any legal answer in the chosen law, the only acceptable way in accordance with the prohibition of *non liquet* in Article 42(2) is to apply the residual rule of Article 42(1) second sentence.

Applicability of the host State's law

The formula in the second sentence of Article 42(1) which includes the application of the law of the host State is unusual. Other instruments governing international arbitration are more open-ended if there is no agreement on applicable law. They give tribunals the power to apply the law they consider most appropriate.²⁹ In the Convention's drafting, representatives of capital-importing countries insisted that only the law of the host country should apply in the absence of agreement between the parties. The victory of this position is mitigated by the fact that, in most cases, the host State's law is also the one to which the investment relationship has the closest connexion and, therefore, would have applied under the general principles of the conflict of laws. Also, the host State's law will be subject to the corrective function of international law.

Application of Article 42(1) second sentence

ICSID tribunals have applied the provision of Article 42(1) second sentence in several cases, where they were unable to find an agreement between the parties on the choice of law.

²⁸ Award, 15 August 1980, 1 ICSID Reports 349.

²⁹ See UNCITRAL Arbitration Rules Art. 33(1); Additional Facility Arbitration Rules Art. 55.

For instance, in *Amco v. Indonesia*, the Tribunal said:

*148. The parties having not expressed an agreement as to the rules of law according to which the disputes between them should be decided, the Tribunal has to apply Indonesian law, which is the law of the Contracting State Party to the dispute, and such rules of international law as the Tribunal deems to be applicable, considering the matters and issues in dispute.*³⁰

In most cases, the tribunals proceeded to examine and apply the respective domestic systems of law.

For example, in *Benvenuti & Bonfant v. Congo* and *SOABI v. Senegal*, the Tribunals found that the corresponding host States' laws were strongly influenced by French law and relied on that law as a manner of determining the pertinent rules of the host State's domestic law.³¹

Subsequent changes in the host State's Law

Stabilization clauses will normally not appear when the parties have not addressed the question of choice of law. Therefore, as a general principle, the host State's law will be applicable as it changes over time.

Renvoi

The second sentence of Article 42(1) contains a renvoi provision which states “...(including its rules on the conflict of laws)...”. The purpose of this provision is to mitigate the reference to the law of the host State, in order to allow the application of another system of law, which may have a closer connection to the transaction.

Summary:

- **In the absence of a choice of law by the parties, the tribunal will apply the law of the host State and such rules of international law as may be applicable.**
- **The application of the host State's law in accordance with Article 42(1), second sentence includes its rules on the conflict of laws (renvoi provision).**

³⁰ Award, 20 November 1984, 1 ICSID Reports 452.

³¹ 1 ICSID Reports 338, 349; 2 ICSID Reports 222 et seq., 229, 249 et seq., 257.

6. RULES OF INTERNATIONAL LAW

Rules of international law

The residual rule of Article 42(1), second sentence refers to:

...such rules of international law as may be applicable...³².

Paragraph 40 of the Report of the Executive Directors to the Convention³³ states:

The term “international law” as used in this context should be understood in the sense given to it by Article 38(1) of the Statute of the International Court of Justice (ICJ), allowance being made for the fact that Article 38 was designed to apply to inter-State disputes.³⁴

Therefore this provision directs ICSID tribunals to look at the full range of sources of international law in a similar way as the International Court of Justice.

Treaties

Treaty law is one of the most relevant aspects of international law to be applied by ICSID tribunals.

First and foremost among treaties is a bilateral investment treaty (BIT) between the host State and the investor's home State. In addition, a number of multilateral treaties such as the NAFTA and the MERCOSUR Investment Protocols contain detailed rules concerning foreign investment.

All these treaties are specifically designed to govern the type of relationship which is likely to come before an ICSID tribunal and are part of the "rules of international law" mentioned in Article 42(1) second sentence of the Convention.

³² This passage contains a curious discrepancy between the English and Spanish texts of the Convention on one side and the French text on the other. Whereas the English text speaks of “rules of international law” (Spanish “normas de derecho internacional”), the French text speaks of “principes de droit international” which would be better translated as “principles of international law” and would indicate a higher level of generality and abstraction. A look at the drafting history of the French text shows that it initially contained the word “règle” also in reference to international law but that this was changed to “principes” in the Revised Draft for no apparent reason. This background would indicate that the French term “principes” should not be accorded any particular significance and should not be used to exclude the application of specific rules. The difference between rules and principles of international law does not seem to have created major difficulties for Tribunals. See Schreuer, *Commentary*, p. 65.

³³ *History*, Vol. II, p. 962, 1029.

³⁴ 1 ICSID Reports 31. The following footnote is attached to the Report of the Executive Directors: Article 38(1) of the Statute of the International Court of Justice reads as follows:

“1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
 b. international custom, as evidence of a general practice accepted as law;
 c. the general principles of law recognized by civilized nations;
 d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules law.”

The large and rapidly growing number of BITs and multilateral treaties dealing with investment make them the most important source of international law for ICSID tribunals or, as decided in *APL v. Sri Lanka*³⁵, the primary source of applicable legal rules.

Other treaties may also become relevant in ICSID arbitration.

For instance, in *SPP v. Egypt*, the 1972 UNESCO Convention for the Protection of the World Cultural and Natural Heritage played a key role in the dispute³⁶.

Customary international law

Customary international law offers important guidance in investment disputes. Its rules on the minimum standard for the treatment of aliens including their property, more specifically on expropriation and compensation, on the prohibition of denial of justice and on State responsibility for injury to aliens are obvious examples.

ICSID tribunals have frequently applied rules of customary international law either under the first or second sentence of Article 42(1):

In *Benvenuti & Bonfant v. Congo*, the Tribunal held that the principle of compensation in case of nationalization constitutes one of the generally recognized principles of international law.³⁷

In *Amco v. Indonesia*, the Tribunal relied on the principle of respect for acquired rights in connexion with the authorization to invest which the Claimant had received from the Respondent.³⁸

In *LETCO v. Liberia*, the Tribunal held that for a nationalization to be lawful, it would have to be based on a legislative enactment, taken for a bona fide public purpose, be non-discriminatory and be accompanied by appropriate compensation.³⁹

General principles of law

General principles of law are found through a process of comparative law whereby features common to domestic legal systems are established. General principles of law are particularly useful in areas of the law which involve non-State actors such as investment relationships and are an important source of international law in ICSID cases. Among those general principles of law usually recognized by ICSID tribunals are the general principles of contract law⁴⁰ including *pacta sunt servanda* and the *exceptio non adimpleti contractus*,⁴¹

³⁶ Award, 20 May 1992, 3 ICSID Reports 206/7.

³⁷ Award, 15 August 1980, 1 ICSID Reports 357.

³⁸ Award, 20 November 1984, 1 ICSID Reports 493.

³⁹ Award, 31 March 1986, 2 ICSID Reports 366.

⁴⁰ *Amco v. Indonesia*, Award, 20 November 1984, 1 ICSID Reports 461 et seq.

⁴¹ *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 61 et seq.

estoppel,⁴² unjust enrichment,⁴³ full compensation of prejudice resulting from a failure to fulfill contractual obligations,⁴⁴ general principles of due process,⁴⁵ the claimant bears the burden of proof⁴⁶ and *res judicata*.⁴⁷

In addition, ICSID tribunals have relied heavily on general principles of law in the valuation of damages.

Before applying presumed general principles of law, great care must be taken to establish these principles by inductive proof and not simply to assume or postulate their existence.

In *Klöckner v. Cameroon*, the Tribunal, while purporting to apply domestic law, added that a “duty of full disclosure to a partner in a contract” was not only a principle of French civil law but that this was “indeed the case under the other national codes which we know of” and that this was the criterion which “applies to relations between partners in simple forms of association anywhere”⁴⁸. The *Ad hoc* Committee took these allusions as a reference to general principles of law.⁴⁹ In annulling the Award, it deplored the absence of any authority for these general principles and concluded that the Award’s reasoning seemed more like a simple reference to equity.

Judicial decisions

ICSID tribunals rely heavily on previous international judicial decisions when dealing with questions of international law. This includes, in particular, previous decisions of ICSID tribunals.

Writings

Like other courts and arbitration tribunals, ICSID tribunals and *Ad hoc* Committees also rely frequently on academic writings on various points of international law.

Resolutions and guidelines

In addition to the classical sources of international law, ICSID tribunals have also referred on occasions to resolutions of the General Assembly on questions such as nationalization.⁵⁰ The World Bank Guidelines on the Treatment of Foreign Direct Investment⁵¹ is another non-binding instrument that is of potential value in ICSID arbitration.

⁴² *Amco v. Indonesia, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 407/8; Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 606; Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 ICSID Reports 140/1; SPP v. Egypt, Decision on Jurisdiction, 27 November 1985, 3 ICSID Reports 123.*

⁴³ *Amco v. Indonesia, Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 607/8; SPP v. Egypt, Award, 20 May 1992, 3 ICSID Reports 246/7.*

⁴⁴ *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 498 et seq.*

⁴⁵ *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 472/3; Decision on Annulment, 16 May 1986, 1 ICSID Reports 529/30.*

⁴⁶ *AAPL v. Sri Lanka, Award, 27 June 1990, 4 ICSID Reports 272; Tradex v. Albania, Award, 29 April 1999, 14 ICSID Review—Foreign Investment Law Journal 197, 219 (1999).*

⁴⁷ *Amco v. Indonesia, Resubmitted Case: Jurisdiction, 10 May 1988, 1 ICSID Reports 548 et seq.*

⁴⁸ *Award, 21 October 1983, 2 ICSID Reports 59.*

⁴⁹ *Decision on Annulment, 3 May 1985, 2 ICSID Reports 121/2.*

These non-binding instruments do not necessarily reflect “rules of international law” as provided in Article 42(1). However, they may become part of the applicable law as a consequence of their incorporation into an agreement on choice of law under the first sentence of Article 42(1) or as a supplementary source in the application of rules of law.

⁵⁰ *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 466; LETCO v. Liberia, Award, 31 March 1986, 2 ICSID Reports 366; SPP v. Egypt, Dissenting Opinion to Award, 2 May 1992, 3 ICSID Reports 254/5.*

⁵¹ *Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment, 31 ILM 1363 (1992).*

7. THE RELATIONSHIP OF INTERNATIONAL AND DOMESTIC LAW

Hierarchy of norms

The relationship of international law to the host State's domestic law has turned out to be a complex question. During the drafting of the Convention, it was made clear that international law would prevail where the host State's domestic law violated international law. At the same time, an important role for international law was seen in the filling of gaps in the host State's law.

The formula of the supplemental and corrective effect of international law has since been accepted. The function of international law is to close any gaps in domestic law as well as to remedy any violations of international law which may arise through the application of the host State's law.

Parallel application of international and domestic law

In earlier ICSID decisions, domestic law and international law were frequently looked at side by side without any deeper analysis of their relationship.

In a number of cases, as in *Adriano Gardella v. Côte d'Ivoire*⁵² or the original award in *Klöckner v. Cameroon*,⁵³ the Tribunals were content simply to state in general terms that there was an identity of rules or that the host State's domestic law was in conformity with international law.

Supplemental and corrective function of international law

In later decisions the tribunals entered into a more careful discussion of the relationship of international and domestic law. The tribunals adopted the doctrine of the corrective and supplemental function of international law. At the same time they emphasized that the application of the host State's domestic law was indispensable.

In *Klöckner v. Cameroon*, the Tribunal had based part of the original award on a somewhat broadly defined principle which it sought to base on French law as well as on other national codes. In the proceedings for the annulment of that award (see Module 2.8) the *Ad hoc* Committee said:

Article 42 of the Washington Convention certainly provides that “in the absence of agreement between parties, the Tribunal shall apply the law of the Contracting State party to the dispute...and such principles of international law as may be applicable.” This gives these principles (perhaps omitting cases in which it should be ascertained whether the domestic law conforms to international law) a dual role, that is, complementary (in the case of a “lacuna” in the law of the State), or corrective, should the State's law not conform on all points to the principles of international law. In both cases, the arbitrators may have recourse to the “principles of international law” only after having inquired into and established the

⁵² Award, 29 August 1977, 1 ICSID Reports 287.

⁵³ Award, 21 October 1983, 2 ICSID Reports 63.

*content of the law of the State party to the dispute (which cannot be reduced to one principle, even a basic one) and after having applied the relevant rules of the State's law. Article 42(1) therefore clearly does not allow the arbitrator to base his decision solely on the "rules" or "principles of international law"*⁵⁴

Subsequent awards also applied the formula of the supplemental and corrective function of international law.

For instance, the second Tribunal in the Resubmitted Case of *Amco v. Indonesia* observed that Indonesia had advanced legal arguments on each of the issues under, first, the heading of Indonesian law and, second, the heading of international law. Nevertheless, counsel for Indonesia had explained that international law was only relevant if there was a lacuna in the law of the host State, or if the law of the host State was incompatible with international law, in which case the latter would prevail. Amco submitted no contrary arguments. The Tribunal said:

*40. This Tribunal notes that Article 42(1) refers to the application of host-state law and international law. If there are no relevant host-state laws on a particular matter, a search must be made for the relevant international laws. And, where there are applicable host-state laws, they must be checked against international laws, which will prevail in case of conflict. Thus international law is fully applicable and to classify its role as "only" "supplemental and corrective" seems a distinction without a difference. In any event, the Tribunal believes that its task is to test every claim of law in this case first against Indonesian law, and then against international law.*⁵⁵

Superiority of international law

The hierarchy of the sources of law in the context of the second sentence of Article 42 (1) was highlighted in the annulment decision in *Wena Hotels v. Egypt*⁵⁶. The *Ad hoc* Committee sustained the prevalence of the host State's treaties over domestic rules of law and, therefore, held:

41. In particular, the rules of international law that directly or indirectly relate to the State's consent prevail over domestic rules that might be incompatible with them. In this context it cannot be concluded that the resort to the rules of international law under the Convention, or under particular treaties related to its operation, is antagonistic to that State's national interest.

The need for ICSID awards to conform with international law also follows from other provisions of the Convention. Art. 54 provides for the enforcement

⁵⁴ *Decision on Annulment, 3 May 1985, 2 ICSID Reports 122. Italics original. The original decision was rendered in French. The reference to «principles of international law» rather than «rules of international law» is explained by a discrepancy between the French and English texts of Article 42(1).*

⁵⁵ *Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 580.*

⁵⁶ *(ICSID Case No. ARB/98/4) Decision on annulment dispatched to the parties on February 5, 2002, unpublished, p. 15.*

of awards in the territory of every Party to the Convention. Art. 27 precludes the exercise of diplomatic protection in respect of claims submitted to ICSID's jurisdiction. Both provisions presuppose that an award would be in compliance with international law.

This line of reasoning was adopted by the *Ad hoc* Committee in *Amco v. Indonesia* which found that the application of international law and its precedence over domestic law was

... suggested by an overall evaluation of the system established by the Convention. The law of the host State is, in principle, the law to be applied in resolving the dispute. At the same time, applicable norms of international law must be complied with since every ICSID award has to be recognized, and pecuniary obligations imposed by such award enforced, by every Contracting State of the Convention (Article 54(1), Convention). Moreover, the national State of the investor is precluded from exercising its normal right of diplomatic protection during the pendency of the ICSID proceedings and even after such proceedings, in respect of a Contracting State which complies with the ICSID award (Article 27, Convention). The thrust of Article 54(1) and of Article 27 of the Convention makes sense only under the supposition that the award involved is not violative of applicable principles and rules of international law.⁵⁷

Summary:

- **An ICSID tribunal applying the second sentence of Article 42(1) may not restrict itself to applying either the host State's law or international law but must examine the legal questions at issue under both systems. In case of conflict, international law prevails.**
- **An ICSID tribunal may not render a decision on the basis of the host State's domestic law which is in violation of a mandatory rule of international law.**
- **An ICSID tribunal may give a decision based on the host State's domestic law, even if it finds no positive support in international law as long as it is not prohibited by any rule of international law.**
- **A claim which cannot be sustained on the basis of the host State's domestic law must be upheld if it has an independent basis in international law.**

⁵⁷ *Decision on Annulment, 16 May 1986, 1 ICSID Reports 515.*

8. PROHIBITION OF *Non liquet*

Prohibition of non liquet

Article 42(2) establishes:

The Tribunal may not bring in a finding of non liquet on the ground of silence or obscurity of the law.

This provision directs that a tribunal may not refuse to render a decision on the ground that the law is not clear. It also prohibits an award that decides certain questions only⁵⁸.

The prohibition of *non liquet* is generally accepted in international adjudication. Similar provisions are adopted by domestic legal systems in order to prevent a denial of justice.

Article 42(2) should be read together with Article 48(3) which states that the award shall deal with every question submitted to the tribunal.

Agreement on applicable law. Closing gaps.

The prohibition to refuse to render a decision applies irrespective of the type of choice of law under the first or second sentence of Article 42(1).

If the parties have agreed on the applicable law, the tribunal must, first, exhaust the possibilities for closing any lacunae within the selected rules of law. The choice of a particular system of law includes whatever gap-filling mechanism the law may establish.

If the chosen law provides no answer to the legal question, the tribunal will resort to the residual rule of Article 42(1), second sentence.

The combination of the host State's law and international law offers such a wide field of authority that a real *non liquet* situation is almost unconceivable.⁵⁹

Perceived gaps in the host State's law may be closed by applying international law's supplementary function.

Techniques for filling gaps

As gap-filling techniques, the tribunal may apply analogy and general principles of law. In addition, judicial decisions, academic writings and codes of conduct may assist the tribunal in the task of closing gaps.

Difference between filling gaps and applying equity

The function of filling *lacunae* is different from the application of equity under Article 42(3). Decisions *ex aequo et bono* require the specific consent of the parties. Failure to apply positive law may constitute an excess of powers and lead to annulment under Article 52(1)(b).

⁵⁸ Schreuer, *Commentary*, p. 632.

⁵⁹ Schreuer, *Commentary*, p. 632

Summary:

- **An ICSID tribunal may not bring a finding of *non liquet*, either by refusing to render an award at all or by avoiding to decide specific questions submitted to the consideration of the tribunal.**
- **In case of an agreement on applicable law, the tribunal must first rely on the selected rules of law. If these yield no answer it must turn to the residual rule of Article 42(1) second sentence and any appropriate technique for the filling of gaps.**
- **The function of filling lacunae differs from the one of applying equity under Article 42(3).**

9. DECIDING *ex aequo et bono*

General meaning

Article 42(3) of the Convention provides:

(3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute ex aequo et bono if the parties so agree.

Therefore, a tribunal, if it is so authorized by the parties, may base its award on extra-legal considerations which it regards as equitable.

In other words, it may disregard the rules of law otherwise applicable under Article 42(1) in favour of justice and fairness.

An agreement to authorize the tribunal to decide *ex aequo et bono* may be particularly appropriate in the case of a complex long-term relationship. As an investment evolves, new circumstances may appear which were not taken into account originally. Thus, a decision based on equity rather than on law may provide a fair solution that takes account of changed circumstances.

Need of an explicit agreement

The power of the tribunal to decide *ex aequo et bono* requires an agreement by the parties. Such an agreement must be explicit.

Partial authorization

The authorization given to the tribunal by the parties to decide *ex aequo et bono* may be general or limited to certain issues only. Matters excluded from the authorization must be decided in accordance with rules of law.

Supervening agreement

While an agreement on decision *ex aequo et bono* will normally be made in advance of the proceedings, this need not be the case. The parties may also agree on decision *ex aequo et bono* in the course of the proceedings.

In *Benvenuti & Bonfant v. Congo*, there was no agreed choice of law and the residual rule of Article 42(1) applied. At the Tribunal's first session, the Claimant suggested that the Tribunal be granted the power to decide *ex aequo et bono*. Although, this initial suggestion was rejected by the Respondent,⁶⁰ later on during the proceedings, the parties reached an agreement to attempt an amicable settlement failing which they authorized the Tribunal "to render its award as quickly as possible by judgment *ex aequo et bono*."⁶¹ After being notified of the failure to settle through negotiations, the Tribunal applied Article 42(3).⁶²

Decision based on equity without parties' consent

An explicit agreement under the terms of Article 42(3) is an absolute prerequisite for a decision based on equity rather than on law. An award deciding

⁶⁰ Award, 15 August 1980, 1 ICSID Reports 338.

⁶¹ At p. 342.

⁶² At p. 349.

ex aequo et bono without the parties' authorization is subject to annulment for excess of powers.

Application of equity and law

The power provided to a tribunal to decide *ex aequo et bono* does not prevent the tribunal from applying rules of law.

Therefore, the tribunal has discretion not just with regard to the selection of the applicable principles of equity, but also to apply rules of law after all.

In *Benvenuti & Bonfant v. Congo*, the Tribunal was authorized by the parties to decide *ex aequo et bono*. This did not preclude the Tribunal from looking at rules of law⁶³. Therefore, it held that compensation in case of nationalization was required by the host State's law, by international law as well as by equity. It determined the quantum of damages *ex aequo et bono*⁶⁴.

Equity within the law

Not every mention of equitable principles constitutes a decision *ex aequo et bono*. A tribunal may exercise some discretion in applying the law on the basis of justice and fairness. In other words, a decision *ex aequo et bono* must be distinguished from equity within the law.

As the *Ad hoc* Committee acting in *Amco v. Indonesia* stated:

*(not) any mention of "equitable consideration" in the Award necessarily amounts to a decision ex aequo et bono and a manifest excess of power on the part of the Tribunal. Equitable considerations may indeed form part of the law to be applied by the Tribunal, whether that be the law of Indonesia or international law... The Ad hoc Committee thus believes that invocation of equitable considerations is not properly regarded as automatically equivalent to a decision ex aequo et bono . . .*⁶⁵.

Limits on equity

Although the tribunal is empowered by the parties with much discretion to select and apply equitable principles, this discretion is not unlimited. The tribunal may not act arbitrarily. Its decision should be based on objective and rational considerations that must be stated.

The obligation imposed by Article 48(3) that the tribunal must state the reasons underlying an award, extends to decisions *ex aequo et bono*. Failure to state any reasons for a decision *ex aequo et bono* may expose the award to annulment under Article 52(1)(e).

In addition, certain principles of international law which may be summarized as international public policy and *ius cogens* constitute an outer margin for the tribunal's discretion. Even *ex aequo et bono* awards must not violate

⁶³ *Award*, 15 August 1980, 1 ICSID Reports 350.

⁶⁴ *At p.* 357.

⁶⁵ *Decision on Annulment*, 16 May 1986, 1 ICSID Reports 516/7.

international public policy principles like the prohibition of slavery or other relevant rules on human rights.

The domestic law of some States does not allow arbitration *ex aequo et bono*. But arbitration under the Convention is truly international and free of any interference of national rules.

Summary:

- **The power of the tribunal to decide *ex aequo et bono* is subject to an explicit agreement by the parties.**
- **The parties' agreement can be made in advance of the proceedings or during them.**
- **The power to decide *ex aequo et bono* does not prevent the tribunal from applying rules of law.**
- **The obligation to state the reasons underlying an award extends to decisions *ex aequo et bono*. Absence of such reasons exposes the award to annulment.**

10. THE RISK OF ANNULMENT

Article 52(1)

Article 52(1) of the ICSID Convention provides:

Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds: [...] (b) that the Tribunal has manifestly exceeded its powers;

Failure to apply the proper law as an excess of power

Ad hoc Committees have determined that the failure to apply the proper law may constitute an excess of powers and a ground for annulment. Therefore, a negligent application of Article 42 can lead to a decision of nullity.

Distinction between non application and mistaken application of the proper law

In *Klöckner v. Cameroon*, the *Ad hoc* Committee made the distinction between a failure to apply the proper law and a mere error *in iudicando*. It found that the Tribunal, after having identified the applicable law correctly, had not, in fact, applied it but had based its decision on a broad equitable principle without establishing its existence in positive law. No attempt had been made to show that Cameroonian law, based on French law, contained a “duty of full disclosure to a partner” in a contract. In the *Ad hoc* Committee's opinion, the Award's reasoning seemed very much like a reference to equity. Therefore, the Tribunal had not applied the law of the Contracting State but had acted outside the framework of Article 42(1) and had thus manifestly exceeded its powers.⁶⁶

Summary:

- **Article 52(1) allows either party to request annulment of the award if the tribunal has manifestly exceeded its powers.**
- **A failure to apply the proper substantive law may constitute a manifest excess of powers and end in the award's annulment.**

⁶⁶ *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 124 et seq.

TEST MY UNDERSTANDING

After having studied this Module the reader you should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. What is the relation between autonomy of the parties and applicable law under the ICSID Convention?
2. In what ways can the parties express their agreement to choose a system of law?
3. How must the tribunal select the proper law in the case of absence of agreement?
4. What is the main effect of a stabilization clause?
5. What is the role of international law if the parties have chosen a domestic legal system?
6. What do the terms “such rules of international law as may be applicable” mean in the context of Article 42 of the Convention?
7. Is there any hierarchy between international law and domestic law?
8. Does the ICSID Convention allow a finding of *non liquet*?
9. How should the tribunal deal with a silence or obscurity of the law?
10. Under what circumstances may the tribunal decide *ex aequo et bono*?
11. What is the remedy under the ICSID Convention if the tribunal has failed to apply the proper law?

HYPOTHETICAL CASES

Amplax Corp. v. Republic of Mollovia

In July 1998, Amplax Corp., a company established under the law of the Republic of Somavek entered into an investment agreement with the Republic of Mollovia. Mollovia and Somavek are both parties to the ICSID Convention. The agreement between Amplax Corp. and Mollovia provides for ICSID arbitration in case of a dispute. It also contains an agreement on the law of the Republic of Mollovia as applicable law. The law of the Republic of Mollovia recognizes the right to expropriate without any compensation. In March 2001, the Republic of Mollovia expropriated Amplax's investment, based on its domestic law. In December 2001, Amplax Corp. instituted ICSID proceedings. There is a BIT between the two States that entered into force in November 1996 which provides for adequate, prompt and effective compensation in case of an expropriation.

Amplax argues that expropriation without compensation is a violation of international law. The Republic of Mollovia bases its defence on the express provision of its domestic legislation and points out that Amplax Corp. agreed to the application of this legislation when the investment agreement was signed.

You are an arbitrator deciding on this matter. Please provide a reasoned decision.

Ramslow Inc. v. Gerkland

In May 1996 Ramslow Inc., a company established under the law of Zaindland, started investing in the State of Gerkland. The investment is governed by an agreement of the same year between Gerkland and Ramslow Inc. providing for dispute settlement under the ICSID Convention. Both Zaindland and Gerkland are parties to the ICSID Convention. The agreement of 1996 also contains a clause on applicable law. This clause provides: "the parties choose exclusively the commercial law of Gerkland to settle any dispute that could arise between them, excluding the application of any provision of international law".

In May 2000, a complex conflict involving administrative, tax and labour aspects, broke out between the Company and the State.

In December 2000, Ramslow Inc. instituted arbitration proceedings before ICSID.

What is the law applicable to the dispute?

Ramslow Inc. alleges that (i) the applicable law clause only covers commercial disputes. Therefore, in accordance with Article 42 of the ICSID Convention, the dispute should be settled under the host State's law as well as international law, and (ii) the waiver to apply international law should be interpreted restrictively, only covering commercial matters.

On the other hand, Gerkland argues that:

- (i) the parties agreed on Gerkland's commercial law to solve any dispute, (ii) the word “exclusively” in the applicable law clause evidences the intention of the parties in choosing Gerkland's domestic law as a whole for all types of disputes, and
- (iii) at all events, the application of international law was expressly excluded by the parties.

Please, try to develop the arguments for either party. Then, try to anticipate the decision of the Tribunal.

FURTHER READING

Books

- **Schreuer, C.**, *The ICSID Convention: A Commentary*, (2001).

Articles

- **Broches, A.**, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 136 *Recueil des Cours* 331 at 381-395 (1972-II).
- **Broches, A.**, *Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965, Explanatory Notes and Survey of its Application*, 18 *Yearbook of Commercial Arbitration* 627 (1993).
- **Cherian, J.**, *Investment Contracts and Arbitration, The World Bank Convention on the Settlement of Investment Disputes* 74 (1975).
- **Curtis, C. I.**, *The Legal Security of Economic Development Agreements*, 29 *Harvard International Law Journal* 317 (1988).
- **Feuerle, P.**, *International Arbitration and Choice of Law under Article 42 of the Convention on the Settlement of Investment Disputes*, 4 *Yale Studies in World Public Order* 89 (1977).
- **Firth, Th. V.**, *The Law Governing Contracts in Arbitration under the World Bank Convention*, 1 *New York University Journal of International Law and Politics* 253 (1968).
- **Kahn, P.**, *The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes*, 44 *Indiana Law Journal* 1 (1968).
- **Lauterpacht, E.**, *The World Bank Convention on the Settlement of International Investment Disputes*, in *Recueil d'études de droit international en hommage à Paul Guggenheim* 642 at 652-662 (1968).
- **Masood, A.**, *Law Applicable in Arbitration of Investment Disputes under the World Bank Convention*, 15 *Journal of the Indian Law Institute* 311 (1973).
- **Schreuer, C.**, *Decisions Ex aequo et bono Under the ICSID Convention*, 11 *ICSID Review-Foreign Investment Law Journal* 37 (1996).
- **Shihata, I. F. I./Parra, A. R.**, *Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention*, 9 *ICSID Review-Foreign Investment Law Journal* 183 (1994).

Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- List of Contracting States and other Signatories of the Convention:
<http://www.worldbank.org/icsid/constate/c-states-en.htm>
- Contracting States and Measures Taken by them for the Purpose of the Convention:
<http://www.worldbank.org/icsid/pubs/icsid-8/main-eng.htm>
- Bilateral Investment Treaties, 1959-1996, Chronological and Country Data:
<http://www.worldbank.org/icsid/treaties/treaties.htm>
- ICSID Model Clauses :
<http://www.worldbank.org/icsid/model-clauses-en/main.htm>
- ICSID Cases:
<http://www.worldbank.org/icsid/cases/cases.htm>

Cases

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- *Adriano Gardella v. Côte d'Ivoire*, Award, 29 August 1977, 1 ICSID Reports 283.
- *AGIP v. Congo*, Award, 30 November 1979, 1 ICSID Reports 306.
- *Amco v. Indonesia*, Award, 20 November 1984, 1 ICSID Reports 413.
- Decision on Annulment, 16 May 1986, 1 ICSID Reports 509.
- Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 569.
- *Atlantic Triton v. Guinea*, Award, 21 April 1986, 3 ICSID Reports 17.
- *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, 1 ICSID Reports 335.
- *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, 14 ICSID Review-Foreign Investment Law Journal 251 (1999).
- *Kaiser Bauxite v. Jamaica*, Decision on Jurisdiction, 6 July 1975, 1 ICSID Reports 298.
- *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 9.
- Decision on Annulment, 3 May 1985, 2 ICSID Reports 95.
- *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 346.
- *Mobil Oil v. New Zealand, Attorney-General v. Mobil Oil NZ Ltd.*, New Zealand, High Court, 1 July 1987, 4 ICSID Reports 119.
- *SOABI v. Senegal*, Award, 25 February 1988, 2 ICSID Reports 190.
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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.7 PROCEDURAL ISSUES



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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OVERVIEW

This Module deals with the most common procedural issues encountered in arbitration proceedings under the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the Convention).

The procedural issues encountered in an ICSID arbitration are likely to be similar to issues encountered in other forms of arbitration. However, the ICSID system is unique in retaining its autonomy and independence from the application of national systems of law or the interference of national courts. As a result, the Convention and its related instruments provide a specific and comprehensive procedural regime for the conduct of ICSID arbitrations, which must be adhered to by the parties to an arbitration.

Arbitration is a consensual process, whereby the parties retain extensive freedom or autonomy to determine the rules of procedure that should govern the arbitration. Proceedings under the Convention are no different, as the parties retain extensive autonomy in this respect. This autonomy is limited, however, by the mandatory provisions of the Convention which provide a framework that governs the arbitral procedure.

In addition, the Administrative Council of ICSID has adopted Administrative and Financial Regulations and Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (Institution Rules). These rules and regulations contain further mandatory provisions that limit the autonomy of the parties.

The majority of the cases that are being brought before ICSID today are cases arising out of international treaties. These tend to take two forms, either bilateral investment treaties entered into between States concerning the promotion and protection of foreign investment (BITs) or multilateral agreements, such as the North American Free Trade Agreement (NAFTA) or the Energy Charter Treaty that contain dispute resolution clauses in favour of ICSID arbitration. Many of these treaties contain mandatory provisions that the parties must abide by in the initiation and conduct of arbitration proceedings.

OBJECTIVES

Upon completion of this Module the reader should be able to:

- Describe the initiation of ICSID arbitration.
- Explain the process of constituting the tribunal.
- Define the significance of the Arbitration Rules.
- Summarize the rules governing the place and the costs of proceedings.
- Discuss the procedure before the tribunal.
- Analyse the consequences of non-cooperation by a party.
- Delineate the role of provisional measures in ICSID arbitration.
- Recount the elements that must be contained in awards.

INTRODUCTION

The basic framework of the arbitration procedure under the Convention¹ is set out in Chapter IV, which contains Articles 36 to 55. The topics covered range from the institution of proceedings to the recognition and enforcement of the resulting awards. In addition, Articles 56 to 63 deal with the replacement and disqualification of arbitrators, the cost of the proceedings and the place of the proceedings.

Arbitration Rules

The Convention contains a large number of procedural rules, some of which go into considerable detail. The Rules of Procedure for Arbitration Proceedings (Arbitration Rules) adopted by the Administrative Council pursuant to Article 6(1) of the Convention provide even more depth and detail. The current set of Rules was adopted by the Administrative Council on September 26, 1984 and took effect immediately.²

Article 44 of the Convention

The Convention's key procedural provision in respect of arbitration proceedings is contained in Article 44:

Any arbitration proceeding shall be conducted in accordance with the provisions of this Section and, except as the parties otherwise agree, in accordance with the Arbitration Rules in effect on the date on which the parties consented to arbitration. If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question.

Autonomy of the parties

In principle, the parties to an ICSID arbitration can depart from the provisions of the Arbitration Rules. Furthermore, several of the articles in Chapters IV to VII of the Convention proclaim the freedom of the parties to agree on the matter at hand or on alternatives to the provision in question. Unlike the Arbitration Rules, the Institution Rules³ and the Centre's Administrative and Financial Regulations⁴ are not subject to modification by the parties. The parties may derogate from the latter, only when expressly permitted to do so.

Hierarchy of procedural rules

Although the parties do retain considerable discretion in specific respects to tailor their arbitration procedure, they are nevertheless bound by the mandatory provisions of the Convention and related instruments, which form the apex of a hierarchy of procedural rules. This interrelationship of the various procedural rules has been described as follows:

- 1 • Mandatory provisions of the Convention.
- 2 • The Administrative and Financial Regulations and the Institution Rules (except to the extent that variation is permitted by their

¹ *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, March 18, 1965, in force October 14, 1996; 575 UNTS 159; 4 ILM 532 (1965); 1 ICSID Reports 3.

² *Rules of Procedure for Arbitration Proceedings (Arbitration Rules)*, 1984, 1 ICSID Reports 157.

³ *Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings*, 1984, 1 ICSID Reports 153.

⁴ *Administrative and Financial Regulations*, 1 ICSID Reports 35.

- own terms).
- 3 • Procedures agreed to by the parties.
 - 4 • Provisions of the Convention that are open to modification by the parties.
 - 5 • The Arbitration Rules.
 - 6 • Decisions of the tribunal on procedural matters.⁵

***The ICSID Additional
Facility***

Non-Contracting States or their nationals may become parties to proceedings under the ICSID Additional Facility (see Module 2.2, Section 6). Disputes administered by the Centre in such cases are subject to the Additional Facility Arbitration Rules. This Module is solely concerned with disputes that fully satisfy the Convention's jurisdictional requirements and will not deal with disputes under the Additional Facility.

⁵ C. Schreuer, *The ICSID Convention: A Commentary*, Article 44, para. 55, p. 685 (2001).

1. INITIATION OF ARBITRATION PROCEEDINGS

a) Commencing the Arbitration

Request for arbitration

A claimant wishing to commence an ICSID arbitration must address its request for arbitration (the request) to the ICSID Secretary-General. Article 36(1) of the Convention provides:

Any Contracting State or any national of a Contracting State wishing to institute arbitration proceedings shall address a request to that effect in writing to the Secretary-General who shall send a copy of the request to the other party.

The request may come from either the host State or the investor, although the request is far more likely to be filed by the investor. The investor does not require the prior permission of its national State to institute proceedings. The request may also be filed jointly by both parties, as expressly foreseen in Institution Rule 1.

The provisions of Article 36(1) of the Convention are elaborated further in the Institution Rules. Thus, Institution Rule 1 provides that the request must be made in writing, indicate that it relates to an arbitration (or conciliation), be dated and signed and drawn up in an official language of the Centre.

Languages and number of copies

The three official languages of the Centre are English, French and Spanish (Administrative and Financial Regulation 34). Institution Rule 4 specifies the number of signed copies of the request that need to be served on the Centre (an original, plus five copies).

Lodging fee

The request should be accompanied by the appropriate lodging fee in accordance with Administrative and Financial Regulation 16. The fee is non-refundable in the event of withdrawal or refusal of the request by the Secretary-General. As of January 1, 2002, the fee was US\$5000.⁶ In accordance with Institution Rule 5, non-payment of the lodging fee will prevent the Secretary-General from proceeding with the arbitration, apart from acknowledging receipt of the request.

Information required

Article 36(2) of the Convention specifies the information to be included in the request:

The request shall contain information concerning the issues in dispute, the identity of the parties and their consent to arbitration in accordance with the rules of procedure for the institution of conciliation and arbitration proceedings.

The requirements of Article 36(2) of the Convention are further amplified in Institution Rule 2. The information to be furnished must satisfy the jurisdictional

⁶ See the Schedule of Fees, dated January 1, 2002, available on the ICSID website.

requirements of the Centre, both *ratione materiae* and *ratione personae*. In addition, information must be provided in respect of the parties' consent to arbitration.

**Rule 2 of the
Institution Rules**

The information specified in Institution Rule 2 must be provided and cannot be waived by the parties. Failure to furnish the necessary information may prevent the Secretary-General from being able to register the request under Article 36(3) of the Convention, as discussed below. The following information must be provided under Institution Rule 2.

Designation of parties

The request must identify precisely each party to the dispute and include their address (Rule 2(1)(a)). In the event that one of the parties is a constituent subdivision or agency of a Contracting State that has been designated to the Centre by that State pursuant to Article 25(1) of the Convention, the claimant must provide evidence to this effect together with the request (Rule 2(1)(b)).

Consent

The request must indicate the date of consent (Rule 2(1)(c)) and provide evidence of the instruments in which consent is recorded (Rule 2(2)), including details of consent in respect of any constituent subdivisions or agencies, if appropriate.

Nationality

Details must also be provided with respect to the nationality of the investor demonstrating that it is a national of a Contracting State (Rule 2(1)(d)). In the event that the investor is a juridical person incorporated in the Contracting State that is party to the dispute, the request must include details of any agreement of the parties that the investor should be treated as a national of another Contracting State in accordance with Article 25(2)(b) of the Convention.

Issues in dispute

Finally, the request must contain information on the issues in dispute to show that there is a legal dispute between the parties in connection with an investment (Rule 2(1)(e)).

Additional information

In addition to the mandatory requirements of Institution Rule 2, Rule 3 provides that the request may contain additional information, regarding, in particular, any agreement between the parties concerning the number of arbitrators and the method of their appointment. Other procedural agreements, concerning, for example, the language of the proceedings or the place of proceedings may also be included.

Summary of case

As the request is also the first document that is likely to be read by the parties, it is useful for the claimant to provide a summary account of its case on the merits, explaining the various grounds that it is relying upon in bringing its claim.⁷

BITs

Although the ICSID Convention does not provide a time limit within which a

⁷ J. Townsend, *The Initiation of Arbitration Proceedings: «My Story Had Been Longer»*, 13 ICSID Review – FILJ 21 (1998), at p. 24.

request must be made, such limits may exist in relation to the parties' arbitration agreement. As discussed above, the majority of cases before ICISID today arise out of BITs entered into between States for the promotion and protection of foreign investment.⁸ Many of the BITs do however make certain time limits a condition of consent. Typically, they require that six months must have elapsed since the events giving rise to a claim or since the investor gave notice of a potential dispute between the parties. The purpose of these requirements is to prevent investors from instituting proceedings against a host State in what is likely to be a high profile dispute, without allowing the State an opportunity to resolve the dispute amicably. In addition, the requirement of a notice period means that the host State will not be surprised when it receives a copy of the investor's request from ICSID.

NAFTA

Proceedings commenced pursuant to Chapter XI of NAFTA also provide for a notice period of six months.⁹ Moreover, under the provisions of NAFTA, a claim may only be allowed within three years from the date on which the investor acquired knowledge of the relevant facts.¹⁰

b) Registration of the Request by the Secretary-General

Screening of requests

Once the request has been received by the Centre, the Secretary-General must screen the request prior to its registration, in accordance with Article 36(3) of the Convention:

The Secretary-General shall register the request unless he finds, on the basis of the information contained in the request, that the dispute is manifestly outside the jurisdiction of the Centre. He shall forthwith notify the parties of registration or refusal to register.

The powers of the Secretary-General are amplified in Institution Rule 6. The screening power enjoyed by the Secretary-General is designed to avoid the filing of spurious or incomplete requests or situations where a tribunal, once established, would almost certainly find itself without jurisdiction.

The power enjoyed by the Secretary-General in this respect is similar to the power enjoyed by the International Court of Arbitration of the International Chamber of Commerce to satisfy itself that *prima facie* an ICC arbitration agreement exists between the parties.

The decision of the Secretary-General is made primarily on the basis of the information contained in the request, and the Secretary-General must assume that the information supplied in the request is correct. In the event that the request is incomplete or inadequate, the Centre is likely to contact the requesting party in order to supplement the request.

⁸ As of December 2000, three quarters of the active cases before the Centre were based on BITs or multilateral agreements. E. Obadia, *Current Issues in Investment Disputes*, *The Journal of World Investment*, Vol. 2, No. 1, p. 219.

⁹ Article 1120(1), 32 ILM 643 (1993).

¹⁰ Articles 1116(2) and 1117(2).

Pre-filing of requests

Advance consultation with the Centre or the filing of a draft request prior to the formal lodging of the request is possible and is beneficial to the claimant in avoiding the cost and delay involved in having its request rejected.¹¹

Refusal to register

The Secretary-General will only refuse to register the request if it is manifestly outside the jurisdiction of ICSID. Examples would include instances where one party is neither a Contracting State or a national of a Contracting State, or in the event that no evidence was furnished of written consent to the Centre's jurisdiction.¹² Thus, by providing the information required under Institution Rule 2 and paying the lodging fee, the claimant can be assured that its request will be lodged.

Notice of registration

Once a request has been registered, the Secretary-General notifies the parties of the registration on the same day (Institution Rule 6(1)(a)). The notice of registration must contain certain information as set out in Institution Rule 7, including, *inter alia*, the date of registration, the appropriate address for communication between the parties and an invitation to the parties to provide details of any agreed provisions regarding the number and method of appointment of arbitrators.

Withdrawal of requests

A request cannot be unilaterally withdrawn once it has been registered (Institution Rule 8). Thereafter, the proceedings may be discontinued at a party's request, only with the other party's agreement under Arbitration Rule 44. Alternatively, the parties may jointly seek the discontinuance of the proceedings following a settlement, pursuant to Arbitration Rule 43.

Summary:

- **ICSID arbitrations are commenced by means of a request for arbitration sent to the Secretary-General.**
- **A request must contain the information specified in Article 36(2) of the Convention and Rule 2 of the Institution Rules.**
- **A claimant must observe the procedural requirements contained in the parties' arbitration agreement or document containing consent.**
- **The Secretary-General will refuse to register the request if he finds that the dispute is manifestly outside the jurisdiction of the Centre.**
- **Once registered, the Secretary-General will notify the parties of the registration on the same day.**

¹¹ C. Brower, *The Initiation of Arbitration Proceedings: «Jack be Nimble, Jack be Quick...!», 13 ICSID Review – FILJ 15 (1998).*

¹² Note C. to Institution Rule 6 of 1968, 1 ICSID Reports 58.

2. THE ARBITRAL TRIBUNAL

Parties' freedom of choice

Articles 37 to 40 of the Convention deal with the constitution of tribunals under the ICSID system.

Once the request for arbitration has been registered, Article 37(1) of the Convention provides that the tribunal is to be constituted as soon as possible thereafter. As discussed in the preceding section, if the parties have reached an agreement concerning the number of arbitrators and the method of their appointment, such information may be included in the request.

a) Constituting the Arbitral Tribunal

An uneven number of arbitrators

Article 37(2)(a) of the Convention has mandatory effect and cannot be deviated from by agreement of the parties. It provides that the tribunal must consist of a sole arbitrator or any uneven number of arbitrators to which the parties agree. Although the Convention foresees the possible appointment of a sole arbitrator or an uneven number greater than three, in practice, the vast majority of ICSID tribunals have been constituted with three arbitrators.

Rule 2 procedure

Arbitration Rule 2 provides a specific procedure to be followed by the parties to facilitate an agreement on the constitution of the tribunal:

- (1) *If the parties, at the time of the registration of the request for arbitration, have not agreed upon the number of arbitrators and the method of their appointment, they shall, unless they agree otherwise, follow the following procedure:*
 - (a) *the requesting party shall, within 10 days after the registration of the request, propose to the other party the appointment of a sole arbitrator or of a specified uneven number of arbitrators and specify the method proposed for their appointment;*
 - (b) *within 20 days after receipt of the proposals made by the requesting party, the other party shall:*
 - (i) *accept such proposals; or*
 - (ii) *make other proposals regarding the number of arbitrators and the method of their appointment;*
 - (c) *within 20 days after receipt of the reply containing any such other proposals, the requesting party shall notify the other party whether it accepts or rejects such proposals.*
- (2) *The communications provided for in paragraph (1) shall be made or promptly confirmed in writing and shall either be transmitted through the Secretary-General or directly between the parties with a copy to the Secretary-General. The parties shall promptly notify the Secretary-General of the contents of any agreement reached.*
- (3) *At any time 60 days after the registration of the request, if no agreement on another procedure is reached, either party may inform the Secretary General that it chooses the formula provided for in Article 37(2)(b) of the Convention. The Secretary-General shall thereupon promptly inform the other party that the Tribunal is to be constituted in accordance with that Article.*

Rule 2 is designed to make it possible to achieve an agreement between the parties and finalize the appointment of a tribunal within 90 days, before the procedure outlined in Article 38 of the Convention becomes available. Thus, whilst preserving the parties' freedom of choice in appointing the tribunal, Rule 2 limits the potential for procrastination.

Default procedure

If the parties have not reached an agreement in respect of the composition of the tribunal, either in the instrument containing consent or within 60 days after the registration of the request, the following default provisions of Article 37(2)(b) take effect:

Where the parties do not agree upon the number of arbitrators and the method of their appointment, the Tribunal shall consist of three arbitrators, one appointed by each party and the third, who shall be the president of the Tribunal, appointed by agreement of the parties.

In order to expedite the process further, Arbitration Rule 3 provides a procedure to be followed if the tribunal is to be constituted in accordance with Article 37(2)(b) of the Convention as follows:

- (1) *If the Tribunal is to be constituted in accordance with Article 37(2)(b) of the Convention:*
 - (a) *either party shall in a communication to the other party:*
 - (i) *name two persons, identifying one of them, who shall not have the same nationality as nor be a national of either party, as the arbitrator appointed by it, and the other as the arbitrator proposed to be the President of the Tribunal; and*
 - (ii) *invite the other party to concur in the appointment of the arbitrator proposed to be the President of the Tribunal and to appoint another arbitrator;*
 - (b) *promptly upon receipt of this communication the other party shall, in its reply:*
 - (i) *name a person as the arbitrator appointed by it, who shall not have the same nationality as nor be a national of either party; and*
 - (ii) *concur in the appointment of the arbitrator proposed to be the President of the Tribunal or name another person as the arbitrator proposed to be President;*
 - (c) *promptly upon receipt of the reply containing such a proposal, the initiating party shall notify the other party whether it concurs in the appointment of the arbitrator proposed by that party to be the President of the Tribunal.*
- (2) *The communications provided for in this Rule shall be made or promptly confirmed in writing and shall either be transmitted through the Secretary-General or directly between the parties with a copy to the Secretary-General.*

Rule 3 requires each party to nominate both its party appointed arbitrators and the president of the tribunal at the same time, thus expediting the constitution of the tribunal. The agreement of the parties is not required for the appointment of party appointed arbitrators. Only the appointment of the president is subject to the agreement of the parties. The parties retain the right

to modify or extend the procedure set out in Rule 3 by agreement. The parties' choice of arbitrators is unencumbered subject only to the limitations discussed further below. Thus, the parties are not required to appoint arbitrators from the Panel of arbitrators, as discussed further below.

Appointment of arbitrators

Once an arbitrator has been appointed by a party, it is incumbent on the parties to notify that appointment to the Secretary-General, who will seek acceptance from the individual concerned (Arbitration Rule 5). In the event that the person appointed fails to accept the appointment within 15 days (Arbitration Rule 5(3)), the party concerned will be given the opportunity to make another selection.

Constitution of the tribunal

In accordance with Arbitration Rule 6, the tribunal is deemed to be constituted and the proceedings to have begun on the date that all of the arbitrators have accepted their appointment.

Fallback procedure

Under Article 38 of the Convention, if the tribunal is not constituted within 90 days from the date of registration of the request, the Chairman of the Administrative Council¹³, at the request of either party, will appoint any arbitrators that the parties have failed to appoint. This provision provides a fallback procedure that may be triggered by either of the parties when faced with an uncooperative counter party.

As the constitution of the tribunal often takes more than 90 days, the parties may agree to extend this period. Even in the absence of an agreement between the parties, the Chairman of the Administrative Council will not intervene without being prompted by one of the parties.¹⁴

Although the request under Article 38 is made to the Chairman of the Administrative Council, it should be made through the Secretary-General in accordance with Administrative and Financial Regulation 24(1).

Consultation with the parties

Once a request has been made by one of the parties, the Chairman of the Administrative Council must consult both parties as far as possible. Although the Chairman of the Administrative Council is free to disregard the views or objections raised by the parties in appointing an arbitrator, in practice, their views are unlikely to be ignored, unless such objections are not reasonable. The obligation to consult extends to any arbitrators not yet appointed at the time the request is made.

The Chairman of the Administrative Council must perform his obligation to appoint within 30 days of receiving a request by the parties (Arbitration Rule 4(4)), although the requirement of 30 days may be extended by agreement of the parties. In appointing an arbitrator, the Chairman of the Administrative Council acts on the recommendation of the Secretary-General. The Chairman of the Administrative Council's choice of arbitrators is limited in two respects.

¹³ Under Article 5 of the Convention the President of the International Bank for Reconstruction and Development is ex officio Chairman of ICSID's Administrative Council.

¹⁴ See Rule 4 of the Arbitration Rules for further clarification in this respect.

First, under Article 38, the Chairman of the Administrative Council is prohibited from appointing arbitrators of the same nationality as the foreign investor or the host State.¹⁵

Second, in accordance with Article 40(1) of the Convention, the Chairman of the Administrative Council may only appoint arbitrators from the Panel of Arbitrators. This will be discussed in further detail below.

Limitation on the choice of the parties

Although the parties have broad freedom to designate the arbitrators of their choice, their freedom of choice is limited in three respects, as follows: (i) the nationality of the arbitrators is subject to Article 39 of the Convention; (ii) the arbitrator must possess the qualities set out in Article 14(1) of the Convention; and (iii) the appointed arbitrator must be independent of the parties. These limitations are discussed below.

Nationality of arbitrators

Article 39 of the Convention provides that the majority of the arbitrators shall be nationals of States other than the Contracting State party to the dispute and the Contracting State whose national is a party to the dispute. The practical effect of Article 39 is that where there are three arbitrators, the parties cannot appoint arbitrators of the same nationality as themselves. This would be possible, however, if there were five or more arbitrators.

In the rules of other arbitral institutions it is not usual to impose restrictions on the nationality of arbitrators appointed by the parties, in the context of investor/State arbitration. By contrast, the Convention aims to minimize the likelihood of party appointed arbitrators being predisposed in favour of the parties appointing them.

The prohibition against national arbitrators does not apply if each individual arbitrator has been chosen by agreement of the parties.

Qualities required of arbitrators

Pursuant to Article 40(2) read in conjunction with Article 14(1) of the Convention, arbitrators (and persons appointed to the Panel of arbitrators) must have the following qualities: high moral character; recognised competence in the field of law, commerce, industry or finance; reliability to exercise independent judgment. The list of qualities required of arbitrators is set out in Article 14(1) of the Convention.

Requirement of independence

In addition to the qualities set out in Article 14(1) of the Convention, potential arbitrators should also be independent of the parties. Thus, the existence of a possible conflict of interest in a particular case would be a bar to the appointment of an arbitrator. Although this is not expressly provided for in the Convention, Arbitration Rule 6 requires that each arbitrator sign a declaration before or at the first session of the tribunal providing details of all past and

¹⁵ This limitation on the choice of the Chairman of the Administrative Council only applies if the choice is being made in accordance with the provisions of Article 38 of the Convention. It therefore does not apply if the Chairman of the Administrative Council is acting as an appointing authority chosen by the parties in appointing an arbitrator.

present professional, business and other relationships with the parties.

The Panel of arbitrators

Articles 12 to 16 of the Convention establish a Panel of Arbitrators to be maintained by the Centre. The Panel is made up of arbitrators appointed by Contracting States (4 appointees by each State) and by the Chairman of the Administrative Council (10 appointees). The Panel of Arbitrators provides the parties with a list of arbitrators that they may select from, although their choice is not restricted to the Panel. The appointments made by the Chairman of the Administrative Council under the provisions of Article 38 of the Convention must be made from the Panel.

Summary:

- **Parties are free to designate the arbitrators of their choice when constituting the arbitral tribunal. When a tribunal is to be composed of three members, as is most commonly the case, each party is entitled to appoint an arbitrator.**
- **Failure to agree on the composition of the tribunal will trigger the default provision of Article 37(2)(b) of the Convention: three arbitrators, two appointed by the parties and the third by agreement.**
- **If the tribunal is not constituted within 90 days of the date of registration of the request, either party may request that the remaining arbitrators be appointed by the Chairman of the Administrative Council.**
- **In a tribunal composed of three arbitrators, the parties may not appoint their nationals or co-nationals as arbitrators, unless each arbitrator has been chosen by agreement.**
- **Arbitrators must have a high moral character, recognised competence in the field of law, commerce, industry and finance and be able to exercise independent judgment.**
- **A Panel of Arbitrators is maintained by the Centre. All appointments made by the Chairman of the Administrative Council must be made from the Panel. However, parties are not required to appoint arbitrators from the Panel.**

b) Replacement and Disqualification of Arbitrators

Vacancy on the tribunal

Article 56(1) of the Convention provides that once a tribunal has been constituted and the proceedings begun, the tribunal's composition shall remain unchanged. In the event that an arbitrator should die, become incapacitated or resign, the resulting vacancy will be filled in accordance with Articles 37 to 40 of the Convention, as discussed above.¹⁶

¹⁶ *In accordance with Rule 11(1) of the Arbitration Rules, a vacancy should be filled by the same method by which the original appointment had been made. This is subject to the condition that if the party or parties fail to make an appointment within 30 days, the appointment will be made by the Chairman of the Administrative Council (Rule 11(2) of the Arbitration Rules).*

The purpose of these provisions is to avoid undue delay and to provide for the swift appointment of an arbitrator in the event of a vacancy on the tribunal.¹⁷

Suspension of proceedings

Upon notification to the parties of a vacancy occurring in any of the circumstances described in Article 56(1), the Secretary-General is obliged to suspend the proceedings until the vacancy has been filled (Arbitration Rule 10).

Resignation

In the event of a resignation, Arbitration Rule 8(2) provides that the resigning arbitrator must submit his resignation to the other members of the tribunal. If the resigning arbitrator was appointed by one of the parties, the other members of the tribunal must consider the reasons for the resignation and whether to consent thereto.

Consent of the other arbitrators

Article 56(3) provides that, in the event of the resignation of a party appointed arbitrator without the consent of the other members of the tribunal, the resulting vacancy will be filled by the Chairman of the Administrative Council from the Panel of Arbitrators. This is an exception to the principle that vacancies should be filled by the same method used for the original appointment. Although the resignation of an arbitrator can thus, not be prevented, there is a sanction attached to a resignation of a party appointed arbitrator that is not accepted by the other arbitrators. The resulting vacancy will be filled by the Chairman of the Administrative Council, rather than the party who made the original appointment.

Procedure following new appointment

Once the vacancy has been filled, the proceedings shall continue from the point they had reached at the time the vacancy occurred. In the event that the oral procedure had already commenced, the new arbitrator has the discretion to request its recommencement (Arbitration Rule 12).

Disqualification

Articles 57 and 58 of the Convention deal with the grounds and process of disqualification of arbitrators. Article 57 provides that:

A party may propose to a Commission or Tribunal the disqualification of any of its members on account of any fact indicating a manifest lack of the qualities required by paragraph (1) of Article 14. A party to arbitration proceedings may, in addition, propose the disqualification of an arbitrator on the ground that he was ineligible for appointment to the Tribunal under Section 2 of Chapter IV.

Procedure for disqualification

The initiative for disqualification must come from a party. In accordance with Arbitration Rule 9, a party proposing disqualification must do so promptly, *i.e.*, as soon as the party has learnt of the grounds for possible disqualification and, in any event, before the close of the proceedings. A party that fails to object promptly to a violation of a relevant rule is deemed to have waived its

¹⁷ It is generally considered in international arbitration that a tribunal may not continue with the proceedings in a truncated form, *i.e.*, when it is not fully constituted. There has been considerable discussion of whether such truncated tribunals can legitimately continue to administer the arbitration. The Convention's provisions deal with such an eventuality by suspending the proceedings until the tribunal is fully reconstituted.

right to object, in accordance with Arbitration Rule 27.

Grounds for disqualification

Under the first sentence of Article 57 of the Convention, a party may propose the disqualification of an arbitrator on account of any fact indicating a manifest lack of the qualities required by Article 14(1) of the Convention in relation to members of the Panel. These were set out above. The requirement that the lack of qualities must be “manifest” implies a heavy burden of proof on the party proposing disqualification.

Conflicts of interest

In addition to the grounds under Article 14(1) of the Convention, an arbitrator would be subject to disqualification if it could be shown that the arbitrator had a conflict of interest.

A proposal for disqualification based on the alleged lack of independence of the arbitrator was presented by Indonesia against the arbitrator appointed by Amco in the case of *Amco v. Indonesia*.¹⁸ Indonesia’s proposal was based upon previous professional contacts between the arbitrator and Amco, which were not in dispute. Thus, such contacts included, previous tax advice given by the challenged arbitrator to the individual who controlled the claimant companies, as well as the fact that the arbitrator’s law firm and Amco’s counsel had had a joint office and profit sharing arrangements for many years, although the profit sharing had ended prior to the commencement of the arbitration. Indonesia’s proposal was rejected by the other arbitrators, who held that the mere appearance of partiality was not a sufficient ground for disqualification. The challenging party must prove not only facts indicating lack of independence, but also that the lack is “manifest” or “highly probable”, not just “possible” or “quasi-certain”. They concluded that the facts did not prove that the challenged arbitrator had a manifest lack of independence.¹⁹

Nationality conditions

The second sentence of Article 57 of the Convention provides for the possibility of disqualification where the nationality conditions of Section 2 of Chapter IV of the Convention have been breached. However, disqualification on this basis is highly unlikely, as any deviation from the nationality requirements of Article 39 of the Convention would usually be noted during the appointment process.

Proposal to disqualify

Article 58 sets out the procedure for dealing with a proposal to disqualify. Normally, the unchallenged members of the tribunal will decide upon the matter. In the event that the two (in the case of three arbitrators) unchallenged arbitrators disagree, the final decision will be made by the Chairman of the Administrative Council, who shall also make the decision in the event that a sole arbitrator is challenged. Further details in this respect are contained in Arbitration Rule 9.

¹⁸ *Amco v. Indonesia, Decision on Jurisdiction, September 25, 1983, 1 ICSID Reports 389.*

¹⁹ *W. M. Tupman, Challenge and Disqualification of Arbitrators in International Commercial Arbitration, 38 International and Comparative Law Quarterly 26, at p. 45 (1989).*

In the event that a proposal for disqualification is successful, the resulting vacancy is to be filled by the same method by which the original appointment had been made (Arbitration Rule 11).

Summary:

- **Upon notification of a vacancy in the tribunal, the proceedings are suspended by the Secretary-General.**
- **Normally, vacancies are filled by the same method as the original appointment.**
- **Resignation of a party-appointed arbitrator requires the consent of the other arbitrators. Without consent, the vacancy is filled by the Chairman of the Administrative Council.**
- **An arbitrator may also be disqualified for a manifest lack of the qualities required by Article 14(1) of the Convention, lack of independence or breach of the nationality requirements set forth in Article 39 of the Convention.**

3. CONDUCTING THE ARBITRATION

Section 3 of Chapter IV of the Convention (Articles 41 to 47), which is entitled “Powers and Functions of the Tribunal”, deals with the tribunal’s conduct of the arbitration.

a) The Rules of Procedure

Autonomous nature of ICSID arbitration

Unlike in other forms of administered arbitration, in an ICSID arbitration neither the parties nor the tribunal are constrained by the arbitration legislation of any national legal system. In particular, the mandatory requirements of the arbitration law at the seat of the arbitration do not apply; nor does the public policy of any national system of law. In this respect, the ICSID system is unique.

Article 44 of the Convention

The Convention contains a number of provisions that deal with the procedure to be followed by the tribunal. Article 44 is the primary provision with respect to the procedural rules of the arbitration. It provides that:

Any arbitration proceeding shall be conducted in accordance with the provisions of this Section and, except as the parties otherwise agree, in accordance with the Arbitration Rules in effect on the date on which the parties consented to arbitration. If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question.

Parties’ autonomy

Article 44 provides that the proceedings shall be governed primarily by the Convention and the Arbitration Rules, although the parties are free to exclude or modify those rules by agreement.

Arbitration Rules

Although the parties retain the freedom to shape the procedural rules governing the arbitration, the most likely scenario once proceedings have commenced is the adoption of the Arbitration Rules, either through express confirmation or by default in the absence of an agreement to the contrary. In this case, the Arbitration Rules in force at the time of consent become binding on the parties and on the tribunal.²⁰

Agreement of parties

It is also possible that, during the course of the arbitration, the parties are able to reach agreement on specific procedural points. The most common examples tend to be with respect to the place of proceedings or the time limits for the constitution of the tribunal.

Procedural lacunae

In the event of a *lacuna* in the rules of procedure provided by the Convention or the Arbitration Rules, the tribunal has the power to close such gaps in accordance with Article 44 of the Convention.

²⁰ *Liberian Eastern Timber Company (LETCO) v. The Government of the Republic of Liberia, Award, March 31, 1986, 2 ICSID Reports 343, at 357.*

Summary:

- **The ICSID system is unique in maintaining its autonomy from national systems of law.**
- **Article 44 of the Convention directs the parties to apply the Arbitration Rules, in the absence of an agreement to the contrary.**
- **In the event of a procedural *lacuna*, the tribunal has the power to close such gaps.**

b) The Tribunal's First Session

Preliminary procedural consultation

Pursuant to Arbitration Rule 19, the tribunal shall make the orders required for the conduct of the arbitration. This is normally done following a preliminary procedural consultation (or first session) with the parties. The tribunal's first session also presents the parties with an opportunity to agree on matters of procedure, as foreseen in Arbitration Rule 20.

Procedural issues

Procedural issues that may be addressed include: the number of arbitrators necessary for a *quorum*, the language of the proceedings, the number and sequence of pleadings, the time limits for pleadings and the apportionment of costs. As discussed above, as long as the Convention or the Administrative and Financial Regulations are not violated, the tribunal will apply any procedure agreed to by the parties.

Organization of the first session

The tribunal's first session should be held within sixty days of its constitution, or within any other time period agreed to by the parties. The tribunal will meet at the Centre, at a place arranged by the Centre or anywhere else agreed to by the parties in accordance with Article 63 of the Convention after consultation with the Secretary-General and approval by the tribunal (Arbitration Rule 13).

Deliberations of the tribunal

The deliberations of the tribunal take place in private and are kept secret. The president of the tribunal presides over deliberations, conducts hearings and sets the date and time of its sessions (Arbitration Rules 14 and 15).

Time limits

The tribunal establishes any necessary time limits for the various steps of the proceedings and may grant extensions to any time limits set (Arbitration Rule 26).

Summary:

- **Within 60 days of its constitution (unless otherwise agreed by the parties), the tribunal shall conduct its first session.**
- **The tribunal shall seek the views of the parties on questions of procedure and issue the orders required for conduct of the arbitration.**

c) The Written and Oral Procedure

Arbitration Rule 29 provides for two distinct phases of the proceedings: a written procedure followed by an oral one. This is subject to modification by the parties.

Written phase

Under Arbitration Rule 31, the pleadings required in the written phase include, in addition to the request for arbitration, the filing of a memorial by the requesting party to be followed by the filing of a counter-memorial by the other party. If the tribunal requests or the parties agree, they may also file additional memorials.

Information to be included in memorials

Arbitration Rule 31(3) requires that a memorial contain a statement of the relevant facts, a statement of law and the party's submissions. A counter-memorial, reply or rejoinder must contain a denial or admission of the statement of facts contained in the previous memorial, any additional facts, a response to the statement of law in the last pleading and the submissions of the party. In addition, the parties are expected to submit supporting documentation in support of their memorials (Arbitration Rule 33).

Pre-hearing conference

A pre-hearing conference is permitted under Arbitration Rule 21 and may be initiated by the Secretary-General, the president of the tribunal or the parties. The Secretary-General or the president of the tribunal may request the holding of a pre-hearing conference to arrange for an exchange of information between the parties, including, for example, the stipulation of uncontested facts in order to expedite the proceedings. In addition, the parties themselves may request such a pre-hearing conference, subject to the discretion of the president of the tribunal. Unlike the Secretary-General or the president of the tribunal, they may also request such a conference be held to consider the issues in dispute with a view to reaching an amicable settlement.

Oral hearing

In accordance with Arbitration Rule 29, the parties are entitled to an oral hearing. Hearings are private and therefore closed to the public. Arbitration Rule 32 provides that the tribunal shall, with the consent of the parties, decide which persons (other than the parties, their agents, counsel and advocates) attend the hearing. At the hearing, the parties may present witnesses of fact and experts. According to Rule 32(2), witnesses and experts may only attend the hearing during their testimony, unless the parties agree to allow them to attend the hearing in its entirety. During the hearing the tribunal may put questions to the parties, their agents, counsel and advocates, as well as witnesses and experts. In addition to the tribunal, the parties may examine the witnesses of fact and experts (Arbitration Rule 35).

Closure of proceedings

Arbitration Rule 38 provides for an order to be made by the tribunal closing the proceedings, once the presentation of the case by the parties is completed and the case has been fully submitted. Once the proceedings have been closed, the period fixed in Arbitration Rule 46 for the rendering of the tribunal's award begins to run (see below). The tribunal may reopen the proceedings if there is

new evidence or there is a vital need for clarification of specific points.

Summary:

- **Proceedings include a written and an oral phase, unless the parties agree otherwise.**
- **In the written phase, the parties present their case in memorials containing statements of fact and law, accompanied by supporting documentation.**
- **Subsequent memorials must contain a response to the previous memorial either accepting or rejecting the statements of fact and responding to the statement of law.**
- **Parties may hold a pre-hearing conference with the tribunal to consider the issues in dispute with a view to reaching an amicable settlement.**
- **During an oral hearing before the tribunal, the tribunal may pose questions to the parties, as well as their witnesses and experts, who may also be examined and cross-examined by the parties.**

d) Dealing with Evidence

Memorials

The parties are expected to plead their case in their memorials. Memorials should include a statement of facts, together with all the evidence necessary to support their case. Arbitration Rule 33 provides:

Without prejudice to the rules concerning the production of documents, each party shall, within time limits fixed by the Tribunal, communicate to the Secretary-General, for transmission to the Tribunal and the other party, precise information regarding the evidence which it intends to produce and that which it intends to request the Tribunal to call for, together with an indication of the points to which such evidence will be directed.

Tribunal's discretion

The tribunal retains complete discretion in judging the admissibility and the probative value of any evidence that is produced by the parties (Arbitration Rule 34(1)). The tribunal is not bound by the parties' submissions in this respect.

The tribunal's power with respect to the taking of evidence is confirmed by Article 43 of the Convention, which provides that, except as the parties otherwise agree, the tribunal is empowered to require the production of documents or other evidence (witnesses and experts) and to make any relevant site visits. The tribunal's power in calling for the production of evidence is further amplified in Arbitration Rule 34(2).

The parties are required to cooperate with the tribunal's requests, which may take the form of procedural orders.

e) Failure to Present Case and Discontinuance of Proceedings

Non-participation of one party in the arbitration proceedings does not prevent the tribunal from rendering an award, provided that a grace period has been given to the party failing to present its case (Article 45(2) of the Convention).

Arbitration Rule 34(3), dealing with the production of evidence requested by the tribunal, provides that the tribunal shall take formal note of the failure by a party to comply with its obligations and of any reasons given for such failure. However, the failure of a party to appear or to present its case is not deemed as an admission of the other party's assertions, as confirmed by Article 45(1) of the Convention.

Thus, notwithstanding the failure of one party to participate in the arbitration, the tribunal is required to verify the assertions of the other party.

In *LETCO v. Liberia*²¹ the respondent failed to appear or present its case. The tribunal confirmed in its award that it had not taken for granted the assertions made by the claimant, but had submitted them to careful scrutiny. The tribunal's actions included the appointment of an accounting firm charged with examining the claimant's claim for damages.

Discontinuance of proceedings

Proceedings may be discontinued in three ways. First, the parties may agree to discontinue or to settle. The tribunal may, if the parties so request in writing and provide a signed copy of a settlement agreement to the Secretary-General, record such settlement in the form of an award (Arbitration Rule 43).

Second, pursuant to Arbitration Rule 44, either party may request a discontinuance, which the tribunal will grant if the other party does not object.

Finally, the proceedings shall be deemed discontinued if the parties fail to act during six consecutive months (or any other time period, as agreed between them and approved by the tribunal), in accordance with Arbitration Rule 45.

f) Ancillary Claims

Consolidation of claims

Article 46 of the Convention deals with the possibility of consolidating closely related claims by the same parties into one set of proceedings. The provisions of the Convention are further amplified in Arbitration Rule 40(1). In addition to the primary claim underlying the dispute, the Convention permits the filing of any incidental, additional or counter-claim (ancillary claims).

Requirements for consolidation

In order to be admissible, ancillary claims must comply with two separate requirements under the Convention. First, ancillary claims will be allowed as

²¹ *LETCO v. Liberia, Award, March 31, 1986, 2 ICSID Reports 343.*

long as they are within the scope of the parties' consent to arbitration and otherwise within the jurisdiction of the Centre pursuant to Article 25 of the Convention. Second, the requirements of Article 46 of the Convention must be fulfilled. According to Note B(a) to Arbitration Rule 40 of 1968:

[...] to be admissible such claims must arise "directly" out of the "subject-matter of the dispute" (French version: "l'objet du différent"; Spanish version: "la diferencia"). The test to satisfy this condition is whether the factual connection between the original and the ancillary claim is so close as to require the adjudication of the latter in order to achieve the final settlement of the dispute, the object being to dispose of all the grounds of the dispute arising out of the same subject matter.²²

Rule 40(2) provides that the requesting party must file any additional or incidental claim no later than in its reply. The other party must file any counter-claim no later than in its counter-memorial. This allows the continuation of the arbitration without further delay. Any later presentation of an ancillary claim by a party would have to be justified and would require a specific decision of the tribunal, after hearing the objections (if any) of the other party.

g) Place of Proceedings

The provisions of the Convention dealing with the issue of the place of proceedings are contained in Articles 62 and 63 of the Convention.

Seat of ICSID

Article 62 of the Convention sets out the basic rule (subject to the exceptions contained in Article 63): proceedings shall be held at the seat of the Centre, Washington D.C.,

Seat has no legal significance

Unlike other types of arbitration, ICSID arbitration is entirely self-contained, and therefore the seat of the proceedings has no legal significance. The choice of the place of proceedings is largely a matter of convenience for the parties and the arbitrators.

Parties may choose place of proceedings

Pursuant to Article 63 of the Convention (Arbitration Rule 13(3)), the parties may agree to hold the proceedings elsewhere than at the seat of the Centre, provided that the Centre has made arrangements with another appropriate institution.

Possible places of proceedings

Apart from the Permanent Court of Arbitration at The Hague, which is specifically mentioned in Article 63 of the Convention, the Centre has made arrangements with a number of institutions in many venues around the world, including: Kuala Lumpur, Cairo, Sydney, Melbourne and Singapore.²³

Offices of the World Bank

Should the parties wish to hold the proceedings in a place other than the seat of the Centre or the places mentioned above, they must seek the approval of

²² 1 ICSID Reports 100.

²³ A. Parra, *The Role of the ICSID Secretariat in the Administration of Arbitration Proceedings Under the ICSID Convention*, 13 ICSID Review – FILJ 85 (1998), at 93.

the tribunal, following consultation with the Secretary-General. Thus, for example, a number of arbitrations have been held at the offices of the World Bank in Paris.

4. PROVISIONAL MEASURES

Parties in international arbitration may often wish to apply to the tribunal for provisional measures in order to safeguard their rights pending the tribunal's final decision. Article 47 of the Convention provides:

Except as the parties otherwise agree, the Tribunal may, if it considers that the circumstances so require, recommend any provisional measures which should be taken to preserve the respective rights of either party.

Tribunal may recommend measures

As indicated in Article 47 of the Convention, the tribunal cannot issue binding orders in the case of provisional measures but may merely recommend them. Nevertheless, the lack of binding force does not deprive the tribunal's recommendations of legal relevance, as the tribunal has the power to take into account the parties' conduct during the proceedings in rendering its award.

Enforceability of tribunal's recommendations

The tribunal's power to recommend provisional measures raises questions as to the enforceability of the tribunal's recommendations, in particular, whether a domestic court will enforce a recommendation of an ICSID tribunal. In several cases involving a conflict between the exclusive jurisdiction of ICSID and actions commenced before national courts, the courts appear to have been strongly influenced by the tribunal's recommendations.

In the case of *MINE v Guinea*,²⁴ the respondent sought an order from the tribunal recommending the discontinuance of various attachment orders issued by several national courts (including the Court of First Instance of Geneva) following applications made by MINE. The tribunal's recommendation to discontinue all proceedings in domestic courts was based on the exclusive remedy provision of Article 26 of the Convention. The tribunal's recommendation that all pending litigation before national courts be discontinued constituted one of the grounds cited by the Court of First Instance of Geneva in support of its decision to lift the attachment orders.²⁵

Types of measures

The types of measures recommended so far have been varied and depend on the circumstances of each case. They have ranged from recommendations concerning the preservation and discovery of documents²⁶ to measures recommending the dismissal of actions before local courts.

Parties' discretion

The tribunal's power to recommend such measures is subject to the parties' agreement, wherein they can choose to modify or even exclude this power. The procedural framework for making a request to the tribunal is set out in Arbitration Rule 39.

²⁴ *Maritime International Nominees Establishment (MINE) v Republic of Guinea, Award, January 6, 1988, 4 ICSID Reports 54.*

²⁵ *The decision of the Tribunal de Première Instance, Geneva, March 13, 1986, 4 ICSID Reports 41.*

²⁶ *See AGIP SpA v Government of the People's Republic of Congo, Award November 30, 1979, 1 ICSID Reports, 306.*

Procedure for making a request

At any time during the proceedings, a party may request that provisional measures for the preservation of its rights be recommended by the tribunal (Arbitration Rule 39(1)). The tribunal may only recommend such measures after giving each party an opportunity to present its observations (Arbitration Rule 39(4)).

Necessity and urgency

Provisional measures will only be recommended in situations of absolute necessity. Although the Convention does not expressly require the requesting party to demonstrate the urgent nature of its request, it is universally accepted that provisional measures will only be recommended where the matter cannot await the final determination of the dispute.

Application to national courts

Arbitration Rule 39(5) precludes the parties from seeking provisional measures from national courts unless they have provided otherwise in the agreement recording their consent.²⁷

Therefore, unless the parties have expressly reserved their rights to seek protection from national courts, they will be precluded from doing so once the proceedings have commenced.

Summary:

- **Subject to the parties' agreement, the tribunal may recommend provisional measures for the preservation of the rights of either party.**
- **Tribunals may only recommend measures and cannot issue binding orders.**
- **A request by a party must be of an urgent nature that cannot await the final award.**
- **The parties cannot seek conservatory orders from national courts, unless they have expressly reserved this right in their agreement recording consent to ICSID arbitration.**

²⁷ For a further discussion of this issue, see Fouchard, Gaillard, Goldman, *On International Commercial Arbitration*, para. 1309, p. 713 (1999).

5. THE AWARD

Articles 48 and 49 of the Convention deal with “the Award”. Apart from a few particularities, the rules concerning the form and rendering of ICSID awards do not differ substantially from those contained in most other international arbitration rules.

Article 48 of the Convention deals with a number of issues concerning the duties and powers of the tribunal in rendering an award and the publication of the Award, as follows:

- (1) *The Tribunal shall decide questions by a majority of the votes of all its members.*
- (2) *The award of the Tribunal shall be in writing and shall be signed by the members of the Tribunal who voted for it.*
- (3) *The award shall deal with every question submitted to the Tribunal, and shall state the reasons upon which it is based.*
- (4) *Any member of the Tribunal may attach his individual opinion to the award, whether he dissents from the majority or not, or a statement of his dissent.*
- (5) *The Centre shall not publish the award without the consent of the parties.*

Mandatory provisions

The provisions of Article 48 of the Convention are mandatory and may not be deviated from. Only subparagraph 5 offers the parties a choice.

Questions decided by majority

Article 48(1) of the Convention provides tribunals with the power to decide questions by a majority. This provision is not limited to the rendering of awards, but relates also to other questions that the tribunal may have to decide during the arbitration procedure.²⁸ One exception is the tribunal’s power to fix time limits, which may be delegated to the president of the tribunal in accordance with Arbitration Rule 26(1).

According to Arbitration Rule 16(1), abstention by a member of the tribunal will count as a negative vote.

a) Formal and Substantive Requirements of an Award

The Convention does not provide a definition of what constitutes an award, although the correct identification of an award is important in the context of the requirements of Article 48, as well as the post-award remedies provided in Articles 49 to 52 of the Convention. For the purposes of this Module, a decision rendered by the tribunal that finally disposes of the questions before it can be described as an award. This includes a decision declining jurisdiction. Thus, an award can be distinguished from the other decisions that a tribunal may

²⁸ This provision is mirrored in Rule 16(1) of the Arbitration Rules.

make during the course of the proceedings, for example, procedural orders or a recommendation of provisional measures.

Article 48(2) of the Convention requires that an award must be in writing and be signed by all members of the tribunal.

Requirements of an award

Arbitration Rule 47 further provides that an award must comply with the following requirements:

- (1) *The award shall be in writing and shall contain:*
 - (a) *a precise designation of each party;*
 - (b) *a statement that the Tribunal was established under the Convention, and a description of the method of its constitution;*
 - (c) *the name of each member of the Tribunal, and an identification of the appointing authority of each;*
 - (d) *the names of the agents, counsel and advocates of the parties;*
 - (e) *the dates and place of the sittings of the Tribunal;*
 - (f) *a summary of the proceedings;*
 - (g) *a statement of the facts as found by the Tribunal;*
 - (h) *the submissions of the parties;*
 - (i) *the decision of the Tribunal on every question submitted to it, together with the reasons upon which the decision is based; and*
 - (j) *any decision of the Tribunal regarding the cost of the proceeding.*
- (2) *The award shall be signed by the members of the Tribunal who voted for it; the date of each signature shall be indicated.*
- (3) *Any member of the Tribunal may attach his individual opinion to the award, whether he dissents from the majority or not, or a statement of his dissent.*

Although many of the requirements of Rule 47 are taken for granted in international arbitration, the rule is much more detailed than comparable provisions in other arbitration rules.

Individual or dissenting opinions

In accordance with Article 48(4) of the Convention, an arbitrator may attach an individual opinion to the award. This applies equally to dissenting opinions or concurring opinions. Such opinions can also take the form of declarations if they only address a few discrete points of contention in the award.

Exhaustiveness

Article 48(3) requires that the award deal with all questions submitted to the tribunal. The requirement of exhaustiveness is mirrored in Arbitration Rule 47(1)(i).

The requirement that the tribunal must hand down an award dealing with the dispute in an exhaustive manner has not been construed, however, as requiring the tribunal to deal with every argument advanced by the parties in their pleadings. Rather, the requirement has been interpreted in ICSID proceedings as meaning only that the tribunal must deal expressly in its award with questions that are decisive.

Failure by a tribunal to deal expressly with a decisive question in its award has

been held to be tantamount to a failure to state reasons, and thus to constitute a possible ground for annulment of the award in accordance with Article 52(1)(e) of the Convention (See Module 2.8).

An award must be reasoned

In addition to the requirement of exhaustiveness, Article 48(3) of the Convention requires that an award shall state the reasons upon which it is based. ICSID tribunals invariably provide reasons. A question that may arise, however, is what constitutes a reason.

Failure to state reasons is expressly foreseen in Article 52(1)(e) of the Convention as a ground for annulment of the award. This requirement, like the requirement of exhaustiveness, has also been subject to interpretation by several *ad hoc* Committees (See Module 2.8).

Summary:

- **Tribunals must decide questions by majority. Abstention by an arbitrator will count as a negative vote.**
- **An award rendered by a tribunal must conform with the requirements set out in Arbitration Rule 47.**
- **An award must deal with all questions submitted by the parties that are decisive to the tribunal’s reasoning. Failure to do so may lead to annulment of the award.**
- **An award must contain sufficient reasoning to explain how the tribunal reached its conclusion. Failure to provide such reasoning may lead to annulment of the award.**

b) The Publication of Awards

Publication by ICSID is conditional on consent of parties

Article 48(5) of the Convention is similar to the rules of other arbitration institutions in restricting the arbitral institution (ICSID) from publishing the award without the consent of the parties. If the parties give their consent, the award is normally published by ICSID in the ICSID Review – Foreign Investment Law Journal and on the ICSID website.²⁹

This rule was enacted in order to assure the parties that ICSID would respect and protect the privacy of the proceedings.

Certain information is made public

The Secretariat of ICSID is able, however, to reveal certain information about ICSID cases, as provided for in Administrative and Financial Regulations 22 and 23. Such information concerns all requests registered with the Centre. The information is provided in the biannual ICSID News and in the ICSID Annual Reports. It can also be found on the ICSID website (www.worldbank.org/icsid), under the sub-heading “ICSID Cases”.

The information available relates to the date of the request, the membership

²⁹ Rule 48(4) of the Arbitration Rules does, however, permit the Centre to include in its publications excerpts of the legal rules applied by the tribunal.

and constitution of the tribunal, the subject matter of the dispute and the outcome of the proceedings.

Restrictions on the parties

Notwithstanding the prohibition against publication by ICSID contained in Article 48(5) of the Convention, there is no express prohibition against publication by the parties of the award or a commentary on the award's findings without obtaining the consent of the other party.

Implied duty of confidentiality

In the absence of an express provision on confidentiality, several ICSID tribunals have addressed the question of whether there exists an implied duty of confidentiality as between the parties to an ongoing proceeding.³⁰

*Amco v Indonesia*³¹ was the first case to address this issue. In that case, the tribunal refused to recommend the provisional measures sought by Indonesia to restrain Amco from discussing the case publicly. The tribunal concluded that “it is right to say that the Convention and the Rules do not prevent the parties from revealing their case; ...”³²

c) The Date of the Award

Dispatch of the award

Article 49 (1) of the Convention provides that the Secretary-General shall promptly dispatch certified copies of the award to the parties.

Signature of the award

The requirement that the award be signed by the arbitrators is a standard feature of international arbitration (Arbitration Rule 47(2)). The date of the last signature acts as the trigger for the Secretary-General's duty to dispatch the award to the parties pursuant to Arbitration Rule 48(1).

Award is rendered on its date of dispatch

Under Article 49(1) of the Convention, the award is deemed to have been rendered on the date of its dispatch by the Secretary-General. The exact date is important in view of the time limits imposed by the Convention for the post-award remedies of rectification, revision and annulment.

Closure of proceedings

Arbitration Rule 46 provides that an award must be drawn up and signed by the members of the tribunal within 60 days after the closure of the proceedings. The tribunal may extend this deadline by 30 days, if it would otherwise be unable to draw up the award.³³

³⁰ *The issue of an implied obligation of confidentiality in non-ICSID arbitration has recently been examined before the courts of two jurisdictions. See the decision of the High Court of Australia in Esso Australia Resources Limited v. Plowman (Minister for Energy and Minerals) (1995) 128 ALR 391; and the judgment of the Swedish Supreme Court in the Bulbank case, which have held that there is no general duty of confidentiality in an arbitration agreement. For commentary on these decisions, see H. Bagner, The Confidentiality Conundrum in International Commercial Arbitration, ICC Bulletin, Vol. 12/No. 1, p. 18. For a discussion of recent ICSID cases dealing with the issue of confidentiality, see M. Stevens, Confidentiality Revisited, ICSID News, Vol. 17, No. 1, p. 1.*

³¹ *Amco v Indonesia, Decision on Provisional Measures, December 9, 1983, 1 ICSID Reports 410.*

³² *Ibid.*, p. 412.

³³ *This requirement also extends to individual or dissenting opinions.*

Arbitration Rule 38 provides that the tribunal shall declare the proceedings closed when the parties' presentation of their case is completed. In practice, tribunals have enjoyed a great deal of discretion in declaring the proceedings closed by treating the provisions of Rule 38 with some flexibility and declaring proceedings closed once they are confident that they can render an award within the deadline of Arbitration Rule 46.

6. COSTS OF THE ARBITRATION

Articles 59 to 61 of the Convention deal with the costs of the proceedings.

Charges incurred by the Centre

Article 59 of the Convention deals with the charges incurred for the use of the facilities of the Centre. These are determined by the Secretary-General in accordance with the Administrative and Financial Regulations. The only fixed general charge is the lodging for a request for arbitration (or other types of requests, for example, annulment).

Lodging fee

As of July 1, 2002, this fee was US\$7,000. The Schedule of Fees is amended from time to time and can be found on the ICSID website under the sub-heading of “ICSID Publications”.

Administrative charge

In addition to the lodging fee, an administrative charge is payable to the Centre following the constitution of the arbitral tribunal. The amount of that charge was US\$3,000 as of July 1, 2002. The Centre also charges for its disbursements and out of pocket expenses in each case. These expenses are borne by the parties to the arbitration, in accordance with Article 61(2) of the Convention and include expenses for the services of persons (such as interpreters, reporters and secretaries) especially engaged by the Centre.

Special services

The Centre is also able to perform special services in connexion with a proceeding (for example, the provision of translations or copies), if the requesting party has provided a deposit in advance sufficient to cover the resulting charges (Administrative and Financial Regulation 15).³⁴

Fees and expenses of the tribunal

Article 60 of the Convention deals with the fees and expenses of the arbitrators and provides that the tribunal shall determine the fees and expenses of its members within limits established by the Administrative Council. Administrative and Financial Regulation 14 provides the basis for the remuneration of arbitrators and the reimbursement of their expenses. In accordance with the Schedule of Fees, dated July 1, 2002, arbitrators are entitled to receive a fee of US\$2,000 per day of meetings or other work performed in connexion with the proceedings in addition to receiving reimbursement for any direct expenses reasonably incurred.

However, nothing precludes the parties from agreeing in advance with the tribunal that the arbitrators shall be remunerated on some other basis.

In addition, arbitrators are entitled to subsistence allowances and reimbursement of travel expenses within limits set forth in Administrative and Financial Regulation 14. These ancillary expenses are determined on the basis of a detailed memorandum on fees and expenses of arbitrators, which can be found on the ICSID website under the sub-heading of “ICSID Publications”.

³⁴ See the Schedule of Fees, dated July 1, 2002, available on the ICSID website.

All payments to arbitrators are made by ICSID

All payments of fees and expenses due to the members of the arbitral tribunal are to be made exclusively by ICSID, in accordance with Administrative and Financial Regulation 14(2).

Advance payments

The payments by ICSID to the arbitrators are financed through advance payments made by the parties, in accordance with Administrative and Financial Regulation 14(3). The payments are made on the basis of statements prepared by the secretary of the tribunal on behalf of the Secretary-General.

The advance payments are apportioned equally between the parties. In the event of failure by one of the parties to make the necessary payments within 30 days, ICSID will inform the parties of the default and allow either party to make the outstanding payment.

Non-payment may cause suspension

In the event of non-payment of the advance by either party within a further 15 days after the initial notice of default has been issued, the proceedings may be stayed at the instigation of the Secretary-General. A stay of over six months may cause the discontinuance of the proceedings by the Secretary-General.

Parties' legal costs

Article 61(2) of the Convention also deals with the issue of the parties' own legal costs and provides the arbitral tribunal with broad discretion to determine how the costs should be allocated between the parties, as follows:

In the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connexion with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award.

Practice of ICSID tribunals

There is no uniform practice amongst ICSID tribunals in apportioning costs. In the majority of cases, tribunals have decided that the parties should bear equally the costs of the arbitration (the fees and expenses of the arbitrators and ICSID's charges) and that each party should bear its own legal costs. Mostly, tribunals do so without providing any reasons.³⁵

In those instances where reasoning has been provided, tribunals have tended to point to the parties' good faith and cooperation with the tribunal,³⁶ or noted that neither party had been wholly successful.³⁷

In a number of cases, tribunals have determined that costs should follow the event and therefore have awarded costs, including the victorious party's legal costs.³⁸

³⁵ *Klockner v. Cameroon, Award, October 21, 1983, 2 ICSID Reports 4; Vacuum Salt v. Ghana, Award, February 16, 1994, 4 ICSID Reports 320; AMT v. Zaire, Award, February 21, 1997, International Arbitration Report, vol. 12, 4/97; Cable TV v. St. Kitts and Nevis, Award, January 13, 1997, 13 ICSID Review – FILJ 328.*

³⁶ *Atlantic Triton v. Guinea, Award, April 21, 1986, 3 ICSID Reports 42.*

³⁷ *Atlantic Triton v. Guinea, Award, April 21, 1986, 3 ICSID Reports 42; SOABI v. Senegal, Award, February 25, 1988, 2 ICSID Reports 273; and Tradex Albania v. Albania, Award, April 29, 1999, 14 ICSID Review – FILJ 197.*

In other cases, the award of costs has reflected the relative success of the two parties on the merits.

In *AAPL v Sri Lanka*,³⁹ the tribunal, having found in favour of the claimant only with respect to some of its claims, decided that the costs of the arbitration (including the fees of the tribunal and the costs of the Centre) should be borne 60 per cent by the respondent and 40 per cent by the claimant. In addition, the respondent bore one third of the claimant's legal costs, in addition to the entirety of its own legal costs.

Finally, tribunals may also penalize parties that they perceive have acted in an uncooperative or dilatory manner by awarding costs against them.⁴⁰

In the case of *LETCO v Liberia*,⁴¹ the respondent failed to participate in the proceedings. In addition, it instituted proceedings before its national courts with respect to the dispute in violation of Article 26 of the Convention. Further to the claimant's request, the tribunal awarded the claimant costs in full. Its decision was largely based on the respondent's "procedural bad faith".⁴²

Summary:

- **Unless the parties agree otherwise, the tribunal has broad discretion to apportion the costs of the arbitration.**
- **The costs of the arbitration include three distinct elements:**
 - (i) **the charges and expenses incurred by ICSID;**
 - (ii) **the fees and expenses of the tribunal; and**
 - (iii) **the parties' legal costs.**
- **The first two categories are financed by means of advance payments made by the parties.**
- **There is no uniform practice amongst ICSID tribunals in apportioning costs between the parties.**

³⁸ For example, *AGIP v Congo*, Award, November 30, 1979, 1 ICSID Reports 306 and *Wena Hotels Limited v. the Arab Republic of Egypt*, Award, 8 December 2000 (unpublished).

³⁹ Award, June 27, 1990, 4 ICSID Reports 246.

⁴⁰ *Benvenuti & Bonfant Srl v. Congo*, Award, August 8, 1980, 1 ICSID Reports 330.

⁴¹ *LETCO v. Liberia*, Award, March 31, 1986, 2 ICSID Reports 343.

⁴² *Ibid*, at p. 378.

TEST MY UNDERSTANDING

After having studied this Module the reader should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. What information must a potential claimant include in its request for arbitration in instituting ICSID arbitration proceedings?
2. What are the official languages of the Centre?
3. Under what circumstances can the Secretary-General refuse to register the request for arbitration?
4. Is the parties' choice of arbitrators constrained in any way under the Convention?
5. In the event that the parties cannot agree on the number and method of appointment of the arbitrators, what is the procedure provided for by the Convention?
6. What action can a claimant take when faced with a respondent who is refusing to nominate an arbitrator after 90 days have passed from the date of registration?
7. Can the parties agree to modify or exclude the Arbitration Rules?
8. What is the written procedure that is typically adopted by parties in presenting their case in an ICSID arbitration?
9. Under what circumstances can the parties introduce additional claims in the arbitration?
10. Can the parties refer to a national court to obtain provisional measures?
11. What are the duties of a tribunal in rendering an award?
12. Must the tribunal deal with every argument raised by the parties in their submissions?
13. Can one party disclose information concerning the award without obtaining the consent of the other party to the arbitration?
14. What is the effective date of the award for the purposes of annulment proceedings pursuant to Article 52 of the Convention?
15. What is the practice of ICSID tribunals in apportioning costs between the parties?

HYPOTHETICAL CASES

Coalco Corporation v. The Republic of Somandia

In June 2000, Coalco Corp. and the Republic of Somandia entered into an investment agreement with respect to an investment by Coalco in the coal mining industry in Somandia. In their agreement, the parties agreed to submit any dispute to ICSID arbitration. Both the Republic of Somandia and Utopia (Coalco's country of establishment) have ratified the ICSID Convention.

Pursuant to the parties' agreement, Somandia undertook to provide Coalco with all necessary permits to enable it to start exploring for coal in a remote region of the country in the province of East Kalit. Coalco's attempts to commence exploration activities were thwarted, however, by a decree passed by the regional government of East Kalit declaring the region where Coalco was set to explore as a natural reserve, prohibiting any exploration or drilling activities.

Unable to commence exploration, Coalco has filed a request for arbitration with the Centre against the Republic of Somandia for breach of their investment agreement and losses incurred.

The request was registered by the Secretary-General on March 1, 2001. In their investment agreement, the parties did not specify the composition or method of appointment of an arbitral tribunal. Accordingly, together with its request, Coalco proposed a sole arbitrator and nominated a national of a third country.

The Republic of Somandia has failed to acknowledge receipt of Coalco's request and has therefore not nominated any arbitrators.

Advise Coalco on the following issues:

1. It is now May 1, 2001 and Coalco suspects that the Republic of Somandia has no intention of participating in the arbitration. What steps can Coalco take in order to ensure the constitution of the tribunal as soon as possible? Are there any limitations on the composition of the tribunal?
2. Following the constitution of the tribunal, Somandia fails to attend the tribunal's first session organized in Washington D.C. and instead confirms by letter to the tribunal that it will not participate in the proceedings. Discuss what impact Somandia's failure to participate will have on the proceedings, especially on the procedure to be followed by the tribunal.
3. In July 2001, Coalco's offices in Takara (Somandia's capital city) are raided by the police and all documents contained therein are removed on the orders of Somandia's Minister of Investment. The documents removed included evidence that Coalco had assembled with respect to the arbitration. Discuss what steps Coalco can take in order to safeguard

- its interests in the arbitration. Can Coalco make an application to the District Court of Takara?
4. As part of its prayer for relief in its memorial submitted in the arbitration, Coalco requests that the tribunal order Somandia to reimburse all of its costs incurred in connexion with the arbitration. Assuming that Coalco is partly successful in its claim against Somandia, discuss the tribunal's options in awarding costs.
 5. The award was rendered on April 1, 2002. For strategic reasons, Coalco has decided to publicize the contents of the award. Advise on whether it can do so and, if so, what options it has in doing so.

Osteria Ltd. v. The Republic of Moravia

Osteria Ltd., a company established under the laws of Utopia, operates a number of mussel farms in the Republic of Moravia. Osteria's farms suffered major damage after they were attacked by a separatist guerilla faction opposed to the government of Moravia.

Both Utopia and Moravia have ratified the Convention. Furthermore, since 1990, there exists a treaty between the two countries for the promotion and protection of foreign investment (the BIT). Pursuant to the terms of the BIT, Moravia is obliged to accord Utopian investors fair and equitable treatment and full protection and security (and *vice versa*).

In accordance with the provisions of the BIT, in the event of a legal dispute between a foreign investor and the host State that cannot be settled within six months of being brought to the attention of the host State, the dispute is to be settled by means of ICSID arbitration.

Osteria has been advised that it may have grounds under the BIT to bring an arbitration against Moravia with respect to the damage that it has suffered.

As Osteria's counsel, advise it on the steps that it needs to take in order to initiate ICSID arbitration proceedings. In addition, prepare a procedural timetable demonstrating the various steps involved up to the rendering of the award.

FURTHER READING

Books

- **Fouchard, Gaillard, Goldman**, *On International Commercial Arbitration* (1999).
- **Schreuer, C.**, *The ICSID Convention: A Commentary* (2001).

Articles

- **Bagner, H.**, *The Confidentiality Conundrum in International Commercial Arbitration*, ICC Bulletin, Vol. 12/No. 1 (2001), p. 18.
- **Broches, A.**, *Observations on the Finality of ICSID Awards*, 6 ICSID Review – FILJ 321 (1991).
- **Brower, C.**, *The Initiation of Arbitration Proceedings: “Jack be Nimble, Jack be Quick...!”*, 13 ICSID Review – FILJ 15 (1998).
- **Parra, A.**, *The Limits of Party Autonomy in Arbitration Proceedings under the ICSID Convention*, ICC Bulletin, Vol. 10/No. 1 (1999), p. 27.
- **Parra, A.**, *The Role of the ICSID Secretariat in the Administration of Arbitration Proceedings Under the ICSID Convention*, 13 ICSID Review – FILJ 85 (1998).
- **Paulsson, J.**, *Arbitration Without Privity*, 10 ICSID Review – FILJ 232 (1995).
- **Obadia, E.**, *Current Issues in Investment Disputes*, The Journal of World Investment, Vol. 2, No. 1, p. 219.
- **Obadia, E.**, *ICSID, Investment Treaties and Arbitration: Current and Emerging Issues*, ICSID News, Vol. 18, No. 2, p. 4.
- **Stevens, M.**, *Confidentiality Revisited*, ICSID News, Vol. 17, No. 1, p. 1.
- **Townsend, J.**, *The Initiation of Arbitration Proceedings: “My Story Had Been Longer”*, 13 ICSID Review – FILJ 21 (1998), at p. 24.
- **Tupman, W.M.**, *Challenge and Disqualification of Arbitrators in International Commercial Arbitration*, 38 International and Comparative Law Quarterly 26 (1989).

Documents

- ICSID website:
<http://www.worldbank.org/icsid>
- ICSID Administrative and Financial Regulations:
<http://www.worldbank.org/icsid/basicdoc/35.htm>

- ICSID Institution Rules:
<http://www.worldbank.org/icsid/basicdoc/57.htm>
- ICSID Arbitration Rules:
<http://www.worldbank.org/icsid/basicdoc/63.htm>
- NAFTA Cases:
[http:// www.naftaclaims.com](http://www.naftaclaims.com)

Cases

- *AGIP SpA v Government of the People's Republic of Congo*, Award, November 30, 1979, 1 ICSID Reports, 306.
- *Amco Asia Corporation and Others v. The Republic of Indonesia*, Decision on Jurisdiction, September 25, 1983, 1 ICSID Reports 389.
- *AMT v. Zaire*, Award, February 21, 1997, International Arbitration Report, vol. 12, 4/97.
- *Asian Agricultural Products Limited (AAPL) v. Republic of Sri Lanka*, Award, June 27, 1990, 4 ICSID Reports 246.
- *Atlantic Triton v. Guinea*, Award, April 21, 1986, 3 ICSID Reports 42.
- *Benvenuti & Bonfant Srl v. The Government of the People's Republic of Congo*, Award, August 8, 1980, 1 ICSID Reports 330.
- *Cable Television v. St. Kitts and Nevis*, Award, January 13, 1997, 13 ICSID Review – FILJ 328 (1998).
- *Klöckner v. Cameroon*, Award, October 21, 1983, 2 ICSID Reports 4.
- *Liberian Eastern Timber Company (LETCO) v. The Government of the Republic of Liberia*, Award, March 31, 1986, 2 ICSID Reports 343.
- *Maritime International Nominees Establishment (MINE) v Republic of Guinea*, Award, January 6, 1988, 4 ICSID Reports 54.
- *MINE v Guinea*, Decision on annulment, December 22, 1989, 4 ICSID Reports 79.
- *SOABI v. Senegal*, Award, February 25, 1988, 2 ICSID Reports 273.
- *Tradex Albania v. Albania*, Award, April 29, 1999, 14 ICSID Review – FILJ 197.
- *Vacuum Salt v. Ghana*, Award, February 16, 1994, 4 ICSID Reports 320.
- *Wena Hotels Limited v. the Arab Republic of Egypt*, Award, December 8, 2000, 41 ILM 896 (2002).

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.8 POST-AWARD REMEDIES AND PROCEDURES



UNITED NATIONS
New York and Geneva, 2003

NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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OVERVIEW

This Module gives an overview of the post-award remedies and procedures in ICSID dispute settlement.

Under Art. 53 of the ICSID Convention, an award is final and binding and not subject to any remedy except those provided for in the Convention. In particular, an award is not subject to any review by domestic courts. But the Convention itself provides for a number of remedies and procedures that are administered by the original tribunal, by a new tribunal or by an *ad hoc* committee. All these remedies and procedures are regulated in detail by the Convention and the Arbitration Rules and are administered by ICSID.

Of these post-award remedies and procedures, some are relatively uncontroversial and deal with routine situations. Thus supplementation and correction deal with minor technical and clerical mistakes in the award. Interpretation clarifies the meaning of the award if the parties disagree on its construction. Revision takes account of new facts that were unknown when the award was rendered.

Annulment is a remedy that is much more dramatic. It is a limited exception to the principle of finality. Awards are not subject to substantive review and an allegation of a mere error of fact or of law will be of no avail. Annulment provides limited emergency relief for situations in which the basic legitimacy of the arbitration process is called into question. It is available only on the basis of a few specific grounds listed in the Convention. A successful plea of nullity leads to a decision that declares the award void in whole or in part. The parties may then resubmit their dispute to a new tribunal.

This Module gives a relatively brief overview of supplementation and correction, interpretation and revision. With respect to annulment, it explains in more detail the grounds for annulment and the procedure that may lead to it. It also describes the powers of the *ad hoc* committee that decides on a request for annulment and the consequences of a decision annulling the award.

OBJECTIVES

Upon completion of this booklet the reader should be able to:

- List the different remedies available after the award has been rendered.
- Compare the function of the different remedies.
- Compare the formal requirements for the different remedies.
- Understand the difference between annulment and appeal.
- Identify the different grounds for annulment.
- Discuss the relevance of the individual grounds for annulment.
- Describe the procedure upon a request for annulment.
- Explain the procedure after the total or partial annulment of an award.

INTRODUCTION

<u>Post-award remedies</u>	The ICSID Convention provides for several possible remedies after an award has been rendered. These are supplementation and rectification (Art. 49(2)), interpretation (Art. 50), revision (Art. 51) and annulment (Art. 52). Of these, annulment has turned out to be by far the most important. An ICSID award is not subject to any other appeal or remedy (Art. 53(1)). In particular, there is no resort to domestic courts against an ICSID award.
<u>Supplementation and Rectification</u>	Art. 49(2) provides a remedy for omissions and errors in the award. Supplementation and rectification can only be made by the tribunal that rendered the award.
<u>Interpretation</u>	Art. 50 deals with disputes between parties to arbitration proceedings relating to the interpretation of the award. The interpretation will be given, if possible, by the tribunal that rendered the award. If this is not possible, a new tribunal will be constituted for this purpose.
<u>Revision</u>	Art. 51 deals with revision, that is a substantive alteration of the original award on the basis of newly discovered facts that were unknown when the award was rendered. Any revision shall be made, if possible, by the same tribunal that rendered the award. If this is not possible, a new tribunal will be constituted for this purpose.
<u>Annulment</u>	Art. 52 foresees the annulment of an award under certain narrowly defined circumstances. Annulment proceedings always take place before a separate <i>ad hoc</i> committee.
<u>Time limits</u>	Interpretation is not subject to a time limit. But supplementation and rectification, revision and annulment are subject to tight time limits. These time limits differ considerably.
<u>Initiative</u>	All post-award remedies require a specific request by a party. There is no <i>ex officio</i> remedy.
<u>The Additional Facility</u>	The ICSID Convention does not apply to arbitration under the Additional Facility Rules ¹ . Therefore, the post-award remedies described in this booklet are not applicable to awards rendered under the Additional Facility. The Additional Facility has its own rules on interpretation, correction and supplementation. ² Unlike ICSID arbitration, arbitration under the Additional Facility is not insulated from national law. An award rendered under the Additional Facility is subject to any review or appeal provided by the law of the place of arbitration. The normal method to challenge such an award would be through national courts.

¹ For an explanation of the Additional Facility see booklet 2.4 dealing with requirements *ratione personae*.

² See *Additional Facility Arbitration Rules, Articles 56-58, 1 ICSID Reports 268-269*.

Summary:

- **There are four types of remedies after an award has been rendered:**
 - 1. supplementation and rectification**
 - 2. interpretation**
 - 3. revision**
 - 4. annulment.**
- **These remedies are available only upon the request of one or both parties.**
- **With the exception of interpretation, these remedies are subject to time limits.**
- **These remedies are exclusive. ICSID awards are not subject to any other remedy.**
- **The ICSID Convention's remedies do not apply to awards under the Additional Facility.**

1. SUPPLEMENTATION AND RECTIFICATION

Art. 49(2) The Convention provides for supplementation and rectification in Art. 49(2) in the following terms:

The Tribunal upon the request of a party made within 45 days after the date on which the award was rendered may after notice to the other party decide any question which it had omitted to decide in the award, and shall rectify any clerical, arithmetical or similar error in the award.

Inadvertent omissions and technical errors This remedy is designed for inadvertent omissions and minor technical errors. It is not designed for a substantive review of the decision. Rather, it enables the tribunal to correct mistakes that may have occurred in the award's drafting in a simple way.

Award only Rectification and supplementation is available only in respect of awards. Therefore, this remedy is not applicable to decisions preliminary to awards. In particular, decisions on jurisdiction and on provisional measures are not, by themselves, subject to this procedure.

Rectification Rectification is appropriate in case of a clerical, arithmetical or similar error. Under the Convention's wording, a rectification is mandatory if such an error is pointed out to the tribunal.

Supplementation Supplementation is discretionary. It relates to an omission in the award. Art. 48(3) of the Convention states that the award shall deal with every question submitted to the tribunal. Supplementation will be useful where the omission is due to an oversight on the part of the tribunal which is likely to be corrected by it once this oversight is pointed out. But supplementation is unlikely to be useful where the omission is the result of a considered and deliberate decision by the tribunal. In such a situation a request for annulment may be the appropriate course of action.

Request Supplementation and rectification depend upon a request by a party to the case directed to the Secretary-General of ICSID. The tribunal may not issue such a decision on its own initiative. The request must say what points it wishes to have supplemented or corrected.

Time limit The request must be made within 45 days of the dispatch to the parties of the original award.

Decision by original tribunal Unlike the other post-award remedies, supplementation and rectification can only be made by the tribunal that rendered the award. If the original tribunal is no longer available, the remedy of Art. 49(2) cannot be used. In that case it may be possible to achieve the desired result through interpretation, revision or annulment.

In *CDSE v. Costa Rica*, the Award was rendered on 17 February 2000. On 30 March 2000, Claimant submitted a Request for Rectification of the Award. The Respondent was given an opportunity to file written observations on the Request. The Tribunal gave its decision on 8 June 2000. It corrected two minor clerical errors as well as a mistake in the identification of a witness. But it refused to correct an alleged misstatement of a party's position on a point of law. It found that the Award had given an accurate summary of Claimant's stated position.³

**Effect of
supplementation or
rectification**

A tribunal's decision on a request for rectification or supplementation has certain substantive and procedural consequences. The rectification or supplementation becomes part of the award. Therefore, all rules relating to an award, as reflected in Arts. 48, 49, 50, 51, 52, 53 and 54 also apply to the rectification or supplementation. Moreover, the time limits for a request for revision or annulment do not start to run until a decision on a request for rectification or annulment has been rendered.

Summary:

- **Rectification takes care of minor technical errors.**
- **Supplementation takes care of inadvertent omissions.**
- **A request must be made within 45 days of the award.**
- **The decision can only be made by the original tribunal.**
- **The decision becomes part of the original award.**

³ *CDSE v. Costa Rica, Rectification of Award, 8 June 2000, 15 ICSID Review—Foreign Investment Law Journal 205 (2000).*

2. INTERPRETATION

Art. 50

The Convention provides for the interpretation of awards in Art. 50 in the following terms:

(1) If any dispute shall arise between the parties as to the meaning or scope of an award, either party may request interpretation of the award by an application in writing addressed to the Secretary-General. (2) The request shall, if possible, be submitted to the Tribunal which rendered the award. If this shall not be possible, a new Tribunal shall be constituted in accordance with Section 2 of this Chapter. The Tribunal may, if it considers that the circumstances so require, stay enforcement of the award pending its decision.

Dispute

There must be a specific dispute concerning the meaning or scope of the award. General complaints about the award's lack of clarity would not be admissible. The existence of a dispute also presupposes a certain degree of communication between the parties. In addition, the dispute must have some practical and not merely theoretical relevance.

Award only

The request for interpretation must relate to an award. A decision preliminary to the award such as a decision on jurisdiction or on provisional measures is not subject to this procedure unless it is eventually incorporated into the award.

Request

The request for interpretation must come from one of the parties to the arbitration. The tribunal may not give an interpretation on its own initiative. The request must state the precise points on which an interpretation is sought.

No time limit

There is no time limit for an application requesting an interpretation. In this respect, interpretation differs from the provisions on supplementation and rectification, revision and annulment. This means that a request for interpretation may be submitted at any time after the award has been rendered. It also means that successive requests for interpretation may be made at different times without any limitation.

Legal Nature of Interpretation

Art. 50 does not state that the decision on interpretation shall become part of the award. But Art. 53(2) provides that for the purposes of the Section on "Recognition and Enforcement of the Award", "award" shall include any decision interpreting, revising or annulling the award pursuant to Arts. 50, 51 and 52. Therefore, for purposes of recognition and enforcement, the award will be binding as interpreted in accordance with Art. 50. On the other hand, the decision on interpretation cannot itself be the object of supplementation and rectification, interpretation, revision and annulment.

Interpretation by original or new tribunal

The purpose of the procedure for interpretation is to clarify the meaning of the original award. Therefore, it seems logical to try to obtain an explanation from the tribunal that gave the award. If this is not possible, a new tribunal will be constituted for the purpose of the interpretation. When constituting

this new tribunal, it may be wise to appoint some or one of the arbitrators who served on the original tribunal. New arbitrators should remain faithful to the considerations and approach of the original tribunal. Their task is to ascertain the meaning of the original award and not to rewrite it.

Stay of enforcement

Under Art. 50(2), a stay of enforcement may be ordered by the tribunal, if so requested by a party, pending the decision on interpretation.

Summary:

- **Interpretation settles disputes between the parties concerning the meaning of an award.**
- **A request for interpretation is not subject to any time limits.**
- **An interpretation is to be treated like an award for purposes of recognition and enforcement.**
- **If possible, the interpretation should be given by the original tribunal.**

3. REVISION

Art. 51

The Convention provides for the revision of awards in Art. 51 in the following terms:

(1) Either party may request revision of the award by an application in writing addressed to the Secretary-General on the ground of discovery of some fact of such a nature as decisively to affect the award, provided that when the award was rendered that fact was unknown to the Tribunal and to the applicant and that the applicant's ignorance of that fact was not due to negligence.

(2) The application shall be made within 90 days after the discovery of such fact and in any event within three years after the date on which the award was rendered.

(3) The request shall, if possible, be submitted to the Tribunal which rendered the award. If this shall not be possible, a new Tribunal shall be constituted in accordance with Section 2 of this Chapter.

(4) The Tribunal may, if it considers that the circumstances so require, stay enforcement of the award pending its decision. If the applicant requests a stay of enforcement of the award in his application, enforcement shall be stayed provisionally until the Tribunal rules on such request.

Award only

Revision involves a substantive alteration of the original award on the basis of newly discovered facts that were unknown when the award was rendered. The request must relate to an award. Revision is not available in respect of decisions preliminary to awards such as a decision on jurisdiction or on provisional measures unless these are eventually incorporated into the award.

Request

The request for revision must come from one of the parties to the arbitration. The tribunal may not revise the award on its own initiative. The application for revision must state the precise points on which a change is sought in the award. It must also specify the new facts which are to affect the award decisively. In addition, the application must contain evidence that these facts were unknown to the applicant and to the tribunal and that the applicant's ignorance was not due to negligence.

New Facts

Revision is contingent upon the discovery of new facts. These must be capable of affecting the award decisively. The new element must be one of fact and not of law.

Decisiveness

The new fact is decisive if it would have led to a different decision had it been known to the tribunal. The new fact may relate to jurisdiction or to the merits. A fact that affects the legal position of the parties in an important way may be regarded as decisive even if it is not reflected in monetary terms in the award. This would be the case if the new fact could have led to a finding of lawfulness or unlawfulness of the acts of one of the parties.

Unknown new fact

The decisive fact must have been unknown to the tribunal and to the party

making the application when the award was rendered. A party's failure to draw the tribunal's attention to a decisive fact where it had the opportunity to do so at any time before the award's signature results in the inadmissibility of an application for revision. In addition, the applicant's ignorance of the newly discovered fact must not be due to negligence.

Time limit

The Convention imposes a dual time limit. A party must make its request within 90 days of the discovery of the new fact. In addition, there is an absolute cut-off for applications after three years from the date on which the award was rendered

Legal nature of revision

The legal nature of a decision on an application for revision is the same as that of a decision on interpretation (see above).

Revision by original or new tribunal

Submission of the request for revision to the original tribunal is the better solution since the original tribunal is in the best position to decide whether the fact adduced by the applicant was unknown to it. If the original tribunal is no longer available in its entirety, a new tribunal will have to be constituted.

Stay of enforcement

A party submitting an application for revision may request a stay of the award's enforcement. Such a request is granted provisionally upon the application's registration. Once the tribunal is constituted, the stay of enforcement will be confirmed or denied at the tribunal's discretion.

Summary:

- **Revision takes account of newly discovered facts.**
- **The new facts must be decisive.**
- **The application must be made within three years of the award and within 90 days of the discovery of the new facts.**
- **If possible, the revision should be made by the original tribunal.**

4. ANNULMENT: SCOPE AND SIGNIFICANCE

Art. 52 constitutes a limited exception to the principle of the finality of awards. Art. 52 is the only way of having the award set aside. Domestic courts have no power of review over ICSID awards.

Annulment and appeal

Annulment is different from an appeal. Appeal may result in the modification of the decision. Annulment results in the legal destruction of the original decision without replacing it. An *ad hoc* committee acting under the ICSID Convention may not amend or replace the award by its own decision on the merits. After annulment, the dispute may be resubmitted to a new tribunal. Annulment is only concerned with the basic legitimacy of the process of decision but not with its substantive correctness. Therefore, annulment is based on a very limited number of fundamental standards.

Request

The request for annulment must come from one of the parties to the arbitration. There is no *ex officio* annulment. Such a request is purely discretionary. Typically, a party requesting annulment hopes for a decision that is more favourable to it after annulment.

Waiver of annulment

A party may waive its right to request annulment. This will normally be done by not submitting a request during the time limit. Exceptionally, a party may also waive its right explicitly.⁴ A party's failure to object before the tribunal to a defect that may give rise to an annulment may also be regarded as a waiver.⁵ The party may not later use this defect as a ground for annulment.

Award only

Only awards are subject to annulment. Annulment is not available in respect of decisions preliminary to awards such as decisions on jurisdiction or on provisional measures unless these are eventually incorporated into the award. But a decision by a tribunal declining jurisdiction is an award and as such subject to annulment.

In *SPP v. Egypt*, the Tribunal had made a Decision on Jurisdiction upholding its competence.⁶ Egypt filed an application for annulment of this decision. The Acting Secretary-General declared that the Decision on Jurisdiction was not an award in the sense of Art. 52 of the Convention. Therefore, he did not have the power to register the application for annulment.⁷

Parts of awards

Art. 52(1) only speaks of a request for the annulment of the award but not of a part of the award. But Art. 52(3) states specifically that the *ad hoc* Committee may annul the award or any part thereof. The practice of *ad hoc* committees

⁴ *Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 513, 527/8.*

⁵ *The situation is covered by Arbitration Rule 27, 1 ICSID Reports 167.*

⁶ *SPP v. Egypt, Decision on Jurisdiction II, 14 April 1988, 3 ICSID Reports 131.*

⁷ *News from ICSID, Vol. 6/1, p. 2.*

demonstrates that annulment of parts of awards as well as requests for partial annulment of awards is covered by Art. 52. The *ad hoc* committee may annul only part of an award even if the annulment of the entire award has been requested.

In *MINE v. Guinea*, Guinea requested partial annulment of the award, explaining that “Guinea does not seek annulment of the decision on the two counter-claims, ...”.⁸ The *ad hoc* Committee had no doubts concerning the admissibility of this request:

*Guinea’s request for partial annulment is clearly admissible. It seeks the annulment of the portion of the Award adjudging MINE’s claim. It does not request annulment of the portion of the Award adjudging Guinea’s counter-claim. Nor, for that matter, has annulment of that portion been requested by MINE. That portion of the Award will remain in effect regardless of the annulment in whole or in part of the portion of the Award in respect of which Guinea has formulated its request for annulment.*⁹

Interrelated parts of awards

If parts of awards are closely interrelated, the nullification of one part of an award may automatically entail the nullification of other parts.

In *MINE v. Guinea*, the Tribunal had based its award of costs on the fact that Guinea was the losing party.¹⁰ The *ad hoc* Committee spoke of the possibility that “by necessary implication annulment entails the annulment of other portions.”¹¹ It applied this principle to the award of costs:

*6.112 The award of costs can nevertheless not remain in existence since its basis, viz., that Guinea was the losing party, had disappeared as a result of the annulment of the portion of the Award relating to damages. The award of costs cannot survive the annulment of that portion of the Award with which it is inextricably linked. The Committee therefore finds that the award of costs must be annulled in consequence of the annulment of the damages portion of the Award.*¹²

Post award decisions

Annulment is not available in relation to decisions interpreting or revising awards. Also, decisions on annulment are not themselves subject to annulment. Decisions on supplementation and correction are subject to annulment since they become part of the award. The award of a new tribunal, to which a dispute is resubmitted after the annulment of the first award, is subject to annulment in exactly the same manner as the award of the first tribunal.

Discretion to annul

The Convention states that the *ad hoc* committee shall have the authority to annul. The question of whether an *ad hoc* committee has some discretion in deciding whether or not to annul has led to conflicting answers.

⁸ *MINE v. Guinea, Decision on Annulment, 22 December 1989, 4 ICSID Reports 82.*

⁹ *At p. 85.*

¹⁰ *MINE v. Guinea, Award, 6 January 1988, 4 ICSID Reports 54, 77-78.*

¹¹ *MINE v. Guinea, Decision on Annulment, 22 December 1989, 4 ICSID Reports 86.*

¹² *At p. 109.*

The first decision on annulment in *Klöckner v. Cameroon* was still based on the conception that once the *ad hoc* committee had found a ground for annulment it was bound to annul no matter how minor the fault. The Committee said:

*...the finding that there is one of the grounds for annulment in Article 52(1) must in principle lead to a total or partial annulment of the award, without the Committee having any discretion,...*¹³

Subsequent decisions on annulment show a more flexible approach.

In *Amco v. Indonesia* the *ad hoc* Committee refused to annul where the Tribunal had reached the correct result though on the basis of the wrong legal system.¹⁴ It supplied missing reasons for a substantively correct decision¹⁵ and it declared certain incriminated passages in the Award as *obiter dicta*.¹⁶

In *MINE v. Guinea*, the *ad hoc* Committee found that it had discretion which had to be exercised in the service of material justice:

*4.10 An ad hoc Committee retains a measure of discretion in ruling on applications for annulment. To be sure, its discretion is not unlimited and should not be exercised to the point of defeating the object and purpose of the remedy of annulment. It may, however, refuse to exercise its authority to annul an award where annulment is clearly not required to remedy procedural injustice and annulment would unjustifiably erode the binding force and finality of ICSID awards.*¹⁷

Summary:

- **Annulment does not modify the award but removes it.**
- **Annulment is possible only on the basis of a limited number of serious grounds.**
- **Annulment is possible only upon the request of a party.**
- **Only awards or parts of awards are subject to annulment.**
- **More recent practice indicates that there is some discretion in a decision on annulment.**

¹³ Klöckner v. Cameroon, *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 162.

¹⁴ Amco v. Indonesia, *Decision on Annulment*, 16 May 1986, 1 ICSID Reports 524/5, 529/30.

¹⁵ At p. 526.

¹⁶ At pp. 538, 539, 540.

¹⁷ MINE v. Guinea, *Decision on Annulment*, 22 December 1989, 4 ICSID Reports 86.

5. GROUNDS FOR ANNULMENT

The grounds for annulment under the ICSID Convention are listed exhaustively in Art. 52(1):

(1) Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:

- (a) that the Tribunal was not properly constituted;*
- (b) that the Tribunal has manifestly exceeded its powers;*
- (c) that there was corruption on the part of a member of the Tribunal;*
- (d) that there has been a serious departure from a fundamental rule of procedure; or*
- (e) that the award has failed to state the reasons on which it is based.*

Exhaustive nature of grounds

Annulment is restricted to the five grounds listed in Art. 52(1). The *ad hoc* committee may not annul on other grounds. Therefore, any request for annulment must be brought under one or several of these grounds. In particular, a party may not present new arguments on fact or law that it failed to put forward in the original arbitral proceeding. Typically, an application for annulment will put forth several of the grounds listed in Art. 52(1). Not infrequently, one and the same perceived flaw is brought under different grounds for annulment cumulatively.

Limitation to grounds in request

An award may be affected by more than one ground for annulment. Parties requesting annulment have almost invariably claimed the presence of more than one defect justifying annulment. But the *ad hoc* committee is limited to the grounds invoked by the party or parties requesting annulment. There is no *ex officio* annulment of awards and annulment is subject to waiver by the parties. It follows that an *ad hoc* committee may not annul on a particular ground unless it is asked to do so by a party.

a) Improper Constitution of Tribunal

The first ground for annulment listed in Art. 52(1)(a) is the improper constitution of the tribunal. Questions concerning the tribunal's constitution could arise from the Convention's provisions on the nationality of arbitrators.¹⁸ Such issues could also arise in relation to the qualifications of arbitrators or an allegation of a conflict of interest. Apart from facts that are hidden at the time, problems in connexion with a tribunal's constitution are unlikely to arise: the ICSID Secretariat carefully monitors the constitution of tribunals. Arts. 57 and 58 provide for the disqualification of an arbitrator. A party that has not availed itself of this procedure where it had the opportunity to do so, will not be able to invoke this ground for annulment after the award has been rendered. In actual practice, this ground has never been used.

¹⁸ Arts. 38 and 39.

b) Manifest Excess of Powers

Excess of powers

The second ground for annulment listed in Art. 52(1)(b) is manifest excess of powers. An arbitral tribunal derives its power from the parties' agreement. A deviation from the terms of the agreement to arbitrate constitutes an excess of powers. The most important form of excess of powers occurs when a tribunal exceeds the limits of its jurisdiction. Another instance of excess of powers would be a non-application of the law agreed by the parties.

Manifest

In order to constitute a ground for annulment, any excess of powers must be manifest. The manifest nature of an excess of powers is not necessarily an indication of its gravity. Rather, it means that the excess of powers must be obvious. An excess of powers is manifest if it can be recognized with little effort.

Lack of jurisdiction

The most obvious example of an excess of powers is a decision on the merits by a tribunal that lacks jurisdiction. Jurisdiction is determined by Art. 25 of the Convention.¹⁹ If any of the requirements listed there²⁰ is not met, there is no jurisdiction. For instance, if there is no legal dispute there is no jurisdiction and an award on the merits would constitute an excess of powers. The same would apply if the dispute does not arise directly out of an investment. The parties must meet certain conditions in that one must be a Contracting State and the other a national of another Contracting State. If these requirements are not met there is no jurisdiction and a decision on the merits would be an excess of powers. If the dispute is not covered by a consent to arbitration there is no jurisdiction and an award on the merits would be an excess of powers.

Failure to exercise jurisdiction

Failure to exercise jurisdiction where jurisdiction does, in fact, exist also constitutes an excess of powers. A decision by a tribunal that states that it lacks competence is rendered in the form of an award. Such an award may be the subject of annulment proceedings. If a tribunal renders an award on the merits but declines jurisdiction on certain points, this may also give rise to a claim of excess of powers.

Failure to apply the proper law

Art. 42(1) of the ICSID Convention deals with the law applicable to the dispute.²¹ The provisions on applicable law are essential elements of the parties' agreement to arbitrate and are part of the framework for the tribunal's activity.

¹⁹ The jurisdictional requirements as set out in Art. 25 of the ICSID Convention are explained in detail in Modules 2.3 (consent), 2.4 (requirements *ratione personae*) and 2.5 (requirements *ratione materiae*).

²⁰ The relevant part of Art. 25(1) runs as follows: «(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.»

²¹ Art. 42(1) provides: «(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.» For a discussion of the law applicable in ICSID arbitration see Module 2.5.

Their violation may amount to an excess of powers. The parties may agree explicitly on the applicable law. In the absence of such an agreement, the residual rule of Art. 42(1) provides that the tribunal is to apply the law of the host State, including its rules on the conflict of laws, and such rules of international law as may be applicable. If the parties do not agree explicitly on the rules of law to be applied by the tribunal, the parties consent to the residual rule of Art. 42(1) by incorporating the ICSID Convention into their agreement to arbitrate.

Erroneous application of the law

A careful distinction must be made between failure to apply the proper law and an incorrect application of that law. Application of a law other than that agreed to by the parties constitutes an excess of powers and is a valid ground for annulment. A mere error in the application of the proper law is not a ground for annulment. *Ad hoc* committees have emphasized this distinction.²²

The *ad hoc* Committee in *Amco v. Indonesia* described its task in the following terms:

23. *The law applied by the Tribunal will be examined by the ad hoc Committee, not for the purpose of scrutinizing whether the Tribunal committed errors in the interpretation of the requirements of applicable law or in the ascertainment or evaluation of the relevant facts to which such law has been applied. Such scrutiny is properly the task of a court of appeals, which the ad hoc Committee is not. The ad hoc Committee will limit itself to determining whether the Tribunal did in fact apply the law it was bound to apply to the dispute. Failure to apply such law, as distinguished from mere misconstruction of that law, would constitute a manifest excess of powers on the part of the Tribunal and a ground for nullity under Articles 52(1)(b) of the Convention.*²³

Standards for the application of the proper law

Ad hoc committees have applied strict standards to the application of the proper law. In one case the non-application of a particular provision in the applicable law led to a holding of excess of powers and hence to annulment.²⁴ A broad reference to general principles also gave rise to discussions as to whether this amounted to a non-application of the proper law:

In *Klöckner v. Cameroon*, the applicable law was Cameroonian law based on French law. The Tribunal had relied on the basic principle of “frankness and loyalty”.²⁵ The *ad hoc* Committee found that this style of reasoning amounted to a failure to apply the proper law.²⁶ It found that the absence of specific legal authority made it impossible to determine whether the proper law had been applied:

²² See also *Klöckner v. Cameroon*, *Decision on Annulment*, 3 May 1985 2 ICSID Reports 119; *MINE v. Guinea*, *Decision on Annulment*, 22 December 1989, 4 ICSID Reports 87.

²³ *Amco v. Indonesia*, *Decision on Annulment*, 16 May 1986, 1 ICSID Reports 515.

²⁴ *Amco v. Indonesia*, *Decision on Annulment*, 16 May 1986, 1 ICSID Reports, 534/5.

²⁵ *Klöckner v. Cameroon*, *Award*, 21 October 1983, 2 ICSID Reports 59-61.

²⁶ *Klöckner v. Cameroon*, *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 121-125.

71. Does the “basic principle” referred to by the Award ... as one of “French civil law” come from positive law, i.e., from the law’s body of rules? It is impossible to answer this question by reading the Award, which contains no reference whatsoever to legislative texts, to judgments, or to scholarly opinions.²⁷

By not demonstrating the existence of concrete rules, the tribunal, in the eyes of the *ad hoc* Committee, had not applied the proper law:

79. ...in this reasoning, limited to postulating and not demonstrating the existence of a principle or exploring the rules by which it can only take concrete form, the Tribunal has not applied “the law of the Contracting State.”²⁸

Subsequent *ad hoc* committees did not apply similarly strict standards:

In *Amco v. Indonesia*, the proper law was Indonesian law and applicable rules of international law.²⁹ The *ad hoc* Committee said:

25. ...the *ad hoc* Committee does not believe that the Tribunal had necessarily to preface each finding or conclusion with a specification of the Indonesian or international law rule on which such finding or conclusion rests.³⁰

The Tribunal had held that the procedure leading to the revocation of the investment license had been contrary “to the general and fundamental principle of due process”.³¹ Before the *ad hoc* Committee, Indonesia argued that Indonesian administrative law did not include a general principle of due process. But Indonesia admitted that Indonesian law offered redress against administrative decisions on the basis of certain general standards.³² The *ad hoc* Committee held:

*It appears to the ad hoc Committee that these general standards of Indonesian law are not qualitatively different from, and seem equivalent in a functional sense to, what the Tribunal appears to have had in mind in referring to “the general and fundamental principle of due process”.*³³

Therefore, the *ad hoc* Committee held that this part of the Award was not vitiated by a failure to apply the proper law amounting to a manifest excess of powers.

Proper law and equity

Art. 42(3) of the ICSID Convention provides that the tribunal may decide *ex aequo et bono* if the parties so agree. The tribunal’s power to decide *ex aequo*

²⁷ At p. 122.

²⁸ At p. 125.

²⁹ *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 452.*

³⁰ *Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 516.*

³¹ *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 472/3.*

³² *Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 529/30.*

³³ At p. 530.

et bono is restricted to cases in which the parties have given their explicit permission. A decision based on equity, rather than on law, without an authorization by the parties, constitutes an excess of powers for failure to apply the proper law.

In *Klöckner v. Cameroon*, the Tribunal rejected both the claim and the counter-claim. The Tribunal had reached this result on the basis of a finding that not only Cameroon but also Klöckner had failed to discharge its obligations properly. It made a quantitative comparison of the respective failures of performance and came to the result that the amounts paid corresponded equitably to the value of the Claimant's performance.³⁴ In the *ad hoc* Committee's view, this amounted to an impermissible resort to equity:

*...the Award is based more on a sort of general equity than on positive law (and in particular French civil law) or precise contractual provisions...*³⁵

In *Amco v. Indonesia*, the *ad hoc* Committee refused to follow this strict course. It found that not every mention of equitable considerations in the award amounted to a decision *ex aequo et bono*:

*Equitable considerations may indeed form part of the law to be applied by the Tribunal, whether that be the law of Indonesia or international law.*³⁶

The *ad hoc* Committee concluded:

*The ad hoc Committee thus believes that invocation of equitable considerations is not properly regarded as automatically equivalent to a decision ex aequo et bono which, in view of the determination of the law applicable to the present case ..., would constitute a decision annulable for manifest excess of powers. Nullity would be a proper result only where the Tribunal decided an issue ex aequo et bono in lieu of applying the applicable law.*³⁷

c) Corruption of an Arbitrator

The third ground for annulment listed in Art. 52(1)(c) is that there was corruption on the part of a member of the tribunal. Corruption of an arbitrator is an obvious ground for annulment. At the same time it appears to be extremely rare. No allegation of corruption has ever been made in ICSID proceedings.

Concept of corruption

Corruption would be improper conduct by an arbitrator induced by personal gain. Acceptance of an improper payment in connection with ICSID proceedings would create a strong presumption of corruption. Mere bias without improper payment would not amount to corruption. A situation in

³⁴ *Klöckner v. Cameroon, Award, 21 October 1983, 2 ICSID Reports 61-72.*

³⁵ *Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 ICSID Reports 156.*

³⁶ *Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 516.*

³⁷ *At p. 517.*

which the arbitrator is likely to derive personal gain from the outcome of the proceedings would create a conflict of interests. This could lead to a presumption of corruption.

Special time limit

Almost by definition, corruption will be clandestine. Evidence of corruption may emerge some time after the conclusion of proceedings. It is for this reason that Art. 52(2) contains a special time limit for corruption. The application for annulment must be made within 120 days of the discovery of the corruption. In addition, there is an absolute cut-off for applications after three years from the date on which the award was rendered. Both time limits must be complied with cumulatively.

d) Serious Departure from a Fundamental Rule of Procedure

The fourth ground for annulment listed in Art. 52(1)(d) is that there has been a serious departure from a fundamental rule of procedure. This provision is designed to safeguard the basic fairness and integrity of the arbitration process. The deviation, in order to constitute a ground for annulment, must be serious and it must affect a fundamental rule.

Serious

To be serious the departure must be substantial rather than minimal. The departure must have had a material effect on the affected party. It must have deprived that party of the benefit of the rule in question. For instance, if a party is deprived of its rights to be heard, the departure is not serious if it is clear from the circumstances that the party never intended to exercise the right.

Fundamental

Not every procedural rule in the Convention or in the Arbitration Rules is fundamental. The history of this provision and the practice under it would suggest that a failure to give both parties the opportunity to be heard would constitute a violation of a fundamental rule. Also, the requirement of deliberation among the arbitrators appears to be fundamental. But arbitrators do not commit a serious departure from a fundamental rule of procedure if they base their decision on an argument that was not developed and discussed by the parties.³⁸

In *Amco v. Indonesia*, Indonesia complained that the Tribunal had attributed to Indonesia knowledge of certain facts, but that it had denied that PT Amco had been duly warned about the failure to register its claimed investments. The *ad hoc* Committee refused to see a lack of impartiality in the conclusions reached by the Tribunal on these two unrelated issues:

88. *The ad hoc Committee acknowledges that differing results were reached by the Tribunal in the two above situations. But the ad hoc Committee,*

³⁸ Klöckner v. Cameroon, *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 127, 129.

*after according due regard to the fundamental rule of equality of the parties, is unable to conclude that the Tribunal in evaluating the surrounding facts in the two situations clearly exceeded the scope of discretionary authority granted to it by Arbitration Rule 34 and must consequently refuse Indonesia's claim of nullity in this regard.*³⁹

Right to be heard

The principle that both sides must be heard (*audiatur et altera pars*) on all issues affecting their legal position is a basic concept of fairness and a fundamental rule of procedure. But this principle does not mean that the tribunal is precluded from adopting legal reasoning that was not put forward by one of the parties without first seeking the parties' opinion.

In *Klöckner v. Cameroon*, Klöckner complained that there had been a serious departure from a fundamental rule of procedure in that the Tribunal had based its decision on arguments not discussed by the parties.⁴⁰ The *ad hoc* Committee observed that the Tribunal was neither under an obligation to hear the parties on the reasons it was about to select for its decision nor bound to choose among the arguments put forward by the parties:

*...arbitrators must be free to rely on arguments which strike them as the best ones, even if those arguments were not developed by the parties (although they could have been). Even if it is generally desirable for arbitrators to avoid basing their decision on an argument that has not been discussed by the parties, it obviously does not follow that they therefore commit a serious departure from a fundamental rule of procedure.*⁴¹

Timely objection

A party must react immediately to a violation of proper procedure by stating its objection and by demanding compliance. Arbitration Rule 27 states that failure to object will be interpreted as a waiver to object at a later stage. A party that has failed to protest against a perceived procedural irregularity before the tribunal when it had the opportunity to do so, is precluded from arguing that this irregularity constituted a serious departure from a fundamental rule of procedure for purposes of annulment.

In *Klöckner v. Cameroon*, the Claimant complained about the violation of its right to be heard. The *ad hoc* Committee said:

*... it suffices to note that the Claimant has not established that it made a timely protest against the serious procedural irregularities it now complains of. ...Rule [27⁴²] of the ICSID Rules of Procedure for Arbitration Proceedings would therefore rule out a good part of its complaints.*⁴³

³⁹ *Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 532. Arbitration Rule 34 deals with evidence: 1 ICSID Reports 169/70.*

⁴⁰ *Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 ICSID Reports 128.*

⁴¹ *At p. 129.*

⁴² *The Arbitration Rules were renumbered in 1984.*

⁴³ *Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 ICSID Reports 128.*

e) Failure to State Reasons

The fifth ground for annulment listed in Art. 52(1)(e) is that the award has failed to state the reasons on which it is based. A statement of reasons is generally seen as a necessity for any orderly administration of justice. The ICSID Convention contains a duty to state reasons in Art. 48(3). The tribunal's obligation to state reasons is absolute and may not be waived. An agreement between the parties to the effect that reasons need not be stated would be invalid.⁴⁴

Incomplete reasons

In view of the clear obligation to state reasons, a total absence of reasons is extremely unlikely and has never occurred. More likely is the absence of reasons for certain parts of an award. The incompleteness of reasons has been argued in most annulment cases.

In *Klöckner v. Cameroon*, the *ad hoc* Committee found that the Tribunal had imposed an "obligation of result" upon the Claimant without ever explaining the reasons for doing so:

... the Award in no way allows the ad hoc Committee or for that matter the parties to reconstitute [reconstruct?] the arbitrators' reasoning in reaching a conclusion that is perhaps ultimately perfectly justified and equitable (and the Committee has no opinion on this point) but is simply asserted or postulated instead of being reasoned. The complaint must therefore be regarded as well founded, to the extent that it is based on Article 52(1)(e).⁴⁵

In other cases the *ad hoc* Tribunals were willing to reconstruct reasoning:³

In *MINE v. Guinea*, Guinea had complained that the Tribunal had failed to give reasons for awarding interest at the United States bank rate. The *ad hoc* Committee said:

6.104 Guinea advances a separate objection to the Tribunal's failure to give reasons for the award of interest at the United States bank rate. In light of the fact that the United States dollar was the currency of the contract, the justification of that currency and bank rate of interest is apparent. An express statement to that effect is however wanting.⁴⁷

Insufficiency of reasons

A statement of reasons that does not explain to the reader of the award, especially to the parties, how and why the tribunal came to its decision may not properly be called a statement of reasons. On the other hand, the standard for an acceptable explanation is highly subjective. *Ad hoc* committees have tried to formulate standards for the adequacy of reasons. They have postulated

⁴⁴ *MINE v. Guinea, Decision on Annulment, 22 December 1989, 4 ICSID Reports 88.*

⁴⁵ *Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 ICSID Reports 149.*

⁴⁶ *See also Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 526.*

⁴⁷ *MINE v. Guinea, Decision on Annulment, 22 December 1989, 4 ICSID Reports 108.*

that reasons must be “sufficiently relevant”⁴⁸ or that they “must constitute an appropriate foundation for the conclusions reached”.⁴⁹

The *ad hoc* Committee in *MINE v. Guinea*, sought to introduce a less subjective test. The standard introduced by *MINE* merely requires that the reasons enable the reader to understand what motivated the tribunal. The *ad hoc* Committee said:

*5.09 In the Committee’s view, the requirement to state reasons is satisfied as long as the award enables one to follow how the tribunal proceeded from Point A. to Point B. and eventually to its conclusion, even if it made an error of fact or of law. This minimum requirement is in particular not satisfied by either contradictory or frivolous reasons.*⁵⁰

Contradictory reasons

Contradictory reasons will not enable the reader to understand the tribunal’s motives. They are inadequate by definition. Contradictory reasons amount to a failure to state reasons since “two *genuinely* contradictory reasons cancel each other out”.⁵¹

In *Amco v. Indonesia*, the issue of contradictory reasons concerned the method employed by the Tribunal for calculating the required amount of invested capital. The Award had included a loan in its calculation although it had acknowledged previously that only equity capital but not loans could be taken into account.⁵² The *ad hoc* Committee said:

*the Tribunal was aware of the rule excluding loan funds from the foreign capital investment ...therefore...the Tribunal seems to have contradicted itself. At least this impression is not fully disproved by the text of the Award itself.*⁵³

The *ad hoc* Committee concluded that the Tribunal had failed to state reasons for its calculation of the investment.

Failure to deal with every question

Article 48(3) of the Convention states:

(3) The award shall deal with every question submitted to the Tribunal, and shall state the reasons upon which it is based.

52(1)(e) lists failure to state reasons but it does not state that failure to deal with every question is a ground for annulment. Nevertheless, *ad hoc* committees have held that both requirements of Art. 48(3) are covered by Art. 52(1)(e).⁵⁴

⁴⁸ Klöckner v. Cameroon, *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 138/9, 143.

⁴⁹ Amco v. Indonesia, *Decision on Annulment*, 16 May 1986, 1 ICSID Reports 520.

⁵⁰ MINE v. Guinea, *Decision on Annulment*, 22 December 1989, 4 ICSID Reports 88.

⁵¹ Klöckner v. Cameroon, *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 137. *Italics original.*

⁵² Amco v. Indonesia, *Award*, 20 November 1984, 1 ICSID Reports 474, 483, 486, 487.

⁵³ Amco v. Indonesia, *Decision on Annulment*, 16 May 1986, 1 ICSID Reports 536.

⁵⁴ Klöckner v. Cameroon, *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 137; Amco v. Indonesia, *Decision on Annulment*, 16 May 1986, 1 ICSID Reports 517/8; MINE v. Guinea, *Decision on Annulment*, 22 December 1989, 4 ICSID Reports 82, 87-89, 96, 104-7.

Supplementation under Art. 49(2) will be useful only in cases of inadvertent omissions of a technical character. Art. 49(2) will not be useful in cases of a failure to address major facts and arguments which go to the core of the tribunal's decision.

Essential questions

The tribunal's obligation to deal with every question submitted to it does not mean that it has to address every argument advanced by a party. Some arguments may be irrelevant, peripheral or obsolete. In order to form a basis for annulment, a question that has not been dealt with, must be an essential question in the sense that it could have affected the outcome of the award. An essential question may also be understood in the sense of a crucial or decisive argument. An argument is crucial or decisive if its acceptance would have altered the tribunal's conclusions.

How to deal with questions

Normally an essential question or a decisive argument should be addressed directly. This may be done by either accepting it or by rejecting it and giving reasons for its rejection. Sometimes it is unnecessary to address an argument directly, since it is logically ruled out or made irrelevant by something the tribunal has found. In situations of this kind, questions may be dealt with indirectly. If it can be implied from the reasons given by the tribunal why a particular argument cannot be sustained, it is not necessary to dismiss that argument explicitly.

Summary:

- **The five grounds for annulment are listed exhaustively in Art. 52(1).**
- **Improper constitution of a tribunal has never been alleged.**
- **Manifest excess of powers may occur if the tribunal decides without or beyond its jurisdiction.**
- **Failure to exercise an existing jurisdiction also constitutes an excess of powers.**
- **Failure to apply the proper law has also been found to constitute an excess of powers.**
- **Failure to apply the proper law must be distinguished from a mere error of law.**
- **If the parties have not authorized the tribunal to decide *ex aequo et bono*, a decision based on equity rather than on law constitutes an excess of powers.**
- **Corruption of an arbitrator has never been alleged in ICSID proceedings.**
- **Not every violation of a procedural rule constitutes a serious departure from a fundamental rule of procedure.**
- **Incomplete, insufficient and contradictory reasons amount to a failure to state reasons.**
- **Failure to deal with an essential question has also been held to constitute a failure to state reasons.**

6. ANNULMENT: PROCEDURE

The procedure governing annulment is covered by the Convention in Art. 52 (2)-(5) in the following terms:

(2) The application shall be made within 120 days after the date on which the award was rendered except that when annulment is requested on the ground of corruption such application shall be made within 120 days after discovery of the corruption and in any event within three years after the date on which the award was rendered.

(3) On receipt of the request the Chairman shall forthwith appoint from the Panel of Arbitrators an ad hoc Committee of three persons. None of the members of the Committee shall have been a member of the Tribunal which rendered the award, shall be of the same nationality as any such member, shall be a national of the State party to the dispute or of the State whose national is a party to the dispute, shall have been designated to the Panel of Arbitrators by either of those States, or shall have acted as a conciliator in the same dispute. The Committee shall have the authority to annul the award or any part thereof on any of the grounds set forth in paragraph (1).

(4) The provisions of Articles 41-45, 48, 49, 53 and 54, and of Chapters VI and VII shall apply mutatis mutandis to proceedings before the Committee.

(5) The Committee may, if it considers that the circumstances so require, stay enforcement of the award pending its decision. If the applicant requests a stay of enforcement of the award in his application, enforcement shall be stayed provisionally until the Committee rules on such request.

Application for annulment

The application for annulment must state which of the award's features exhibit flaws that constitute grounds for annulment. The information contained in the application may be developed by the requesting party in subsequent phases of the proceeding.

Time limits

Art. 52(2) imposes a general time limit for all cases except corruption and a special set of time limits for corruption. The general time limit is 120 days calculated from the date on which the award was rendered. In the case of an allegation of corruption, the time limit of 120 days is calculated from the day the corruption is discovered. In addition, there is an absolute cut-off date three years after the award was rendered.

Effect of time limit

The time limit means that any application for annulment must be submitted before its expiry. But it also means that all grounds for annulment must be put forward within the time limit. A party may not rely on additional grounds for annulment after the time limit has lapsed. The application must state the grounds on which it is based in detail.⁵⁵ Therefore, it is not sufficient to file a formal application within 120 days and provide substantiation later on.

⁵⁵ *Arbitration Rule 50(1)(c).*

In *Amco v. Indonesia*, Amco contended that a number of pleas advanced by Indonesia for the annulment of the Award were time-barred since they were raised for the first time in a memorial, after the expiry of the time limit. The *ad hoc* Committee agreed that it would be insufficient for an application for annulment merely to recite grounds for annulment as contained in Art. 52(1) together with a prospect for further submissions at a later stage. But it also found that statements made in the Application could be taken together with their development and amplification in a later memorial. The *ad hoc* Committee proceeded to a detailed examination of whether the claims for annulment made by Indonesia were reasonably covered by the statements made in Indonesia's Application for annulment, which had been lodged in a timely manner.⁵⁶ This examination led to the following result:

*53. The ad hoc Committee believes that the grounds above pointed to by Amco are not really new grounds raised for the first time by Indonesia in its Memorial but were either in fact referred to in the Application or reasonably implicit in the Application. The statements in Indonesia's Memorial thus constitute developments or specifications of statements already made in the Application.*⁵⁷

Appointment of members of ad hoc committee

Annulment proceedings take place before an *ad hoc* committee that is appointed especially for this purpose. Unlike an arbitral tribunal, an *ad hoc* committee is not appointed by the parties but by the Chairman of ICSID's Administrative Council. This function is performed *ex officio* by the President of the World Bank. Appointments must be made from the Panel of Arbitrators. The Panel of Arbitrators is composed of persons designated by Contracting States and by the Chairman in accordance with Arts. 12-16.

Exclusionary rules

Art. 52(3) of the Convention excludes certain categories of persons from serving on an *ad hoc* committee. These exclusionary rules are considerably stricter than those for arbitral tribunals as provided by Arts. 38 and 39. The exclusionary rules are designed to safeguard maximum objectivity and to avoid even the remote semblance of partisanship.

Procedure: applicable provisions

Many but not all of the Convention's provisions on procedure before a tribunal apply to annulment proceedings. Article 52(4) specifies which of the Convention's provisions apply *mutatis mutandis*⁵⁸ to annulment. Provisions dealing with procedure that are to be applied by analogy include Art. 43 dealing with evidence, Art. 45 dealing with default by a party and Art. 48 dealing with majority voting, written form, statement of reasons, individual opinions and publication of awards. Other provisions that apply in annulment proceedings are Art. 49 dealing with dispatch, supplementation and correction. The reference to Art. 53 means that the decision on annulment is binding on the

⁵⁶ *Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 521/2, 528.*

⁵⁷ *At p. 523.*

⁵⁸ *Mutatis mutandis: with the necessary changes.*

parties and not subject to any appeal or remedy except as provided in the Convention. The reference to Art. 54 means that decisions on annulment must be recognized and enforced by all States parties to the Convention. The reference to Chapter VI means that the Convention's provisions on the cost of proceedings extend to annulment proceedings. The reference to Chapter VII means that the place of annulment proceedings is the seat of the Centre unless the parties agree otherwise.

Procedure: provisions that are not applicable

Other provisions of the Convention are not applicable to annulment proceedings. These include Art. 47 dealing with provisional measures, Art. 46 dealing with incidental, additional or counter-claims, Art. 50 dealing with interpretation and Art. 51 dealing with revision. The non-inclusion of Art. 52 means that a decision on annulment is not itself subject to annulment. The non-inclusion of Chapter V (Arts. 56-58) dealing with the replacement and disqualification of conciliators and arbitrators creates a curious gap. In practice, this gap has been closed by the application of Arbitration Rules 8-12⁵⁹ dealing with the incapacity, resignation and disqualification of arbitrators and with the resulting procedural steps.

Stay of Enforcement

Under Art. 52(5) the *ad hoc* committee has the power to stay enforcement of the award pending its decision. This power is discretionary. Until the committee is constituted and can rule on a request for stay of enforcement, the stay will be automatic if it is requested in the application for annulment.

Posting of security

Some *ad hoc* committees have required that the award debtor provide some security for the eventual payment of the award, should it be upheld. This is a useful counterbalance to a stay of enforcement. Such a security may be in the form of a bank guarantee or a similar arrangement that may be drawn upon when the award becomes final. The guarantee will only operate if annulment is rejected and the award becomes enforceable.

Summary:

- **A request for annulment is generally subject to a time limit of 120 days. Corruption has special time limits.**
- **Appointment of members of *ad hoc* committees follows strict rules designed to safeguard maximum objectivity.**
- **Some but not all of the Convention's provisions on procedure before a tribunal apply to annulment proceedings.**
- **Enforcement of the award may be stayed during annulment proceedings.**

⁵⁹ 1 ICSID Reports 162/3.

7. RESUBMISSION TO A NEW TRIBUNAL AFTER ANNULMENT

Article 52(6) of the Convention provides for resubmission of a dispute after the annulment of an award in the following terms:

(6) If the award is annulled the dispute shall, at the request of either party, be submitted to a new Tribunal constituted in accordance with Section 2 of this Chapter.

New tribunal

A decision to annul does not replace the award with a new decision. Rather, the parties are given the opportunity to start ICSID arbitration proceedings before a new tribunal. The initiative for resubmission must come from one or both parties. A person who had previously acted as arbitrator or member of the *ad hoc* committee in the case may not be appointed as a member of the new tribunal⁶⁰ unless the parties agree otherwise.

Partial annulment and res judicata

If the original award had only been annulled in part, the unannulled portion of the original award remains *res judicata* and is binding on the new tribunal.⁶¹

In *Amco v. Indonesia*, the *ad hoc* Committee annulled the first Award subject to broad qualifications. In addition, it identified certain specific findings of the first Tribunal to which the annulment did or did not apply.⁶² The new Tribunal in the resubmitted case undertook a careful stocktaking of findings of the first Tribunal that had been annulled or had not been annulled by the *ad hoc* Committee.⁶³ It identified a list of points on which the *ad hoc* Committee had explicitly refused to annul the first Tribunal's findings or had specifically confirmed the holdings in the original Award. In addition, the new Tribunal gave a list of specific annulment findings of the *ad hoc* Committee.⁶⁴ It was clear that points on which the Award was annulled fell to be relitigated.⁶⁵ It was equally clear that matters sought by a party to be annulled but which had expressly not been annulled or had been expressly confirmed were *res judicata*.⁶⁶ Holdings by the first Tribunal that had not been challenged in the annulment proceedings and on which the *ad hoc* Committee, consequently, had not made a pronouncement were also held to be *res judicata*.⁶⁷

⁶⁰ *Arbitration Rule 1(4)*.

⁶¹ *Arbitration Rule 55(3)*.

⁶² *Amco v. Indonesia, Decision on Annulment, 16 May 1986, 1 ICSID Reports 542*.

⁶³ *Amco v. Indonesia, Resubmitted Case: Decision on Jurisdiction, 10 May 1988, 1 ICSID Reports 547*.

⁶⁴ *At pp. 546/6, 553-556*.

⁶⁵ *See also at p. 558*.

⁶⁶ *At p. 553*.

⁶⁷ *At pp. 556/7*.

Reasoning of ad hoc committees

At times *ad hoc* committees did not restrict themselves to finding that there were grounds for annulment but also expressed opinions as to what the correct decision should have been. The question arises whether the findings of the *ad hoc* committee on the substance of the case are binding on the new tribunal or whether it is free to make its own determinations once the award or part of the award has been annulled.

In *Amco v. Indonesia*, Indonesia argued that certain findings of fact and law that were essential to, or necessarily flow from the Annulment Decision, must also be binding on the new Tribunal.⁶⁸ The new Tribunal refused to accept the Indonesian argument under which the reasons of the *ad hoc* Committee were to be treated as *res judicata*. Rather, the normal effect of annulment was to place the parties in the legal position in which they stood before the commencement of the proceedings.⁶⁹ Only the *ad hoc* Committee's determination as to the existence of one of the grounds for annulment listed in Art. 52(1) was binding. The *ad hoc* Committee was not an appeals court rehearing the case on its merits.⁷⁰ The new Tribunal said:

The authority given to the ad hoc Committee is clearly that of nullity and not of substantive revision. If the present Tribunal were bound by "integral reasoning" of the ad hoc Committee, then the present Tribunal would have bestowed upon the ad hoc Committee the role of an appeal court.⁷¹

New claims and arguments

Under Art. 52(6) it is the original dispute which may be submitted for relitigation. This means that the parties may not introduce new claims before the new tribunal. This does not mean that a party may not reintroduce claims or arguments that it had used before the first tribunal but on which that tribunal had found it unnecessary to rule.

In *Amco v. Indonesia*, a claim of unjust enrichment had been advanced by Amco before the first Tribunal but that Tribunal reached its findings on other grounds. The second Tribunal rejected Indonesia's contention that the introduction of unjust enrichment would create a new argument to evade the force of *res judicata*. It ruled that the claim of unjust enrichment could still be advanced in the resubmitted proceeding⁷² but rejected it on the merits.⁷³

⁶⁸ At p. 548.

⁶⁹ At p. 459.

⁷⁰ At p. 550.

⁷¹ At p. 552.

⁷² At p. 560/1.

⁷³ *Amco v. Indonesia, Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 578, 607/8.*

Summary:

- **If the award has been annulled, the dispute may be submitted to a new tribunal.**
- **In the case of partial annulment, the unannulled portion of the award remains binding.**
- **The reasons of the *ad hoc* committee are not binding on the new tribunal.**
- **The parties may not introduce new claims before the new tribunal.**

TEST MY UNDERSTANDING

After having studied this Module the reader should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. What remedies are available to a party after an ICSID award has been rendered?
2. Is it possible to take steps against an ICSID award before domestic courts?
3. What are the bodies that decide upon the various remedies?
4. What is the difference between annulment and appeal?
5. May a party request partial annulment of an award?
6. What are the grounds for annulment listed in the Convention?
7. Which of these grounds have been used in practice?
8. Why does failure to apply the proper law constitute an excess of powers?
9. What constitutes a serious departure from a fundamental rule of procedure?
10. Does “failure to state reasons” just mean a total absence of reasons?
11. What remedies are available if an award is incomplete and does not cover all points raised by the parties?
12. May a party raise new grounds for annulment in the course of annulment proceedings?
13. How and by what criteria are members of *ad hoc* committees appointed?
14. If an *ad hoc* committee finds that there is a ground for annulment, is it under an obligation to annul?
15. If an award is annulled and the dispute is resubmitted to a new tribunal, is that tribunal in any way limited in its discretion by:
 - a) the decision of the original tribunal?
 - b) the decision of the *ad hoc* committee?

HYPOTHETICAL CASES

Asterix Corp. v. Middleland

The ICSID Tribunal in *Asterix Corp. v. Middleland* found that it had jurisdiction and upheld the claim on the merits. In this case, a concession contract between the two parties had granted an investment license to Asterix to establish film studios in Northtown, the capital of Middleland. The contract provided for the settlement of any disputes arising from the investment through ICSID arbitration but did not contain a choice of law clause. Asterix is a national of Easterly. Both Middleland and Easterly are parties to the ICSID Convention.

Shortly after Asterix started operating, the authorities of Middleland complained in a letter to the management that Asterix was operating in violation of the local labour law. That law contains a provision mandating that all businesses must adhere to employment practices that avoid any form of discrimination especially those on the basis of gender and national origin. All higher management positions in Asterix's operation in Middleland were occupied by male nationals of Easterly. Exactly one year after the complaint, Middleland revoked the investment license on the ground that Asterix had consistently violated the non-discrimination provision in Middleland's labour law. At the same time, Middleland ordered all of Asterix's employees of Easterly nationality to leave the country. Asterix was also informed that this decision was not subject to any appeal.

The Tribunal held that the revocation of the license was "a grave violation of the principles of fair procedure and due process" and that it constituted a "de facto expropriation" of Asterix. The Tribunal did not rely on any specific provisions of the law of Middleland but referred to "basic and universally recognized precepts of international law" without entering into a specific discussion of their contents. The Tribunal's award of damages was based on an "equitable estimate" of possible future profits. The Tribunal awarded compound interest on the amount of damages to run from the date of the cancellation of the license. This more than doubled the amount of the damages. Neither party had presented arguments on the method of calculating damages to the Tribunal.

Middleland wishes to request the annulment of the award. It turns to you for advice. You have three tasks:

1. Advise Middleland on the procedure and the necessary steps to be taken to secure annulment.
2. Draft Middleland's application for annulment to be submitted to ICSID.
3. Advise Middleland on possible counter-arguments by Asterix and ways to deal with these.

Aquarius Corp. v. Eldorado

Aquarius is a company with its registered head office in Franconia. It is specialized in the processing and distribution of drinking water. In 1999 Aquarius entered into a contract with Aridia, a province of Eldorado. The contract provides for the setting up and operation of a modern water supply system in Aridia by Aquarius. The contract with Aridia contains a dispute settlement clause which provides:

“Any dispute between the parties to this agreement concerning its interpretation and application shall be subject to the exclusive jurisdiction of the courts of Aridia.”

A Bilateral Investment Treaty (BIT) between Eldorado and Franconia contains the following clause:

“10.4: Any dispute between a Contracting Party and a national of the other Contracting Party relating to an investment shall be submitted, at the request of the investor, to arbitration by the International Centre for Settlement of Investment Disputes.”

The BIT also contains the following choice of law clause:

“10.6: The tribunal shall decide on the basis of this treaty, the law of the Contracting Party which is a party to the dispute, the terms of possible specific agreements concluded in relation to the investment and principles of international law.”

The BIT also provides for full protection and security, for national treatment and for most favoured nation treatment for investors of the other country. In addition, the BIT prohibits direct or indirect expropriation except for a public purpose, without discrimination and against full, prompt and effective compensation.

Both Franconia and Eldorado are parties to the ICSID Convention.

Shortly after Aquarius completed constructing the water supply system and commenced operations, the provincial government of Aridia increased the taxes to be paid by Aquarius sevenfold. At the same time, Aridia issued a decree freezing the rates for public utilities, thereby preventing Aquarius from passing on the costs of the tax increases to its customers. Aquarius argues that, as a consequence, it was no longer able to operate profitably.

Aquarius instituted ICSID proceedings against Eldorado on the basis of the BIT. The Tribunal issued an Award consisting of a part dealing with jurisdiction and a part dealing with the merits.

In the Award’s section on jurisdiction, the Tribunal held:

1. The BIT between the two countries conferred jurisdiction upon the tribunal, notwithstanding the dispute settlement clause in the 1999 contract between Aquarius and Aridia.
2. Under accepted principles of State responsibility, acts of a constituent subdivision or province of a State that are in violation of international law, are attributable to the central government.

In the Award's section on the merits, the Tribunal held:

In view of the dispute settlement clause in the 1999 contract, an ICSID tribunal will not hear the claim until and unless the Claimant has first used all remedies available in the courts of Aridia.

Aquarius seeks annulment of the Award.

Your task is to:

1. Draft a memorial for Aquarius setting out the grounds for annulment as comprehensively as possible.
2. Draft a memorial for Eldorado refuting all the grounds for annulment put forth by Aquarius.
3. Draft the decision of the *ad hoc* Committee.
The decision may either:
 - a) refuse to annul the Award; or
 - b) annul the Award in its entirety; or
 - c) annul the Award in part.

FURTHER READING

Books

- **Schreuer, C.**, *The ICSID Convention: A Commentary* (2001).

Articles

- **Broches, A.**, *Convention on the Settlement of Investment Disputes between States and Nationals of Other States 1965, Explanatory Notes and Survey of its Application*, 18 *Yearbook of Commercial Arbitration* 627, 686-699 (1993).
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- **Caron, D. D.**, *Reputation and Reality in the ICSID Annulment Process: Understanding the Distinction Between Annulment and Appeal*, 7 *ICSID Review—Foreign Investment Law Journal* 21 (1992).
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- **Leigh, M.**, *Arbitration—Annulment of Arbitral Award for Failure to Apply Law Applicable Under ICSID Convention and Failure to State Sufficiently Pertinent Reasons*, 81 *American Journal of International Law* 222 (1987).
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- **Reisman, W. M.**, Repairing ICSID's Control System: Some Comments on Aron Broches' «Observations on the Finality of ICSID Awards», 7 ICSID Review—Foreign Investment Law Journal 196 (1992).
- **Schreuer, Ch.**, Decisions Ex Aequo et Bono Under the ICSID Convention, 11 ICSID Review—Foreign Investment Law Journal 37 (1996).
- **Sturzenegger, M.**, ICSID Arbitration and Annulment for Failure to State Reasons, 9 Journal of International Arbitration 173 (1992).

Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- List of Contracting States and other Signatories of the Convention:
<http://www.worldbank.org/icsid/constate/c-states-en.htm>
- ICSID Cases:
<http://www.worldbank.org/icsid/cases/cases.htm>
- ICSID Arbitration Rules (1984).

Cases

- *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, 1 ICSID Reports 509.
- — Resubmitted Case: Decision on Jurisdiction, 10 May 1988, 1 ICSID Reports 543.
- — Resubmitted Case: Award, 5 June 1990, rectified 17 October 1990, 1 ICSID Reports 569.
- — Resubmitted Case: Rectification, 17 October 1990, 1 ICSID Reports 638.
- *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, Award, 21 November 2000, 40 ILM 457 (2001).
- — Decision on Annulment, 3 July 2002, 41 ILM ??? (2002).
- *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, 2 ICSID Reports 95.
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- *MINE v. Guinea*, Decision on Annulment, 22 December 1989, 4 ICSID Reports 79.
- *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, 41 ILM 933 (2002).

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.9 BINDING FORCE AND ENFORCEMENT



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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OVERVIEW

This Module deals with an ICSID award's binding force and with its enforcement. These matters are regulated in the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention).

ICSID awards are final and not subject to any appeal or other remedy except as provided for by the Convention itself. Under the Convention, post-award remedies are limited to supplementation and rectification, interpretation, revision and annulment. These post-award remedies are described in Module 2.7.

ICSID awards are binding on the parties. The parties are under a legal obligation to comply with awards.

Voluntary compliance is the norm. If it is not forthcoming, the Convention provides for enforcement.

Enforcement takes place through the appropriate authorities of the States parties to the Convention. All States parties to the Convention are under an obligation to recognize and enforce ICSID awards as if they were final judgments of local courts.

Enforcement has its limit in State immunity. An award against a host State need not be enforced if this would be in violation of the rules on State immunity as applied in the enforcing State.

OBJECTIVES

Upon completion of this Module the reader should be able to:

- Explain the finality of ICSID awards.
- Explain the binding force of ICSID awards.
- Distinguish the recognition and enforcement of awards.
- Delineate the obligation to recognize and enforce awards.
- Describe the procedure for the enforcement of awards.
- Appreciate the significance of State immunity in the enforcement of awards.
- Recount the practice of domestic courts in the enforcement of ICSID awards.
- Evaluate the overall effectiveness of ICSID arbitration.

INTRODUCTION

<u>Binding force</u>	Under Article 53, an award is binding on the parties to the proceedings. This means that a losing party is under a legal obligation to comply with an award. A winning party has a legal right to demand compliance. Non-compliance by a party with an award would be a breach of a legal obligation.
<u>No review</u>	ICSID awards are not subject to any remedy, except as provided for in the Convention. The remedies under the Convention are: supplementation and rectification (Art. 49(2)), interpretation (Art. 50), revision (Art. 51) and annulment (Art. 52). These remedies are described in Module 2.7. This system of remedies is exhaustive and self-contained. In particular, awards are not subject to any review by domestic courts.
<u>Finality</u>	ICSID awards are final. This means that once an ICSID award has been rendered, the parties may not seek a remedy on the same dispute in another forum. This <i>res judicata</i> effect applies in relation to other arbitration tribunals, including ICSID tribunals, as well as domestic courts. In the case of a partial annulment under Art. 52(3), this effect applies to those parts of the award that have not been annulled.
<u>Recognition and enforcement</u>	The obligation to recognize and enforce an ICSID award is incumbent upon all States parties to the ICSID Convention. The procedure for enforcement is governed by the laws of the country where enforcement is sought. The award must be treated for purposes of enforcement like a final decision of a local court.
<u>Competent court or authority</u>	The Convention leaves the choice of the appropriate court or authority charged with the enforcement of ICSID awards to each State party to the Convention. Each State party must designate a court or authority for this purpose and notify the designation to the Secretary-General of ICSID. The party seeking recognition and enforcement must submit the award to the court or authority thus designated.
<u>Immunity from execution</u>	Under Art. 55, a State's immunity from execution remains unaffected by the ICSID Convention's provisions on enforcement. In practice, this means that only State property serving commercial purposes is subject to execution for the enforcement of an ICSID award.
<u>Additional Facility</u>	The ICSID Convention does not apply to the Additional Facility. ¹ The Additional Facility Arbitration Rules embody the principles of finality and binding force ² . But they do not contain a rule excluding external review. Also, recognition and enforcement of awards made under the Additional Facility are governed by the national law of the place of arbitration and by any applicable

¹ For an explanation of the Additional Facility see Module 2.4 dealing with requirements *ratione personae*.

² Art. 53 of the Additional Facility Arbitration Rules, 1 ICSID Reports 267.

treaties. This means that an award rendered under the Additional Facility is subject to any review or appeal provided by the law of the place of arbitration. The Additional Facility Rules provide³ that the place of arbitration must be in a State party to the 1958 [New York] Convention on the Recognition and Enforcement of Foreign Arbitral Awards.⁴ This is designed to facilitate the recognition and enforcement of resulting awards in States parties to the New York Convention. But it also means that an Additional Facility award will be subject to the reasons for non-enforcement listed in Art. V of the New York Convention.

Summary:

- **ICSID awards are final and binding. They are not subject to any review outside the Convention's system.**
- **All States parties to the Convention are under an obligation to recognize and enforce ICSID awards.**
- **Execution of an ICSID award against a State is subject to the rules on State immunity.**
- **Awards rendered under the Additional Facility are not subject to the Convention's rules on recognition and enforcement.**

³ Art. 20 of the Additional Facility Arbitration Rules, 1 ICSID Reports 258.

⁴ 330 UNTS 38; 7 ILM 1046 (1968).

1. BINDING FORCE AND FINALITY

Article 53

Art. 53 of the Convention provides for the binding force and finality of ICSID awards in the following terms:

- (1) *The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention. Each party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention.*
- (2) *For the purposes of this Section, “award” shall include any decision interpreting, revising or annulling such award pursuant to Articles 50, 51 or 52.*

Nature of arbitration

The binding nature of the award is inherent in the concept of arbitration. Arbitration is based on an agreement between the parties and this agreement includes a promise to abide by the resulting award.

Awards only

The term “award”, as used in Art. 53, only refers to final decisions of the tribunal. It does not include decisions on provisional measures under Art. 47 or procedural orders which the tribunal makes in the course of the proceedings. Also, it does not include preliminary decisions on jurisdiction. But these will ultimately be reflected in the award and will then be binding like other parts of the award. Art. 53(2) specifies that the obligation to abide by and comply with the award relates to the award as interpreted or revised. If the award is annulled, the obligation to comply disappears. If the award is annulled in part, the obligation to comply with the award applies to the unannulled portion of the award unless there is a stay of enforcement.

Constituent Subdivision or Agency

In accordance with Art. 25(1), the party on the host State’s side may be a constituent subdivision or agency designated to the Centre by that State. Under these circumstances, the effect of the award’s binding force under Art. 53 would be upon that entity. The host State, not being a party to the proceeding, would not be subject to the obligation of Art. 53. But the host State would be responsible for the compliance with an award rendered against one of its constituent subdivisions or agencies.⁵

No binding precedent

Art. 53(1) may also be read as excluding the applicability of the doctrine of binding precedent for subsequent ICSID cases.⁶ ICSID tribunals and *ad hoc* committees have repeatedly referred to and relied on previous decisions.⁷ But they have also pointed out that they were not bound by these decisions.⁸

⁵ Broches, A., *Awards Rendered Pursuant to the ICSID Convention: Binding Force, Finality, Recognition, Enforcement, Execution*, 2 *ICSID Review—Foreign Investment Law Journal* 287, 298 (1987).

⁶ Art. 59 of the Statute of the International Court of Justice is more specific on this point by saying: “The decision of the Court has no binding force except between the parties and in respect of that particular case.”

⁷ Schreuer, C., *The ICSID Convention: A Commentary*, 617 (2001).

⁸ *Amco v. Indonesia, Decision on Jurisdiction*, 25 September 1983, 1 *ICSID Reports* 395; *Amco v. Indonesia, Decision on Annulment*, 16 May 1986, 1 *ICSID Reports* 521; *LETCO v. Liberia, Award*, 31 March 1986, 2 *ICSID Reports* 352.

Obligation to comply

The award's binding force implies that the parties are under an obligation to comply with it. This obligation is independent of any procedural obstacles that may arise in the course of enforcement. In particular, even if State immunity is available to thwart enforcement, this does not affect the obligation to comply with the award.

The *ad hoc* Committee in *MINE v. Guinea* expressed this principle in the following terms:

25. ... *It should be clearly understood, ..., that State immunity may well afford a legal defense to forcible execution, but it provides neither argument nor excuse for failing to comply with an award. In fact, the issue of State immunity from forcible execution of an award will typically arise if the State party refuses to comply with its treaty obligations. Non-compliance by a State constitutes a violation by that State of its international obligations and will attract its own sanctions. The Committee refers in this connection among other things to Article 27 and 64 of the Convention, and to the consequences which such a violation would have for such a State's reputation with private and public sources of international finance.*⁹

Stay of enforcement

The duty to comply is suspended while a stay of enforcement is in force. A stay of enforcement may be granted under Arts. 50(2), 51(4) and 52(5) while proceedings for interpretation, revision or annulment are pending. A stay of enforcement is not possible in connexion with a request for supplementation or rectification in accordance with Art. 49(2).

Means to secure compliance

If a party fails to comply with an award, two types of legal action are available. One is recognition and enforcement in accordance with Art. 54. Recognition and enforcement action may be taken against either the host State or the investor. The other is legal action by a State party to the Convention in accordance with Arts. 27 (diplomatic protection) and 64 (action before the International Court of Justice). The latter remedy is only available against a host State that has failed to comply with the award.

Diplomatic protection

Diplomatic protection for the purpose of securing compliance with the award may be exercised only by the State of nationality of the aggrieved investor. Diplomatic protection may be exercised through negotiations, the institution of judicial proceedings between the two States or by any other means of dispute settlement that may be available. Referral of the dispute between the two countries to the International Court of Justice in accordance with Art. 64 of the Convention would be one of the means for dispute settlement available in such a situation. In actual practice, this has never happened.

No review by domestic courts

The Convention provides for its own self-contained system of review of awards. The exclusion of any external remedy, as expressed in Art. 53(1), also bars any review by domestic courts. A party to ICSID proceedings may not initiate

⁹ *Interim Order No. 1 on Guinea's Application for Stay of Enforcement of the Award*, 12 August 1988, 4 ICSID Reports 115/6.

action before a domestic court to seek the annulment or another form of review of an ICSID award. A court of a State that is a party to the ICSID Convention would be under an obligation to dismiss such an action. This independence from national procedures for review of arbitral awards means that the place of arbitration in ICSID proceedings is irrelevant for the award's validity and enforcement. In the same vein, national courts charged with the enforcement of an ICSID award, have no power to review that award for substantive correctness or procedural irregularities.

The *ad hoc* Committee in *MINE v. Guinea* expressed this effect of Art. 53 in the following terms:

4.02 Article 53 of the Convention provides that the award shall be binding on the parties "and shall not be subject to any appeal or to any other remedy except those provided for in this Convention". The post-award procedures (remedies) provided for in the Convention, namely, addition to, and correction of, the award (Art. 49), and interpretation (Art. 50), revision (Art. 51) and annulment (Art. 52) of the award are to be exercised within the framework of the Convention and in accordance with its provisions. It appears from these provisions that the Convention excludes any attack on the award in national courts.¹⁰

No review by ICJ

Art. 53 also excludes any appeal against an ICSID award to the International Court of Justice (ICJ). Art. 64 of the ICSID Convention provides that a dispute between Contracting Parties concerning the interpretation or application of the Convention may be referred to the ICJ. But the preparatory works to the Convention make it quite clear that Art. 64 does not confer jurisdiction on the ICJ to review the decision of an arbitral tribunal¹¹.

Exclusion of another remedy

The exclusion of another remedy means that a party to ICSID proceedings that is dissatisfied with the award may not turn to another forum to seek relief for the same claim. Once the ICSID tribunal has rendered its award and the review procedures under the Convention have been exhausted, the case is *res judicata*. The principle *ne bis in idem* precludes resort to any national or international judicial remedy. Therefore, an ICSID award may be used as a defence against an action in the same matter before another judicial forum. This would apply even if a court or tribunal otherwise had jurisdiction over the matter. This principle applies only if the ICSID award has yielded a decision on the merits of the dispute. The exclusion of another remedy would not apply if the ICSID tribunal has given an award in which it finds that the dispute is not within its jurisdiction.

¹⁰ *MINE v. Guinea, Decision on Annulment, 22 December 1989, 4 ICSID Reports 84. Cf. also at pp. 85 and 88.*

¹¹ *See Schreuer, Commentary, pp. 1084-1085.*

Summary:

- **The Convention's provisions on binding force and enforcement only relate to an "award", that is, the final decision of a tribunal.**
- **If the party to the arbitration was a constituent subdivision or agency, the obligation to comply with the award is incumbent upon that entity.**
- **There is no doctrine of binding precedent with respect to earlier ICSID awards. But earlier decisions enjoy a high degree of authority.**
- **A stay of enforcement suspends the obligation to comply.**
- **If a State party to ICSID proceedings fails to comply with the resulting award, the State of the investor's nationality may exercise diplomatic protection.**
- **ICSID awards are final and not subject to review by any decision maker including domestic courts or the International Court of Justice.**
- **A decision on the merits contained in an ICSID award is *res judicata*.**
- **Successful reliance on obstacles to enforcement, including State immunity, does not affect the obligation to comply with the award.**

2. RECOGNITION AND ENFORCEMENT

Article 54

Article 54(1) provides for a general obligation to recognize and enforce ICSID awards in the following terms:

(1) Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. A Contracting State with a federal constitution may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state.

Obligation to recognize and enforce

Under Art. 54, all States parties to the ICSID Convention shall recognize and enforce an ICSID award as if it were a final judgment of a court in that State. This obligation under the ICSID Convention is highly unusual. Other instruments governing international adjudication do not cover enforcement but leave this issue to domestic laws and treaties. These typically provide for some review of arbitral awards at the enforcement stage.¹² Enforcement under the ICSID Convention is independent of the New York Convention and other international and domestic rules dealing with the enforcement of foreign arbitral awards. Art. 54 of the Convention does not distinguish between the recognition and enforcement of awards against investors on the one side, and against host States, on the other.

Obligation of each Contracting State

Recognition and enforcement of an award may be sought in any State party to the ICSID Convention not just in the State party to the arbitration proceedings and the State of nationality of the investor who was a party to the proceedings. Therefore, the party seeking recognition and enforcement of an award has the possibility to select the forum most favourable for this purpose. This selection will be determined primarily by the availability of suitable assets. Failure of a State party to the Convention to recognize and enforce an award would be a breach of a treaty obligation and would carry the usual consequences of State responsibility, including diplomatic protection.

Awards only

The obligation to recognize and enforce only applies to final awards. Decisions preliminary to awards such as decisions upholding jurisdiction under Art. 41, decisions recommending provisional measures under Art. 47 and procedural orders under Arts. 43 and 44 are not awards and are therefore not subject to recognition and enforcement. But if these preliminary decisions are later incorporated into an award, they become part of the award and are subject to recognition and enforcement. A decision on supplementation or rectification, in accordance with Art. 49(2), also becomes part of the award with the same consequence. A settlement by the parties that is embodied into an award in accordance with Arbitration Rule 43(2), is also subject to recognition and enforcement.

¹² The most important treaty in this context is the 1958 [New York] Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Art. V of that Convention lists a number of grounds on which recognition and enforcement may be refused.

Interpretation, revision and annulment

Under Art. 53(2), “award” for purposes of Art. 54 includes decisions under Arts. 50, 51 and 52 on interpretation, revision and annulment. This means that awards are to be recognized and enforced subject to any interpretation, revision or annulment. A decision annulling the award removes the obligation to recognize or enforce it. In case of a partial annulment, the obligation to recognize and enforce the award is limited to the unannulled portion of the award.

Stay of enforcement

Recognition and enforcement is subject to the condition that there is no stay of enforcement. The duty to recognize and enforce is suspended while a stay of enforcement is in force. A stay of enforcement may be granted under Arts. 50(2), 51(4) and 52(5) while proceedings for interpretation, revision or annulment are pending.

No review

ICSID awards must not be made subject to conditions for their recognition and enforcement not provided for by the Convention. Nor is it permissible to subject them to review on the occasion of their recognition and enforcement. In the process of recognition and enforcement, the domestic court’s or other authority’s task is limited to verifying the authenticity of the ICSID awards. It may not re-examine the ICSID tribunal’s jurisdiction. It may not re-examine the award on the merits. Nor may it examine the fairness and propriety of the proceedings before the ICSID tribunal. Not even the *ordre public* (public policy) of the State where recognition and enforcement of an ICSID award is sought, is a valid ground for a refusal to recognize and enforce. This is in contrast to non-ICSID awards, including Additional Facility awards, which may be reviewed under domestic law and applicable treaties on the occasion of their recognition and enforcement.

a) Recognition of Awards

Recognition is the official confirmation that the award is authentic. It has two possible effects. One is the confirmation of the award as final and binding. The other is a step preliminary to enforcement.

Res judicata

The recognition of an award has the effect of rendering it *res judicata* in the country concerned. This means that the claim on which the award has decided must not be the subject of another proceeding before a domestic court or arbitral tribunal. The restriction to pecuniary obligations contained in the text of Art. 54(1) only relates to the enforcement of awards but not to their recognition. Therefore, a non-pecuniary obligation of specific performance, like restitution or an obligation to desist from a certain course of action, that is spelt out in an award, once recognized, will enjoy the effect of *res judicata* even though it is not subject to enforcement.

Recognition leading to enforcement

As a rule, recognition is a preliminary step leading to enforcement or execution. After recognition, the award is a valid title for execution. Recognition as a preliminary step to execution may be useful even if there are no immediate prospects of an execution because there are no available assets in the State

where recognition is sought. Once recognition has been obtained, execution will be easier should assets become available at a later stage.

Domestic law

Recognition may not be refused for reasons of domestic law. In particular, the provision on sovereign immunity from execution in Art. 55 does not apply at the stage of recognition. By contrast, Art. 54(3) subjects execution to the modalities of the local law of the country where execution is sought, including the law relating to State immunity.

Practice of domestic courts

Domestic courts, confronted with applications to recognize ICSID awards, have at times had certain difficulties in distinguishing between recognition and enforcement.¹³ In the end, the distinction was maintained.

In *SOABI v. Senegal*, the Award¹⁴ received an *exequatur*, or recognition, by the *Tribunal de grande instance* of Paris. Senegal appealed and the *Cour d'appel* of Paris vacated the order of *exequatur*.¹⁵ It held that the State of Senegal had not waived its right to invoke its immunity from execution in a Contracting State under Art. 55 of the Convention. It had not been demonstrated that execution would be carried out against commercial property. Therefore, the execution of the Award in France would be contrary to the international *ordre public* (public policy) since it would violate the principle of immunity.¹⁶

An appeal against this decision to the *Cour de cassation* was successful.¹⁷ The Court held that an *exequatur* did not constitute an act of execution which could give rise to immunity from execution. The Court added that the ICSID Convention had in its Articles 53 and 54 created an autonomous and simplified regime for recognition and execution that is independent of provisions of domestic law dealing with the recognition and enforcement of other arbitral awards.

b) Enforcement of Awards

Enforcement and execution

Article 54 of the Convention in its English version uses the words “enforcement” and “execution” interchangeably. Any attempt to create a distinction between the two concepts cannot be sustained in light of the equally authentic French and Spanish texts of the Convention.¹⁸

Pecuniary obligations

The obligation to enforce is limited to the pecuniary obligations imposed by

¹³ See also *Benvenuti & Bonfant v. Congo*, *Cour d'appel, Paris*, 26 June 1981, 1 ICSID Reports 368 et seq.; 108 *Journal du Droit International* 365/6, 843, 845 (1981); *LETCO v. Liberia*, *US District Court SDNY*, 5 September 1986, 12 December 1986, 2 ICSID Reports 383-389.

¹⁴ *SOABI v. Senegal*, Award, 25 February 1988, 2 ICSID Reports 190.

¹⁵ *Cour d'appel, Paris*, 5 December 1989, 2 ICSID Reports 337; 117 *Journal du Droit International* 141 (1990).

¹⁶ 2 ICSID Reports 340/1.

¹⁷ *Cour de cassation*, 11 June 1991, 2 ICSID Reports 341; 118 *Journal du Droit International* 1005 (1991).

¹⁸ For a detailed analysis see Schreuer, *Commentary*, pp. 1121-1124.

the award. The obligation to recognize extends to any type of obligation under an award. There are many possibilities for non-pecuniary obligations that awards might impose. Examples would be the reinstatement of wrongfully discharged personnel or compliance with performance requirements like the use of local components. Non-pecuniary obligations imposed upon the host State by an award could include the restitution of seized property, the granting of a permission to transfer currency or desistance from imposing unreasonable taxes. ICSID tribunals have in all known cases only imposed pecuniary obligations. But it is possible that future awards will provide for specific performance or injunctions. Obligations imposed by an award that are not expressed in monetary terms are equally binding even though the enforcement procedure of Art. 54 does not apply to them.

**Constituent
subdivision or agency**

A constituent subdivision or agency, designated to the Centre in accordance with Art. 25(1) of the Convention, may become a party to ICSID arbitration independently of its parent State.¹⁹ In such a case, the obligation to abide by and comply with an award (Art. 53) would be incumbent upon the constituent subdivision or agency rather than upon the host State. It follows that any measures of enforcement would have to be taken against the constituent subdivision or agency and not against the host State. Conversely, an award rendered against the host State would not be enforceable against one of its subdivisions or agencies. This would also apply with respect to State-controlled entities that are not designated as constituent subdivisions or agencies under Art. 25(1). Therefore, an award against a State may not be enforced against a separate juridical person that has some connexion to the State.

In *Benvenuti & Bonfant v. Congo*, an attempt was made in France to enforce the ICSID Award rendered against The Congo²⁰ against Banque Commerciale Congolaise (BCC). BCC was not a constituent subdivision or agency designated under Art. 25(1). The attempt to enforce the Award rendered against the State by seizing property of BCC failed. The *Cour de cassation*, upholding a decision of the *Cour d'appel* of Paris, held that Benvenuti & Bonfant was the creditor of the State of The Congo but not of BCC. The bank, though dependent on the State, could not be regarded as an emanation of the State of the Congo. The control exercised by the State was not sufficient to regard it as an emanation of that State.²¹

**Final judgment of
domestic court**

The reference to a final judgment of a domestic court puts ICSID awards on the same footing with domestic judgements that are not subject to review. A final court decision is one against which no ordinary remedy is available. Even a judgment of a lower court may be final if it is not subject to review or if the time limits for an appeal or another remedy have expired.

¹⁹ For the role of constituent subdivisions and agencies of host States see Module 2.4 on jurisdiction *ratione materiae*.

²⁰ Award, 15 August 1980, 1 ICSID Reports 330.

²¹ *Benvenuti and Bonfant v. Banque Commerciale Congolaise, France, Cour de cassation*, 21 July 1987, 1 ICSID Reports 373, 115 *Journal du Droit International* 108 (1988).

Federal constitutions

The clause in Art. 54(1), second sentence, referring to a State with a federal constitution was inserted upon the insistence of the United States. As far as it provides for enforcement of ICSID awards through federal courts it is superfluous since States are free to choose the courts or authorities designated for enforcement anyway. Treatment of an award like a judgment of a component state may be problematical if the federal courts have the power to review the judgments of component States. No practical problems have arisen in this context.

c) Procedure

The procedure for recognition and enforcement is covered by Art. 54(2) and (3) in the following terms:

(2) A party seeking recognition or enforcement in the territories of a Contracting State shall furnish to a competent court or other authority which such State shall have designated for this purpose a copy of the award certified by the Secretary-General. Each Contracting State shall notify the Secretary-General of the designation of the competent court or other authority for this purpose and of any subsequent change in such designation.

(3) Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought.

Certified copy of award

A party must furnish a copy of the award certified by the Secretary-General in order to obtain recognition or enforcement by the competent court or authority. Under Art. 11 of the Convention, the Secretary-General authenticates arbitral awards and certifies copies thereof. Certified copies of the award will be dispatched promptly by the Secretary-General to the parties. Only awards that are not subject to a stay of enforcement may be furnished to a competent court or other authority for purposes of recognition and enforcement. Certified copies of awards dispatched after the imposition of a stay of enforcement will reflect this fact.

Submission by party to proceedings

Only a party to the original ICSID arbitration proceeding may submit the award for recognition and enforcement. An interested third party is not entitled to do so. This would exclude action by a State acting on behalf of its constituent subdivision or agency that was a party to the ICSID proceedings. A State acting in the exercise of diplomatic protection of its national who was a party to an ICSID proceeding, is also barred from acting under Art. 54(2).

Parallel proceedings

There is no reason why proceedings for recognition and enforcement of an ICSID award should not be initiated in several States simultaneously. Recognition of an award in several States may be necessary to secure its *res judicata* effect. If execution of the award is sought in several States, the courts and competent authorities in these States will have to co-ordinate their steps to make sure that payment is not made more than once.

Designation of competent court or other authority

Many States parties to the Convention have made the designations required by Art. 54(2). These States cover practically all major commercial and financial centres where assets are likely to be found. The Centre publishes a list of Designations of Courts or Other Authorities Competent for the Recognition and Enforcement of Awards Rendered Pursuant to the Convention.²² Designations vary widely. Most designations refer to courts but some refer to executive authorities. Some countries have designated a single court or authority, others have designated certain types of courts. Where courts have been designated, these are sometimes the courts of first instance and sometimes the supreme courts.

Application of local procedure

The execution of ICSID awards is subject to the law of the country where the execution takes place. Therefore, only procedures and remedies that are available under the local law will be applied to ICSID awards. Obstacles to the enforcement of an ICSID award under the law where execution is sought in no way affect the obligation of the party to the ICSID arbitration to abide by and comply with the award in accordance with Art. 53(1). A State that successfully relies on the laws concerning State immunity from execution will still be in violation of its obligation under the Convention. The consequence would be a revival of the right of diplomatic protection under Art. 27(1).

Summary:

- **A party to ICSID arbitration may seek recognition and enforcement in any State party to the Convention.**
- **Only a final award is subject to recognition and enforcement.**
- **Awards are to be recognized and enforced subject to any interpretation, revision and annulment.**
- **Recognition and enforcement are not an opportunity for review.**
- **Recognition is a confirmation of the award's authenticity.**
- **The award is *res judicata* in the country where it has been recognized.**
- **The obligation to enforce an award is restricted to its pecuniary obligations.**
- **Awards may be enforced only against a party to the arbitration proceedings.**
- **Only a party to the arbitration proceedings may seek the award's enforcement.**
- **A party seeking enforcement must submit a certified copy of the award to a competent court or other authority.**
- **States parties to the Convention have designated the competent court or other authority to the Centre.**

²² <http://www.worldbank.org/icsid/pubs/icsid-8/icsid-8-e.htm>.

3. STATE IMMUNITY

Art. 55

Art. 55 of the Convention preserves State immunity from execution in the following terms:

Nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.

State immunity under local law

Art 55 is a specification of Art. 54(3) which states that the execution of an award is governed by the law of the State in which execution is sought. This law includes the law on State immunity. In accordance with Art. 54(1), State immunity will apply to the execution of an ICSID award in the same way as it would apply to the execution of a judgment of a domestic court. Art. 55 does not grant State immunity but simply refers to the prevailing situation under the law of the State where execution is sought. Art. 55 does not freeze the law on State immunity at a particular point in time but refers to the law on immunity from execution as it evolves over time.

Assets of foreign States are most likely to be located at important commercial centres. Therefore, attempts to enforce the pecuniary obligations arising from an award will be made in these countries. It is the legal situation in these countries that is most important for purposes of Art. 55. Under the wording of Art. 55, a State against which execution of an ICSID award is sought in its own courts, may also rely on any immunity it may enjoy in its courts under the local law.

Legal nature of State immunity

The law relating to State immunity is at the borderline between international law and domestic law. It was developed by domestic courts which created State practice leading to the formation of customary international law. Several important developments in the law of State immunity have taken place since the adoption of the Convention in 1965. Since the 1970s, a number of countries, including the United States,²³ United Kingdom,²⁴ Canada²⁵ and Australia²⁶ have adopted legislation to regulate the law of State immunity domestically. There is also treaty law on the subject. The European Convention on State Immunity of 1972²⁷ has displayed relatively little practical effect. The International Law Commission adopted Draft Articles on Jurisdictional Immunities of States and Their Property in 1991.²⁸

Immunity from execution

Art. 55 applies only to immunity from execution. It does not apply to immunity from jurisdiction. Jurisdiction is governed by Art. 25 of the Convention and, in accordance with Art. 41, is determined by the tribunal. Also, State immunity

²³ *Foreign Sovereign Immunities Act (FSIA) 1976, 28 USC §§ 1330, 1602-1611, 15 ILM 1388 (1976), as amended in 1988, 28 ILM 396 (1989) and in 1996/7, 36 ILM 759 (1997).*

²⁴ *State Immunity Act (SIA) 1978, 17 ILM 1123 (1978).*

²⁵ *State Immunity Act 1982, 21 ILM 798 (1982). Canada is not a Party to the ICSID Convention.*

²⁶ *Foreign States Immunities Act 1985, 25 ILM 715 (1986).*

²⁷ *European Treaty Series No. 74, 11 ILM 470 (1972).*

²⁸ *General Assembly Doc. A/46/405, YBILC 12 (1991-II/2), 30 ILM 1563 (1991).*

does not apply to proceedings for the recognition of an award. Art. 55 refers to execution but not to recognition. In addition, State immunity does not affect the *res judicata* effect of an award once it has been recognized. State immunity only comes into play when concrete measures of execution are taken to enforce the award's pecuniary obligations.

Execution of awards

The law relevant to the execution of ICSID awards will normally be the law relating to State immunity from execution of judgments of domestic courts. Art. 54 states that ICSID awards shall be enforced like final judgments of domestic courts. But in some countries the law on State immunity offers separate rules on the execution of arbitral awards. In the case of ICSID awards, the law in force on immunity from execution of domestic judgments as well as of arbitral awards is applicable.

Immunity and obligation to comply with award

The possibility to rely on State immunity from execution does not alter the fact that non-compliance with an award is a violation of the Convention. State immunity is merely a procedural bar to measures of execution but does not affect the award debtor's obligation under Art. 53 to abide by and comply with the award. Successful reliance on State immunity may still amount to a violation of the Convention and may lead to the usual consequences of State responsibility, including diplomatic protection under Art. 27(1).

Limit to Convention's effectiveness

ICSID tribunals do not have the power to order execution of their own awards. Therefore, the self-contained nature of the procedure, which excludes the intervention of domestic courts, has its limit when it comes to execution. For purposes of execution of awards, the ICSID system depends on the cooperation of domestic courts or other authorities. The domestic courts or other authorities, which are otherwise under an obligation to lend their hand in the execution of an ICSID award, may refuse to do so on grounds of State immunity. This weakness of the enforcement procedure may have effects already before the stage of execution is reached. It may affect the bargaining position of the parties during the ICSID proceedings and may be reflected in a settlement between the parties.

a) Assets Subject to Immunity from Execution

Nature of property

The most important criterion for State immunity from execution is the nature of the assets which are to be the object of enforcement. A distinction is made between commercial and non-commercial property. Execution is permitted against commercial property but not against property serving official or governmental purposes. But the exact difference between the two types of property is not always clear.

Link between property and claim

Some national laws require a specific link between the underlying claim and the property that is subject to execution. The United States Foreign Sovereign Immunities Act of 1976 (FSIA)²⁹ provides for an exception to State immunity

²⁹ 15 ILM 1388 (1976). Amended in 1988, 28 ILM 396 (1989).

from execution in respect of property in the United States of a foreign State used for commercial activity in the United States if that property is or was used for the commercial activity upon which the claim is based.³⁰ But it is unlikely that a host State will keep commercial assets in another country that can be said to have a direct connection to an investment in its territory. In addition, it will usually be doubtful whether the host State's underlying activity was commercial. The host State's actions *vis-à-vis* the investor that led to the dispute are more likely to be official than commercial. Therefore, this provision is unlikely to be helpful in the execution of an ICSID award.

Expropriated property exception

Another exception to State immunity from execution under United States law concerns commercial property which has been taken in violation of international law or which has been exchanged for such property.³¹ This provision would be relevant for the execution of an ICSID award that has found that there has been an unlawful expropriation. Execution of such an award would be possible if pecuniary proceeds from the expropriation can be demonstrated to be present in the United States. Execution in the form of restitution in kind of unlawfully expropriated property is possible under the FSIA but is not foreseen by the ICSID Convention since Art. 54 provides for the enforcement of pecuniary obligations only. But outright expropriations of foreign investments have become rather unusual.

Arbitral awards exception

A 1988 amendment to the United States FSIA has added an important exception to State immunity from execution for purposes of executing arbitral awards.³² That amendment provides for non-immunity of commercial property of a foreign State if a "judgment is based on an order confirming an arbitral award rendered against the foreign State, provided that attachment in aid of execution, or execution, would not be inconsistent with any provision in the arbitral agreement."³³ This provision is an important step towards facilitating the execution of ICSID awards. It allows execution only against property used for a commercial activity in the United States. But it does not require that there is a special nexus between the property and the claim underlying the award. Nor does it require that the underlying transaction, in our case the investment, is of a commercial nature.

In *LETCO v. Liberia*, attempts were made to execute the ICSID award³⁴ in the United States. The District Court for the Southern District of New York first recognized the Award and declared it enforceable.³⁵ The Court then examined the issue of whether the property in question was "used for a commercial activity in the United States." The assets were registration fees and other taxes due from ships flying the Liberian flag

³⁰ 28 USC 1610(a)(2). The Draft Articles on Jurisdictional Immunities of States and their Property adopted by the International Law Commission in 1991 contain a similar provision except that they do not require that the underlying activity is commercial: 30 ILM 1563 (1991), Art. 18, 1.(c).

³¹ FSIA, 28 USC 1610(a)(3).

³² 28 ILM 396, 398 (1989).

³³ 28 USC 1610(a)(6).

³⁴ *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 343.

³⁵ District Court, S.D.N.Y., 5 September 1986, 2 ICSID Reports 384.

and collected in the United States. The Court held that these were revenues for the support and maintenance of government functions. Therefore, Liberia's motion to vacate the executions was granted.³⁶

The decision was rendered before the 1988 amendment to the FSIA. But that amendment would not have altered the outcome of the decision since it still requires that the assets in question must be of a commercial nature.

Commercial property

Other domestic statutes dealing with State immunity typically provide for non-immunity of property that is used or intended for commercial activity. These statutes do not require a connexion between the property in question and the underlying transaction. Provisions of this kind are contained in the United Kingdom³⁷, Canadian³⁸ and Australian³⁹ Acts. In case of uncertainty as to the nature of the property in question, the United Kingdom⁴⁰ and the Canadian⁴¹ Acts provide for a certificate by the head of the affected State's diplomatic mission.

French court practice has developed along similar lines. The immunity of assets depends on whether they are used for commercial or governmental activities. In particular, immunity from execution is not granted if the property attached was intended to be used for the commercial activity upon which the claim is based.

In *SOABI v. Senegal*, the order of *exequatur* for the award⁴² by the *Tribunal de grande instance* was set aside on appeal by the *Cour d'appel* of Paris on the ground that there was no assurance that any measures of execution would be carried out against assets designated for commercial activity. The court said:

*Considering that the immunity from enforcement [exécution] enjoyed by a foreign State in France is a matter of principle; that in exceptional circumstances it can be set aside when the assets against which enforcement is sought have been assigned by the State to an economic and commercial activity governed by private law;*⁴³

This judgment of the *Cour d'appel* was set aside by the *Cour de*

³⁶ District Court, S.D.N.Y., 12 December 1986, 2 ICSID Reports 385, 388/9. The decision was affirmed on appeal with no published opinion by the United States Court of Appeals for the Second District on 19 May 1987.

³⁷ State Immunity Act, Sec. 13(4).

³⁸ State Immunity Act, Sec. 11(1)(b).

³⁹ Foreign States Immunities Act, Sec. 32(1).

⁴⁰ Sec. 13(5).

⁴¹ Sec. 41.

⁴² *SOABI v. Senegal*, Award, 25 February 1988, 2 ICSID Reports 190.

⁴³ *Cour d'appel, Paris*, 5 December 1989, 2 ICSID Reports 338, 340; 117 *Journal du Droit International* 141 (1990).

*cassation*⁴⁴ since the granting of an *exequatur* did not constitute an act of execution which might give rise to immunity from execution. But the *Cour de cassation* did not contradict the *Cour d'appel*'s distinction between commercial assets which would be subject to execution and other assets which would enjoy immunity.

The courts of other countries, such as Germany and Switzerland, have also adopted the distinction between property serving commercial purposes and property serving sovereign purposes. Assets that are designated for public functions of the foreign State are considered immune from execution.

Distinguishing commercial from official property

The distinction between commercial property and property serving sovereign purposes is not always easy to make. In the context of State immunity from jurisdiction, a test that looks at the nature of the activity and not at its purpose is widely accepted.⁴⁵ But the test for immunity from execution is usually the purpose of the property in question, although the origin of the property is also sometimes taken into account.⁴⁶ If the property in question is not clearly designated, it is often difficult to determine its intended use or purpose.

Bank accounts

In the case of bank accounts, it is particularly difficult to distinguish commercial from sovereign property. The intended use of bank accounts is not easy to determine since the future use of money is usually uncertain.⁴⁷ In practice, the decisive criterion has been whether money is specifically earmarked for a particular public function. Funds that are allocated to serve specific official activities and are held by the agency carrying out that function are immune. This is particularly so with bank accounts held by diplomatic missions. Accounts kept for mixed official and commercial purposes raise particular problems. The tendency is to grant immunity to these accounts.⁴⁸

Diplomatic property

Diplomatic property is protected by the Vienna Convention on Diplomatic Relations of 1961.⁴⁹ Under the Vienna Convention, the premises of the mission, their furnishings and other property thereon and the means of transport of the mission shall be immune from attachment or execution.⁵⁰ The national statutes dealing with State immunity typically grant special protection to diplomatic property. This is true for the United States FSIA⁵¹, the United Kingdom State Immunity Act⁵², and the Australian Act.⁵³

Embassy accounts

The Vienna Convention on Diplomatic Relations is silent on bank accounts

⁴⁴ *Cour de cassation*, 11 June 1991, 2 ICSID Reports 341; 118 *Journal du Droit International* 1005 (1991).

⁴⁵ See Schreuer, *State Immunity*, pp. 15 et seq.

⁴⁶ *Op. cit.* at p. 145.

⁴⁷ *Op. cit.* at pp. 149 et seq.

⁴⁸ *Op. cit.* at pp. 151 et seq.

⁴⁹ 500 UNTS 95.

⁵⁰ Art. 22(3).

⁵¹ 28 USC 1610(a)(4)(B).

⁵² Sec. 16(1).

⁵³ Sec. 32(3)(a).

kept by a diplomatic mission. Courts have treated embassy accounts with much caution.⁵⁴ The German Constitutional Court⁵⁵ and the House of Lords in the United Kingdom⁵⁶ came to the conclusion that money in a diplomatic mission's bank account used for meeting the expenses of running the mission did not serve commercial purposes. In the United Kingdom case, the ambassador's certificate was accepted as conclusive evidence. The Austrian Supreme Court⁵⁷ and the Italian Court of Cassation⁵⁸ reached the same result.

In *LETCO v. Liberia*, LETCO attempted to attach bank accounts of the Embassy of the Republic of Liberia in Washington, D.C. for the purpose of executing an ICSID award.⁵⁹ The US District Court for the District of Columbia⁶⁰ rejected the attempt to seize Liberia's bank accounts. It based its decision that Liberia's bank accounts were immune from attachment on two grounds: Art. 25 of the Vienna Convention on Diplomatic Relations provides in general terms that "[t]he receiving State shall accord full facilities for the performance of the functions of the mission." In the court's view, the "full facilities" included the bank accounts which required full protection so that the Embassy could function efficiently.⁶¹ The second ground for immunity was based on the FSIA. The Court held that the accounts did not qualify as property in use for commercial activity⁶² since the bank accounts were utilized to perform Liberia's diplomatic and consular functions and were, therefore, of a public or governmental nature. The Court also rejected the idea of separating commercial from public funds for purposes of execution:

The court presumes that some portion of the funds in the bank accounts may be used for commercial activities in connection with running the Embassy, such as transactions to purchase goods or services from private entities. The legislative history of the FSIA indicates that these funds would be used for a commercial activity and not be immune from attachment. The Court, however, declines to order that if any portion of a bank account is used for a commercial activity then the entire account loses its immunity. ... On the contrary, following the narrow definition of "commercial activity," funds used for commercial activities which are "incidental" or "auxiliary," not denoting the essential character of the use of the funds in question, would not cause the entire bank account to lose its mantle of sovereign immunity.⁶³

Military property

Military property of foreign States also enjoys immunity and is given special

⁵⁴ See also Schreuer, *State Immunity*, pp. 153 et seq.

⁵⁵ Philippine Embassy Bank Account, *Bundesverfassungsgericht*, 13 December 1977, 65 ILR 146 (1984).

⁵⁶ *Alcom v. Colombia*, *House of Lords*, 12 April 1984, 23 ILM 719 (1984).

⁵⁷ Execution of Embassy Account, *Oberster Gerichtshof*, 30 April 1986, 77 ILR 489 (1988).

⁵⁸ *Benamar v. Embassy of the Democratic and Popular Republic of Algeria*, *Corte di cassazione*, 4 and 25 May 1989, 84 AJIL 573 (1990).

⁵⁹ *LETCO v. Liberia*, *Award*, 31 March 1986, 2 ICSID Reports, 343.

⁶⁰ 16 April 1987, 2 ICSID Reports 390.

⁶¹ 2 ICSID Reports 392/3.

⁶² 28 USC 1610(a).

⁶³ 2 ICSID Reports 395.

protection from execution under most of the national laws dealing with State immunity.⁶⁴ This applies for the United States FSIA⁶⁵, the Canadian State Immunity Act⁶⁶ and the Australian Foreign States Immunities Act.⁶⁷

Central bank property

Most of the national statutes dealing with State immunity provide special protection for central banks and other monetary authorities and their property. The United States FSIA grants immunity from attachment and execution to property belonging to a foreign central bank or monetary authority held for its own account.⁶⁸ The phrase “held for its own account” relates to the distinction between funds held in connection with genuine central bank activities and those used to finance commercial transactions.⁶⁹ The Canadian Act⁷⁰, the United Kingdom Act⁷¹ and the Australian Act⁷² contain provisions to the same effect.

b) Waiver of Immunity

Possibility to waive immunity

In view of the far-reaching protection of State-owned property from execution, an investor has a strong interest in securing a waiver of immunity for the execution of an ICSID award from the host State. A waiver of immunity from execution is possible, in principle, but may be subject to specific conditions or limitations under the law of the country where execution is sought. The possibility to waive immunity is not necessarily unlimited. Certain waivers may have to be explicit while others may be given implicitly. Certain forms of waiver of immunity may be invalid even if agreed upon by the parties.

Discretionary nature of waiver

It is left to the judgment of the parties whether a waiver of immunity should be agreed upon and how far it should go. Some States may refuse to grant waivers in principle or may refuse to waive immunity for certain types of property. A refusal to agree to any waiver of immunity from execution may adversely affect the confidence of the investor in the host State’s willingness to abide by its obligations.

Conditions and limitations on Waiver

Under the United States FSIA, all exceptions to immunity from execution, including a waiver, only apply in respect of property used for a commercial activity in the United States.⁷³ Therefore, it is doubtful whether a waiver of immunity from execution in respect of non-commercial property of a State is even possible. Since arbitration is an independent and equivalent basis for non-immunity of commercial property under the FSIA,⁷⁴ it is doubtful whether an explicit waiver would add anything for purposes of enforcing an ICSID

⁶⁴ See also Schreuer, *State Immunity*, p. 146.

⁶⁵ 28 USC 1611(b)(2).

⁶⁶ Sec. 11(3). *The British State Immunity Act is rather vague on this point: Sec. 16(2).*

⁶⁷ Sec. 32(3)(a). See also the *International Law Commission’s Draft Articles, Art. 19, 1.(b)* 30 ILM 1573 (1991).

⁶⁸ 28 USC 1611(b)(1).

⁶⁹ *House Report, 15 ILM 1414 (1976).*

⁷⁰ Sec. 11(4)(5).

⁷¹ Sec. 14(4).

⁷² Sec. 35(1). See also the *International Law Commission’s Draft Articles, Art. 19, 1.(c).*

⁷³ 28 USC 1610(a)(1).

⁷⁴ 28 USC 1610(a)(6), 28 ILM 398 (1989).

award. By contrast, under the United Kingdom State Immunity Act a waiver of immunity from execution is independent of the commercial nature of the property concerned.⁷⁵ Under the United Kingdom Act, the commercial nature of property is a separate and equivalent exception to immunity from execution.⁷⁶ Therefore, a waiver would only make sense with respect to non-commercial property since commercial property does not enjoy immunity anyway. The situation is similar under the Canadian⁷⁷ and Australian Acts⁷⁸.

Diplomatic and military property

Under most national statutes dealing with immunity from execution, a waiver of immunity in respect of diplomatic or military property does not even appear possible. This is the case under the United States FSIA,⁷⁹ the United Kingdom State Immunity Act⁸⁰ and the Canadian Act.⁸¹ Under the Australian Act⁸² diplomatic or military property would have to be expressly covered by a waiver.

Central bank property

Immunity of central bank property may be waived explicitly under most national statutes but should be mentioned specifically in the waiver clause to achieve that effect. This would be the case under the United States FSIA,⁸³ the United Kingdom State Immunity Act,⁸⁴ the Canadian Act⁸⁵ and the Australian Act.⁸⁶

Conservatory Measures

Conservatory measures are taken before a decision on the merits has been rendered. The assets against which these conservatory measures are directed may eventually serve as objects for the execution of the decision. In the context of ICSID arbitration, conservatory measures by domestic courts are unlikely. Art. 26 of the Convention bars resort to remedies outside the Convention's system unless the parties agree otherwise. Under Arbitration Rule 39(5), the parties may agree, in addition to giving consent to jurisdiction, that provisional measures may be taken by a judicial or other authority. But such an agreement would be unusual. Under normal circumstances, the parties would be restricted to provisional measures recommended by the ICSID tribunal itself under Art. 47. Even if the parties were to agree to provisional measures by domestic courts, a domestic court would most probably allow such measures only if they are directed at commercial property of the State concerned.

⁷⁵ *Sec. 13(3)*.

⁷⁶ *Sec. 13(4)*.

⁷⁷ *Sec. 11(1)(a)(b)*.

⁷⁸ *Sec. 31*.

⁷⁹ *28 USC 1611(b)(2)*.

⁸⁰ *Sec. 16(1)(2)*.

⁸¹ *Sec. 11(3)*.

⁸² *Sec. 31(4)*.

⁸³ *28 USC 1611(b)(1)*.

⁸⁴ *Sec. 14(4)*.

⁸⁵ *Sec. 11(4)(5)*.

⁸⁶ *Sec. 35(1)*.

Summary:

- **The Convention does not grant State immunity from execution but leaves any existing immunity unaffected.**
- **State immunity is regulated under customary international law. A number of countries have passed legislation in this area.**
- **State immunity does not affect the obligation to comply with the award.**
- **As a general rule, property serving commercial purposes is subject to measures of execution whereas property serving official State functions is not.**
- **Money or bank accounts are immune if they are specifically earmarked for an official function.**
- **Property serving diplomatic missions, including embassy accounts, as well as military property are immune from measures of execution.**
- **Funds of a Central Bank or other monetary authority also enjoy special immunity from execution.**
- **A waiver of immunity from execution is possible, in principle, but may be subject to certain limitations under the law of some States.**
- **Conservatory measures would be permissible only if the parties have agreed to them.**

TEST MY UNDERSTANDING

After having studied this Module the reader should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation:

1. What is the legal nature of an ICSID award?
2. What is the significance of the statement that ICSID awards are *res judicata*?
3. Do the Convention's rules on recognition and enforcement apply to the Additional Facility?
4. What is the effect of a stay of enforcement?
5. May an investor's State of nationality exercise diplomatic protection to secure compliance with an award?
6. Are ICSID awards subject to review in connexion with their recognition and enforcement?
7. What is the difference between recognition and enforcement?
8. Is there an obligation to recognize and enforce an ICSID award beyond the parties to the arbitration proceedings?
9. Does the obligation to recognize and enforce extend to decisions preliminary to awards, like decisions concerning the tribunal's jurisdiction?
10. The Convention provides for the enforcement of "pecuniary obligations". What does this mean?
11. Who may request enforcement of an award?
12. What are the competent organs for the enforcement of awards?
13. Does the Convention create State immunity from execution?
14. Does State immunity absolve the debtor State from complying with the award?
15. What State property is subject to execution for the purpose of enforcing an ICSID award?
16. Is a bank account held by a State or by a State controlled entity subject to execution?
17. Can a State waive its immunity from execution?
18. Is it possible to impose conservatory measures while ICSID proceedings are pending in order to facilitate later execution?

HYPOTHETICAL CASES

Federalia v. Ergon

Subsidia is a province of the State of Federalia. Federalia has designated Subsidia as a constituent subdivision in accordance with Art. 25(1) of the ICSID Convention and has approved Subsidia's consent to ICSID's jurisdiction in accordance with Art. 25(3).

Ergon Corp., a national of Eurostan, is an investor in Subsidia. In an ICSID arbitration between Subsidia and Ergon, the tribunal has awarded Subsidia a large amount of money as compensation against Ergon. Two years after the award has been rendered, there is still no prospect of payment.

Ergon has considerable assets in bank accounts in the Republic of Monetaria. Federalia, through its ambassador in Monetaria, has submitted an application for the recognition and enforcement of the award to the district court in the capital of Monetaria. The application requests the seizure of Ergon's bank accounts for the purpose of satisfying the award.

Federalia and Eurostan are Contracting Parties to the ICSID Convention. Monetaria has signed but not ratified the Convention.

You are the judge deciding on Federalia's application. Please provide a reasoned decision.

Beflat v. Tuba

Beflat Inc., a national of the Kingdom of Major, is an investor in the Democratic Republic of Tuba. Beflat has won an ICSID award against Tuba. The award grants compensation in the amount of • (Euro) 3 million to Beflat. In addition, the award orders Tuba to desist from infringing Beflat's copyright in musical recordings in the future.

Beflat entertains serious doubts as to whether Tuba will honour its obligations under the award. Beflat wants to take all possible legal steps to make the award effective. You are Beflat's legal representative working at the law firm Besharp & Presto and are asked to develop a strategy. You are given the following information:

1. Tuba continues to infringe Beflat's copyright in the countries Viola and Harp. In Harp, Tuba has even started court proceedings to obtain a declaration that the copyright in question belongs to Tuba rather than to Beflat.
2. Tuba has assets in the Republic of Timpani. Beflat has information that in Timpani there are bank accounts in the name of the Tuban

Embassy with a balance of over • 5 million. This amount is far in excess of what is needed for the day-to-day running of the Embassy. In addition, Fortissimo, a State-owned but legally independent company of Tuba, operates in Timpani with as yet undisclosed assets.

3. Tuba also has a bank account in its name in the Commonwealth of Bassoon. This bank account has no particular designation and appears to be used for various types of government procurement including occasional arms purchases. The balance in this bank account is currently less than • 1 million. In addition, Tuba owns the Allegro Hotels chain in Bassoon. But the hotel business is currently depressed in Bassoon and it would be difficult to liquidate these hotels.

All countries in question are Contracting States to the ICSID Convention.

Beflat wants to know where and how it should pursue its rights. In particular, it wants to know if it would be permissible to orchestrate a concerted effort at enforcement of the award in several countries simultaneously.

In addition, Beflat has learned that the Foreign Minister of Major, O.B.O. Reed, has indicated her readiness, in principle, to exercise diplomatic protection on behalf of Beflat. You are asked to express an opinion whether this would be permissible.

FURTHER READING

Books

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- **Leahy, E. R./Orentlicher, D. F.**, *Enforcement of Arbitral Awards Issued by the Additional Facility of the International Centre of Settlement of Investment Disputes (ICSID)*, 2 *Journal of International Arbitration*, No. 3, at 15 (1985).
- **Van den Berg, A. J.**, *Recent Enforcement Problems under the New York and ICSID Conventions*, 5 *Arbitration International* 2 (1989).

Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- List of Contracting States and other Signatories of the Convention:
<http://www.worldbank.org/icsid/constate/c-states-en.htm>
- ICSID Cases:
<http://www.worldbank.org/icsid/cases/cases.htm>
- Designations of Courts or Other Authorities Competent for the Recognition and Enforcement of Awards Rendered Pursuant to the Convention (Art. 54(2) of the Convention):
<http://www.worldbank.org/icsid/pubs/icsid-8/icsid-8-e.htm>
- ICSID Arbitration Rules (1984), relevant excerpts:

Cases

- *Benvenuti et Bonfant SARL v. Banque Commercial Congolaise and Others*, France, Cour de cassation, 21 July 1987, 1 ICSID Reports 373; 82 ILR 91 (1990); 115 Journal du droit international 108 (1988).
- *LETCO v. The Government of the Republic of Liberia*, U. S. District Court, Southern District, New York, 5 September 1986, 12 December 1986; U. S. District Court, District of Columbia, 16 April 1987, 2 ICSID Reports 383, 390; 26 ILM 695 (1987); 89 ILR 355, 360 (1992); 2 ICSID Review—Foreign Investment Law Journal 187 (1987); 3 ICSID Review—Foreign Investment Law Journal 161 (1988).
- *SOABI v. Senegal*, France, Tribunal de grande instance, Paris, 14 November 1988; Cour d’appel, Paris, 5 December 1989; Cour de cassation, 11 June 1991, 2 ICSID Reports 337, 341; 29 ILM 1341 (1990); 30 ILM 1167 (1991); 5 ICSID Review—Foreign Investment Law Journal 135 (1990); 6 ICSID Review—Foreign Investment Law Journal 598 (1991); 117 Journal du droit international 141 (1990); 118 Journal du droit international 1005 (1991).

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.1 OVERVIEW



UNITED NATIONS
New York and Geneva, 2003

NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

The World Trade Organization (the “WTO”) was established and became operational on 1 January 1995. It is the youngest of all major international intergovernmental organizations and yet, it is arguably one of the most influential in these times of economic globalization. It has also been one of the most controversial and contested international organizations. To date, the most successful feature of the WTO has been its dispute settlement system. Some of the disputes dealt with by the WTO dispute settlement system have triggered considerable public debate and have attracted much media attention. This has been the case, for example, of the dispute on the European Union’s preferential import regime for bananas¹, the dispute on the European Union’s import ban on meat from cattle treated with growth hormones², the dispute on the United States’ import ban on shrimp harvested with nets not equipped with turtle excluder devices³, the dispute on the United States’ special tax treatment of export-related earnings⁴, the dispute on a French ban on asbestos⁵, and most recently, the dispute on the United States’ safeguard measures on steel.⁶ Many of these disputes involve, directly or indirectly, developing countries.

This Module is the first of four on the dispute settlement system of the WTO. It gives a general introduction to the WTO and then describes the basic features of the WTO’s dispute settlement system. Particular attention is given to the position of developing countries in both the WTO in general and its dispute settlement system in particular. Subsequent modules in this Course deal with specific elements of the WTO dispute settlement system: the panel process (Module 3.2), the appellate review process (Module 3.3) and the implementation of recommendations and rulings (Module 3.4).

The first Section of this Module describes the origins of the WTO, its objectives, functions, institutional structure, membership and decision-making procedures. The second Section examines the basic rules of WTO law and policy, such as the non-discrimination principles, the market access rules and the fair trade rules, as well as the exceptions to these rules on economic and non-economic grounds. The third Section describes the position of developing country Members in the WTO system and the special and differential treatment these

¹ European Communities - Regime for the Importation, Sale and Distribution of Bananas (“EC – Bananas III”), *complaint by Ecuador, Guatemala, Honduras, Mexico and the United States (DS27)*.

² EC Measures concerning Meat and Meat Products (Hormones) (“EC – Hormones”), *complaints by the United States (DS26) and Canada (DS48)*.

³ *United States – Import Prohibition of Certain Shrimp and Shrimp Products (“US – Shrimp”), complaint by India, Malaysia, Pakistan and Thailand (DS58)*.

⁴ *United States – Tax Treatment for “Foreign Sales Corporations” (“US – FSC”), complaint by the European Communities (DS108)*.

⁵ *European Communities – Measures Affecting the Prohibition of Asbestos and Asbestos-Containing Products (“EC – Asbestos”), complaint by Canada (DS135)*.

⁶ *United States - Definitive Safeguard Measures on Imports of Certain Steel Products, complaints by the EC, Japan, Republic of Korea, China, Switzerland, Norway, New Zealand and Brazil (DS248, DS249, DS251, DS252, DS253, DS254, DS258 and DS259)*.

Members enjoy under WTO law. The fourth Section deals with WTO's unique dispute settlement system and examines the origins of the dispute settlement system, its object and purpose, its jurisdiction, the access to the system, the methods of dispute settlement, and the institutions and the proceedings of WTO dispute settlement. The fifth Section addresses the use made by developing country Members of the WTO dispute settlement system and gives an overview of the special rules and procedures provided to allow these Members to use the system more easily and effectively. Finally, the sixth Section, briefly addresses past and current negotiations on the reform of the WTO dispute settlement system.

1. THE WORLD TRADE ORGANIZATION (WTO)

Objectives

On completion of this section, the reader should be able to describe the historical origins of the WTO and the main elements of the *Agreement Establishing the WTO* as well as the policy objectives of the WTO, its functions, its institutional structure, its membership, its decision-making procedures and its budget.

1.1 Origins of the WTO

1.1.1 General Agreement on Tariffs and Trade of 1947

Article XVI:1 WTO

Article XVI:1 of the *Agreement Establishing the World Trade Organisation* states:

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

The origins of the WTO undisputedly lay in the General Agreement of Tariffs and Trade on 1947 (“GATT 1947”). As is clear from Article XVI:1, quoted above, these origins remain relevant because the decisions, procedures and customary practices of the GATT 1947 still guide the WTO in many of its actions.

ITO

In 1946 negotiations were started in London at the initiative of the United States on the establishment of an international organization for trade to complete the Bretton Woods structure of international economic institutions already consisting at the time of the World Bank and the International Monetary Fund. The negotiations on the Charter of the International Trade Organization (the “ITO”) were continued in Geneva in 1947. In parallel with the negotiations on the ITO Charter, countries also negotiated in Geneva on the reduction of tariffs and on general clauses to protect the agreed tariff reductions. The latter negotiations were successfully concluded in Geneva and resulted in the General Agreement on Tariffs and Trade of 1947. While the GATT 1947 was intended to be the first agreement concluded under the auspices of, and administered by, the ITO, the negotiators were not able to reach agreement on the ITO Charter in Geneva in 1947. It was decided, however, to apply the GATT 1947 on a provisional basis while waiting for the completion of the negotiations on the ITO Charter. In Havana in 1948, agreement was reached on the ITO Charter. However, in the following years the United States Congress refused to approve the Charter and consequently the ITO was never established.

GATT

The demise of the ITO left an important gap in the Bretton Woods structure of international economic institutions. To handle problems relating to their trade relations, countries would as from the early 1950s onwards, turn to the only existing multilateral “institution” for international trade, the GATT 1947. Although the GATT was conceived as a multilateral *agreement* for the reduction of tariffs, and *not* an international *organization*, it would over the years successfully “transform” itself - in a pragmatic and incremental manner - into a *de facto* international organization. In particular with regard to the reduction of tariffs the GATT was very successful. However, it was less successful with respect to the reduction of non-tariff barriers. Negotiations on the reduction of non-tariff barriers are much more complex and, therefore, required among other things a more “sophisticated” institutional framework than the GATT offered. Furthermore, the GATT was only concerned with trade in goods. However, in view of the ever increasing importance of services in the economic activity of many countries, it was clear from the early 1980s that for trade in services multilateral GATT-like disciplines would need to be agreed upon and administered.

1.1.2 Uruguay Round Negotiations (1986-1993)

Uruguay Round

In September 1986, the GATT Contracting Parties decided in Punta del Este, Uruguay, to start a new round of negotiations on the further liberalization of international trade. The agenda for these negotiations was very broad and ambitious and included for the first time trade in services, as well as the very controversial issues of trade in agricultural products and trade in textiles. Also, the improvement of the institutional mechanisms of the GATT and its dispute settlement system was on the agenda. The establishment of a new international organization for trade however, was initially not on the agenda of the Round. It was only in 1990 that the first proposals for the establishment of a new international trade organization were tabled by Canada and the European Community, followed in 1991 by a joint proposal by Canada, the European Community and Mexico. Initially many developing countries were quite critical with respect to the idea of establishing a new international organization for trade, partly because they considered that UNCTAD could and should fulfil this function. Also the United States objected to the establishment of a new international trade organization. In the course of 1992, however, most developing countries became convinced of the appropriateness and the timeliness of a new international trade organization. Only in the final stages of the Uruguay Round negotiations in 1993 did the United States agree to such a new organization.

WTO Agreement

More than seven years after its start in Punta del Este, the Uruguay Round was finally concluded successfully in Geneva in December 1993. In April 1994 the *Agreement Establishing the World Trade Organization* was signed in Marrakesh, Morocco. On 1 January 1995, the *WTO Agreement* entered into force and the WTO became operational.

1.2 The Agreement Establishing the World Trade Organization

The Marrakesh *Agreement Establishing the World Trade Organization* (the “*WTO Agreement*”) is the most ambitious and far-reaching international trade agreement ever concluded. It consists of a short, 16-article long basic agreement establishing the WTO *and* numerous agreements and understandings included in the annexes to this agreement.

AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION

ANNEX 1

ANNEX 1A: Multilateral Agreements on Trade in Goods

General Agreement on Tariffs and Trade 1994

Agreement on Agriculture

Agreement on the Application of Sanitary and Phytosanitary Measures

Agreement on Textiles and Clothing

Agreement on Technical Barriers to Trade

Agreement on Trade-Related Investment Measures

Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994

Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994

Agreement on Pre-shipment Inspection

Agreement on Rules of Origin

Agreement on Import Licensing Procedures

Agreement on Subsidies and Countervailing Measures

Agreement on Safeguards

ANNEX 1B: General Agreement on Trade in Services and Annexes

ANNEX 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights

ANNEX 2: Understanding on Rules and Procedures Governing the Settlement of Disputes

ANNEX 3: Trade Policy Review Mechanism

ANNEX 4: Plurilateral Trade Agreements

Agreement on Trade in Civil Aircraft

Agreement on Government Procurement

Article II:2 & 3 WTO

On the relationship between the *WTO Agreement* and its Annexes as well as on the binding nature of the Annexes, Article II of the *WTO Agreement* states in relevant part:

2. *The agreements and associated legal instruments included in Annexes 1, 2 and 3 (hereinafter referred to as “Multilateral Trade Agreements”) are integral parts of this Agreement, binding on all Members.*
3. *The agreements and associated legal instruments included in Annex 4 (hereinafter referred to as “Plurilateral Trade Agreements”) are also part of this Agreement for those Members that have accepted them, and are binding on those Members. The Plurilateral Trade Agreements do not create either obligations or rights for Members that have not accepted them.*

Article XVI:3 WTO

Furthermore, Article XVI:3 of the *WTO Agreement* provides:

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

Annexes 1 to 4 WTO

Most of substantive WTO law is found in the agreements contained in Annex 1. This Annex consists of three parts. Annex 1A contains 13 multilateral agreements on trade in goods, Annex 1B contains the *General Agreement on Trade in Services* (the “GATS”) and Annex 1C the *Agreement on Trade Related Aspects of Intellectual Property Rights* (the “TRIPS Agreement”). The most important of the 13 multilateral agreements on trade in goods, contained in Annex 1A, is the *General Agreement on Tariffs and Trade 1994* (the “GATT 1994”). The GATT 1994 consists of the provisions of the GATT 1947, the provisions of the legal instruments that have entered into force under the GATT 1947, six Understandings on particular GATT provisions and the *Marrakesh Protocol* on tariff concessions. The plurilateral agreements in Annex 4 also contain provisions of substantive law but are only binding upon those WTO Members that are a party to these agreements. Annexes 2 and 3 hold respectively, the *Understanding on Rules and Procedures Governing the Settlement of Disputes* and the *Trade Policy Review Mechanism*, and also contain procedural provisions.

1.3 Objectives of the WTO

Preamble WTO

The policy objectives that the WTO is to pursue are set out in the Preamble of the *WTO Agreement*. According to this Preamble, the Parties to the *WTO Agreement* agreed to the terms of this agreement and the establishment of the WTO:

Recognizing that their relations in the field of trade and economic endeavour



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

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

The *ultimate* objectives of the WTO are thus the raising of standards of living, the attainment of full employment, the growth of real income and effective demand, and the expansion of production of, and trade in, goods and services. However, it is clear from the Preamble that in pursuing these objectives the WTO must take into account the need to preserve the environment as well as the needs of developing countries. The Preamble stresses the importance of *sustainable* economic development and of the integration of developing countries, and, in particular, least-developed countries, in the world trading system. Both these aspects were absent from the preamble of the GATT 1947. The statements in the Preamble of the *WTO Agreement* on the objectives of the WTO are not without legal significance. In *US – Shrimp*, the Appellate Body stated:

[The language of the Preamble of the WTO Agreement] demonstrates recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe it must add colour, texture and shading to our interpretation of the agreements annexed to the WTO Agreement, in this case, the GATT 1994. We have already observed that Article XX(g) of the GATT 1994 is appropriately read with the perspective embodied in the above preamble.⁷

The preambular statements of the objectives of the WTO contradict the contention that the WTO is only about trade liberalization without regard to environmental degradation and global poverty.

The Preamble also indicates how these objectives are to be achieved. It states:

Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction



⁷ Appellate Body Report, *United States – Shrimp*, para. 153

⁸ Article II:1 of the *WTO Agreement*

of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations,

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

Determined to preserve the basic principles and to further the objectives underlying this multilateral trading system [...]

According to the Preamble of the *WTO Agreement* the two main instruments, or means, to achieve the objectives of the WTO are agreements on the reduction of trade barriers and the elimination of discrimination. These were also already the two main instruments of the GATT 1947 but the *WTO Agreement* aims at constituting the basis of an integrated, more viable and more durable multilateral trading system.

1.4 Functions of the WTO

Article 2:1 WTO

In the broadest of terms, the primary function of the WTO is to:

... provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to [the WTO] Agreement.⁸

More specifically, the WTO has been assigned five widely defined functions. These functions are set out in Article III of the *WTO Agreement* and are described below.

1.4.1 Implementation of the WTO Agreements

Article III:1 WTO

A first function of the WTO is to facilitate the implementation, administration and operation of the *WTO Agreement* and the multilateral and plurilateral agreements annexed to it. The WTO is also entrusted with the task of furthering the objectives of these agreements. A concrete example of what this function of “facilitating” and “furthering” entails, is the work of the WTO Committee on Sanitary and Phytosanitary Measures (the “SPS Committee”). Article 12 of the *SPS Agreement* states that the SPS Committee shall *inter alia*:

... encourage and facilitate ad hoc consultations or negotiations among Members on specific sanitary or phytosanitary issues. The Committee shall encourage the use of international standards, guidelines or recommendations by all Members and, in this regard, shall sponsor technical consultation and study with the objective of increasing co-ordination and integration between



international and national systems and approaches for approving the use of food additives or for establishing tolerances for contaminants in foods, beverages or foodstuffs.

This function of facilitating the implementation, administration and operation of the WTO agreements and furthering the objectives of these agreements is an *essential* function of the WTO. It involves most of its bodies and takes up much of their time.

1.4.2 Forum for Trade Negotiations

Article III: 2 WTO

A second function of the WTO is to provide a permanent forum for negotiations amongst its Members. These negotiations may concern matters already dealt with in the WTO agreements but may also concern trade matters currently not yet addressed in WTO law. With regard to negotiations on matters already dealt with, the WTO is “the” forum for negotiations while for other negotiations, it is “a” forum among others. To date, WTO Members have negotiated and concluded in the framework of the WTO a few trade agreements providing for further market access in particular regarding services.

At the Doha Session of the Ministerial Conference in November 2001, the WTO decided to start a new round of trade negotiations, commonly referred to as the Doha Development Round. In the Ministerial Declaration, Ministers stressed their “commitment to the WTO as the unique forum for global trade rule-making and liberalization”.⁹ The Ministerial Declaration provides for an ambitious agenda for negotiations. These negotiations include matters on which WTO Members had already agreed in 1994 in the *WTO Agreement* to continue negotiations, such as trade in agricultural products and trade in services (the “built-in” agenda).¹⁰ In fact, negotiations on these matters had already started in early 2000. Furthermore, the Doha Development Round negotiations also include negotiations on matters such as market access for non-agricultural products, dispute settlement, rules on anti-dumping duties, subsidies and regional trade agreements and certain issues relating to trade and the environment. The WTO Members also decided that after the Fifth Session of the Ministerial Conference in 2003, they would start negotiations on the relationship between trade and investment, the relationship between trade and competition law, transparency in government procurement, trade facilitation and issues relating to trade and the environment other than those already the subject of negotiations. At the 2003 Session of the Ministerial Conference, the modalities of these negotiations will be decided upon by “explicit consensus”. In the meantime, the relevant WTO bodies will “prepare” these negotiations by discussing and attempting to clarify the matters that will be addressed in the negotiations.

⁹ Ministerial Declaration, adopted 14 November 2001, WT/MIN(01)/DEC/1, 20 November 2001, para. 4.

¹⁰ Article 20 of the Agreement on Agriculture and Article XIX of the GATS.

With regard to the organization of the negotiations, the Doha Ministerial Declaration states that the negotiations to be pursued under the terms of this declaration shall be concluded not later than 1 January 2005. With the exception of the improvements and clarifications of the Dispute Settlement Understanding, the conduct, conclusion and entry into force of the outcome of the negotiations shall be treated as parts of a single undertaking.

The Doha Ministerial Declaration explicitly states:

*The negotiations shall be conducted in a transparent manner among participants, in order to facilitate the effective participation of all. They shall be conducted with a view to ensuring benefits to all participants and to achieving an overall balance in the outcome of the negotiations.*¹¹

1.4.3 Settlement of Disputes

Article III: 3 WTO

A third and very important function of the WTO is the administration of the WTO dispute settlement system which is detailed below.¹²

1.4.4 Monitoring of Trade Policies

Article III: 4 WTO

A fourth function of the WTO is the administration of the trade policy review mechanism (the “TPRM”).¹³ The TPRM provides for the regular *collective* appreciation and evaluation of the full range of *individual* Members’ trade policies and practices and their impact on the functioning of the multilateral trading system. The purpose of the “TPRM” is to contribute to improved adherence by all Members to the WTO agreements by achieving greater *transparency* in, and *understanding* of, the trade policies and practices of Members.

Under the TPRM, the trade policies and practices of all Members are subject to *periodic review*. The four largest trading entities, i.e., the European Communities, the United States, Japan and Canada are subject to review every two years. The next 16 largest trading nations are reviewed every four years. Other Members, including most developing country Members, are reviewed every six years, except that a longer period may be fixed for least-developed country Members. The trade policy reviews are carried out by the Trade Policy Review Body on the basis of two reports: a report supplied by the Member under review, in which the Member describes the trade policies and practices it pursues and a report drawn up by the WTO Secretariat.¹⁴ These reports, together with the minutes of the meeting of the Trade Policy Review Body are

¹¹ Ministerial Declaration, adopted 14 November 2001, WT/MIN(01)/DEC/1, 20 November 2001, paras. 45, 47 and 49.

¹² See below, Sections 4 and 5 of this Chapter.

¹³ WTO Agreement, Annex 3, Trade Policy Review Mechanism.

¹⁴ The two reports cover all aspects of the Member’s trade policies, including its domestic laws and regulations, the institutional framework, bilateral, regional and other preferential agreements, the wider economic needs and the external environment.

published after the review and are a valuable source of information on a WTO Member's trade policy and practices.

It is important to note that the TPRM is not intended to serve as a basis for the enforcement of specific obligations under the WTO agreements or for dispute settlement procedures, or to impose new policy commitments on Members. However, by *publicly* denouncing the inconsistency with WTO law of a Member's trade policy or practices, the TPRM intends to "shame" Members into compliance *and* to bolster domestic opposition against trade policy and practices inconsistent with WTO law. Likewise, by *publicly* praising free trade policies, the TPRM bolsters, both internationally and domestically, support for such policies.

In his concluding remarks at the meeting in January 2002 at which the TPRB concluded the trade policy review of Pakistan, the Chairperson of the TPRB observed:

Purely as an aside, and as much a comment on the review process as on this Review, I was struck by [Pakistan's] Secretary Beg's remarks that questions had given his delegation food for considerable thought and that sources of information had been found of which he was unaware. This goes to the heart of our work: not only do we learn a lot about the Member, but also often the Member learns a lot about itself. Moreover, this is put into a multilateral setting, thus serving to strengthen our system. Increasingly our work highlights the value of the Trade Policy Review Body.¹⁵

1.4.5 Cooperation with other Organizations

A fifth and final function of the WTO is to cooperate with international organisations and non-governmental organizations.

Article III:5 WTO

Article III:5 of the *WTO Agreement* refers specifically to cooperation with the IMF and the World Bank. Such cooperation is mandated by the need for greater coherence in global economic policy making. The WTO has concluded agreements with both the IMF and the World Bank to give form to this cooperation.¹⁶

Article V WTO

Pursuant to Article V of the *WTO Agreement*, which is entitled "Relations with Other Organizations", the WTO is also to cooperate with other international organizations and may cooperate with non-governmental organizations ("NGO's"). The WTO has concluded cooperation arrangements with, *inter alia*, the International Labour Organization, the World Intellectual Property Organization and UNCTAD. The WTO and UNCTAD jointly operate and finance the International Trade Centre (the ITC), which works with

¹⁵ PRESS/TPRB/187, dated 25 January 2002.

¹⁶ Agreement between the International Monetary Fund and the World Trade Organization, contained in Annex I of WT/GC/W/43¹⁶ and the Agreement between the International Bank for Reconstruction and Development and the World Trade Organization, contained in Annex II of WT/GC/W/43.

developing countries and economies in transition to set up effective trade promotion programmes, with a focus on the private sector.

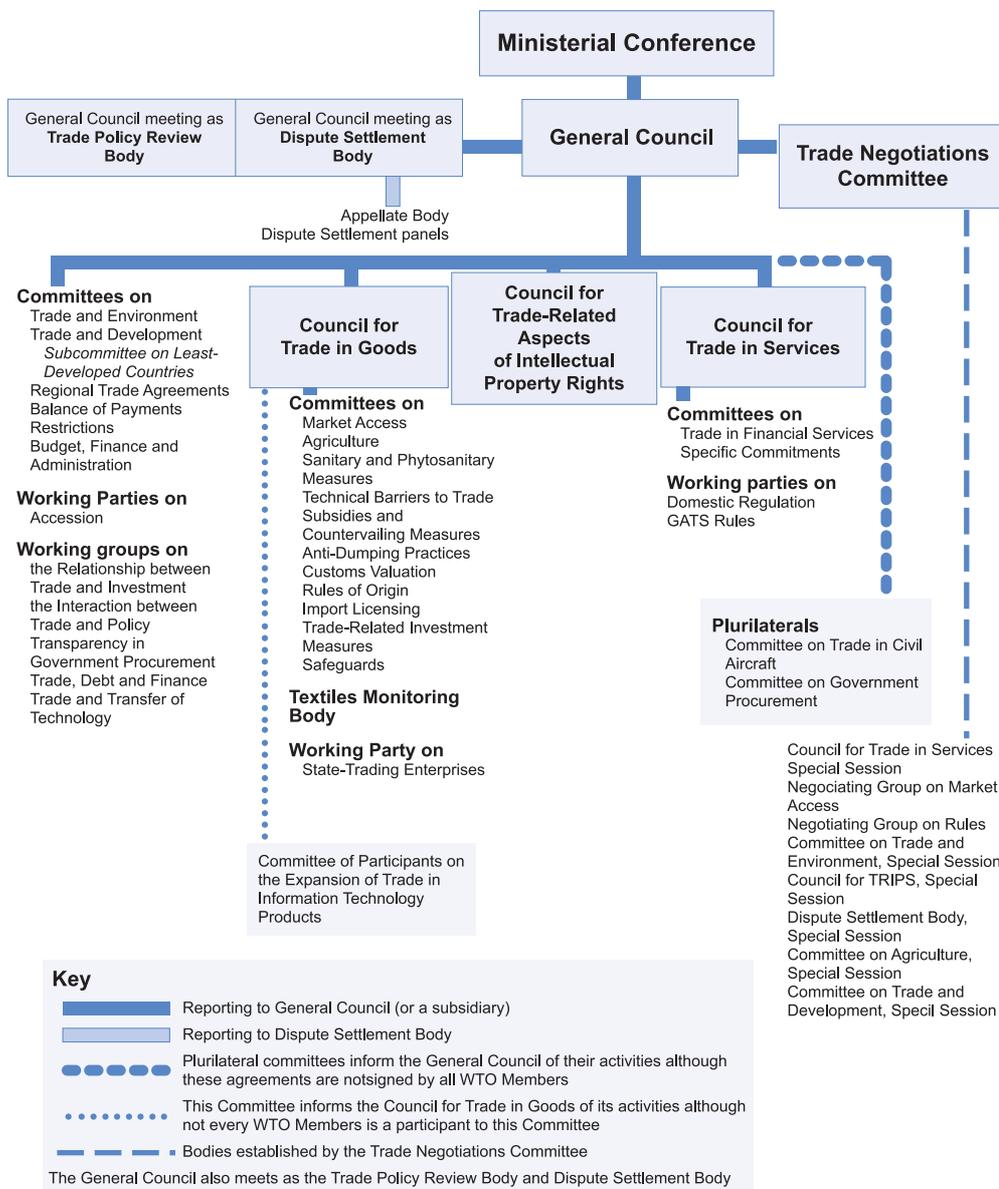
The WTO Secretariat also keeps close links with numerous NGO's concerned with trade matters. On 18 July 1996 the General Council adopted a set of guidelines clarifying the framework for relations with NGOs.¹⁷ In these guidelines the General Council "recognizes the role NGOs can play to increase the awareness of the public in respect of WTO activities." It is important for the WTO to maintain an informal and positive dialogue with the various components of civil society. To date, "cooperation" with NGOs has essentially focused on attendance by NGOs of Ministerial Conferences, symposia for NGOs on specific issues, regular briefings for NGOs on the work of the WTO and the day-to-day contact between the WTO Secretariat and NGOs. The WTO Secretariat also forwards regularly to WTO Members a list of documents, position papers and newsletters submitted by NGOs. This list is also made available on a special section of the WTO Website, devoted to NGOs and WTO activities organized for the benefit of NGOs.

1.5 Institutional Structure of the WTO

To carry out the functions and tasks entrusted to the WTO, the *WTO Agreement* provides for a manifold of bodies. The basic institutional structure of the WTO is set out in Article IV of the *WTO Agreement*. Subordinate committees and working groups have been added to this structure by later decisions.

¹⁷ **Guidelines for arrangements on relations with Non-Governmental Organizations**, Decision adopted by the General Council on 18 July 1996, WT/L/162, 23 July 1996.

WTO Organization Chart¹⁸



This chart in fact only shows the “tip of the iceberg”. There is at present a total of 70 WTO bodies of which 34 are standing bodies open to all Members.¹⁹ Many of these WTO bodies meet on a regular basis and this makes for a very heavy workload for WTO diplomats. In 2001, WTO bodies held nearly 1,000 formal and informal meetings.²⁰ For many developing country Members, with

¹⁸ This chart can be found at www.wto.org.

¹⁹ Statement by Mr. Miguel Rodriguez Mendoza, WTO Deputy Director-General, to the General Council on 13 February 2002, at www.wto.org. The ad hoc bodies (i.e., the non-standing bodies), which are also open to all Members, include the TNC, the two TNC negotiating groups and the 28 accession working parties. There are currently five plurilateral bodies which are only open to the parties to the relevant plurilateral agreement.

²⁰ Statement by Mr. Miguel Rodriguez Mendoza, WTO Deputy Director-General, to the General Council on 13 February 2002, at www.wto.org. In 2001, there were nearly 400 formal meetings, 500 informal meetings and some 90 other meetings such as symposia, workshops and seminars organized under the auspices of WTO bodies. The number of meetings is calculated on the basis of half-day units.

no or a very small permanent delegation in Geneva, the intensity of the work of the WTO is a serious problem.

The institutional structure of the WTO includes, at the highest level, the Ministerial Conference, at a second level, the General Council, the DSB and TPRB, and, at lower levels, specialised Councils, Committees and working groups. Furthermore, this structure includes quasi-judicial and other non-political bodies as well as the WTO Secretariat.

1.5.1 Ministerial Conference

Article IV:1 WTO

The Ministerial Conference is the supreme WTO body. The Ministerial Conference is composed of minister-level representatives of all Members. The Ministerial Conference has decision-making powers on all matters under any of the *multilateral* WTO agreements. The Ministerial Conference is, however, not often in session. Since 1995, there have been four sessions of the Ministerial Conference, each lasting only a few days: Singapore (1996), Geneva (1998), Seattle (1999) and Doha (2001). Since the Ministerial Conference is required to meet at least once every two years, the next session of the Ministerial Conference will take place before the end of 2003.

The sessions of the Ministerial Conference are major media events and thus focus the minds of the political leaders of the WTO Members on the current challenges to, and the future of, the multilateral trading system. The “Ministerials” offer a much-needed bi-annual opportunity to give political leadership and guidance to the WTO and its actions.

1.5.2 General Council

Article IV:2 WTO

The General Council is composed of ambassador-level diplomats and normally meets once every two months. All WTO Members are represented in the General Council. As all other WTO bodies, except the Ministerial Conference, the General Council normally meets at the WTO headquarters in Geneva.

The General Council is responsible for the continuing, day-to-day management of the WTO and its many activities. In between sessions of the Ministerial Conference, the General Council exercises the full powers of the Ministerial Conference. In addition to the powers of the Ministerial Conference, the General Council also carries out a few functions specifically assigned to it. The General Council is responsible for the adoption of the annual budget and the financial regulations.²¹

The functions assigned to the General Council also concern dispute settlement and trade policy review. As Articles IV:3 and 4 of the *WTO Agreement* state, the General Council convenes as appropriate to discharge the responsibilities of the Dispute Settlement Body (the “DSB”) and the Trade Policy Review

²¹ Article VII:1-3 of the *WTO Agreement*.

Body (the “TPRB”) respectively. The General Council, the DSB, and the TPRB are in fact the same body although they each have their own chairperson and rules of procedure. The DSB and the TPRB are the *alter ego* of the General Council. The DSB has a regular meeting once a month but may have additional meetings in between. The TPRB normally also meets (at least) once a month.

1.5.3 Specialized Councils, Committees and Working Groups

Article IV:5 WTO

At the level below the General Council, the DSB and the TPRB, there are three, so-called specialized Councils: the Council for Trade in Goods; the Council for Trade in Services; and the Council for TRIPS. All WTO Members are represented in these specialized Councils although many Members, in particular developing country Members, may find it difficult to attend all of the meetings. Under the general direction of the General Council, these specialized Councils oversee the functioning of the multilateral agreements in Annex 1A, 1B or 1C respectively. They assist the General Council and the Ministerial Conference in carrying out their functions. They carry out the tasks that the General Council or provisions of the relevant agreements have entrusted to them. The *WTO Agreement* itself explicitly stipulates, for example, that the Ministerial Conference and the General Council can only exercise their authority to adopt authoritative interpretations of the multilateral trade agreements of Annex 1 on the basis of a recommendation of the specialized Council overseeing the functioning of the agreement at issue.²² The specialized Councils also play an important role in the procedure for the adoption of waivers and the amendment procedure.²³

Article IV:6 WTO

Apart from three specialized Councils, there is a number of committees and working groups to assist the Ministerial Conference and the General Council in carrying out their functions. The *WTO Agreement* itself provides for three such committees: the Committee on Trade and Development, the Committee on Balance-of-Payments Restrictions and the Committee on Budget, Finance and Administration. The Committee on Trade and Development (the “CTD”) is the body in which any WTO Member can bring up any matter relating to international trade and development. Its core functions are to review continuously the participation of developing countries in the multilateral trading system and take initiatives to expand the trade opportunities of developing countries. The CTD also reviews the application of the special and differential treatment provisions for developing country Members provided in the WTO agreements. The Sub-Committee on Least-Developed Countries assists the CTD on trade and development issues relating to those countries.

In 1995 the General Council established the Committee on Trade and Environment (the “CTE”). In November 2001, the Doha Ministerial Conference established a Trade Negotiations Committee (the “TNC”) to supervise the overall conduct of the new trade negotiations mandated in the Doha Ministerial

²² *Article IX:2 of the WTO Agreement.*

²³ *Article IX:3(b) and Article X:1 of the WTO Agreement.*

Declaration.²⁴ Most of the actual negotiations are conducted in two newly established negotiating groups, one on market access and one on rules, and six already existing standing WTO bodies that meet in special session.

A number of the Multilateral Agreements on Trade in Goods also provide for a committee to carry out certain functions relating to the implementation of the particular agreement. By way of example, we mention here the SPS Committee. Article 12.1 of the *SPS Agreement* states *inter alia*:

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

1.5.4 Quasi-judicial and Other Non-political Bodies

All the above WTO bodies are political in nature. The WTO also has a number of quasi-judicial and other non-political bodies. Most prominent among these bodies are the *ad hoc* dispute settlement panels and the standing Appellate Body, which are discussed in detail below.²⁵ However, the WTO also has other bodies that are, if not quasi-judicial in nature, definitely non-political. The best example of such a body is the Textile Monitoring Body (the “TMB”).²⁶ The TMB is composed of nationals of Members who sit not as representatives of their country but in their personal capacities.

1.5.5 WTO Secretariat

Article VI: 1 WTO

The WTO has a Secretariat based in Geneva, Switzerland, with a staff of some 550 officials.²⁷ This makes it undoubtedly one of the smallest Secretariats of the main international organizations. A Director-General, who is appointed by the Ministerial Conference, heads the Secretariat.²⁸ The Ministerial Conference also adopts regulations setting out the powers, duties, conditions of service and term of office of the Director-General. The current Director-General, Dr. Supachai Panitchpakdi, of Thailand, took office on 1 September 2002.

²⁴ *Para. 46 of the Doha Ministerial Declaration.*

²⁵ *See below, Section 4.6*

²⁶ *Article 8:1 of the Agreement on Textiles and Clothing.*

²⁷ *This number does not include the staff of the Secretariat of the Appellate Body, which is independent from the WTO Secretariat (see below). The 2001 WTO budget provided in total for 552 posts for the WTO and Appellate Body Secretariats; however, almost 40 posts were vacant or under recruitment. Vacancies are the subject of open competition. The final selection of professional staff is always done on the basis of a written exam and an interview. The recruitment process is highly competitive. Vacancies are advertised by means of vacancy notices, the distribution of which is made to all of the official representatives of the governments participating in the WTO. They are also posted on the WTO website (www.wto.org) and occasionally advertised in the press.*

²⁸ *Article VI:2 of the WTO Agreement.*

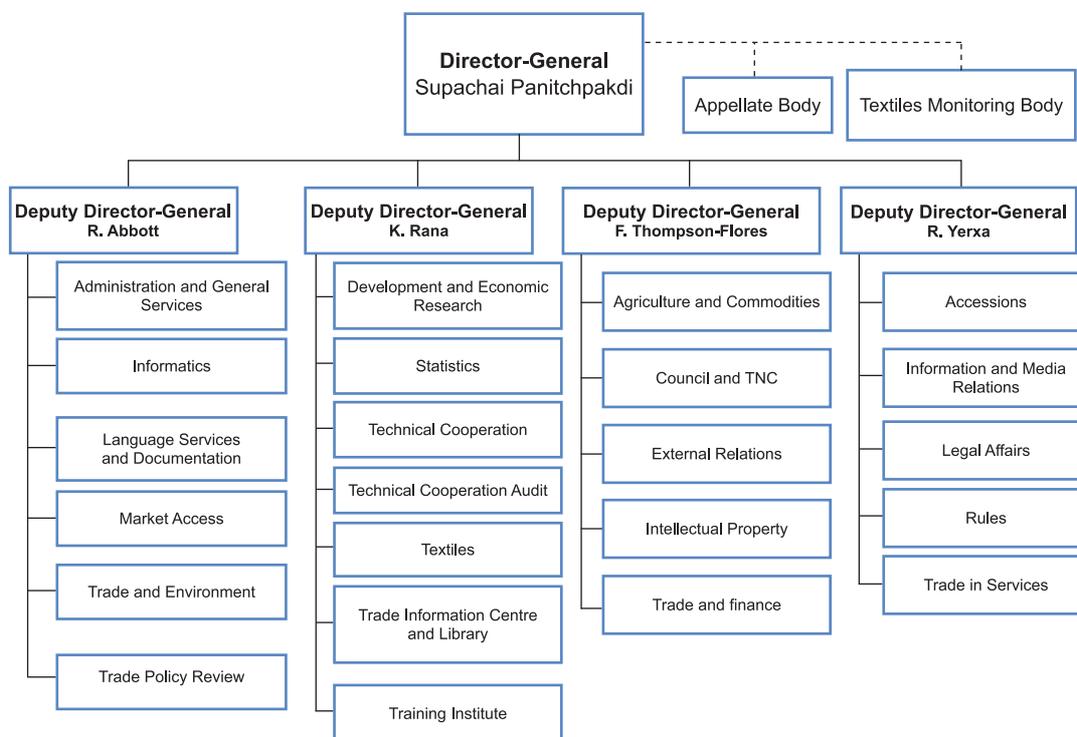
Article VI: 4 WTO

The Director-General and WTO staff are independent and impartial international officials, who shall not seek or accept instructions from any government or any other authority external to the WTO. The Members of the WTO are under an obligation to respect the international character of the responsibilities of the Director-General and of the WTO staff and must not seek to influence them in the discharge of their duties.

As WTO Members often point out, the WTO is “a Member-driven” organization. The Members, and not the Director-General or the WTO Secretariat, take decisions. Neither the Director-General nor the WTO Secretariat has any decision-making powers. The Director-General and the WTO Secretariat act primarily as an “honest broker” in, or a “facilitator” of, the decision-making processes in the WTO. They will seldom be the initiator of proposals for action or reform. In that seemingly modest role, the Director-General and the WTO Secretariat can, however, make an important contribution to helping the Members to come to an agreement or decision. The main duties of the WTO Secretariat are to provide technical and professional support for the various WTO bodies, to provide technical assistance for developing country Members, to monitor and analyse developments in world trade, to advise governments of countries wishing to become Members of the WTO, and to provide information to the public and the media. The Secretariat also provides administrative support and legal assistance in the dispute settlement process.

The WTO Secretariat is organized into divisions with a functional role (e.g., the Agriculture and Commodities Division, the Services Division and the Market Access Division), divisions with an information and liaison role (e.g., the Information and Media Relations Division) and divisions with a support role (e.g. the Administration and General Services Division and the Language Services and Documentation Division). Divisions are normally headed by a Director who reports to one of the WTO’s four Deputy Directors-General or directly to the Director-General.

WTO Secretariat Organization Chart on 1 October 2002²⁹



1.6 Membership and Accession

1.6.1 Membership

States & customs territories

On 1 September 2002, the WTO had 144 Members. The current list of Members can be found on the WTO website (www.wto.org). The WTO Membership includes not only States. Also separate customs territories pos-essing full autonomy in the conduct of their external commercial relations and in the other matters covered by the *WTO Agreement* can be WTO Members. Two examples of such WTO Members that are not States but separate customs territories, are **Hong Kong, China**, and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu. Also the European Communities is a WTO Member but this is a case apart, specifically provided for in the *WTO Agreement*. Both the European Communities and the 15 Member States of the European Union are Members of the WTO.

Developing countries

A large majority of the 144 Members of the WTO are developing countries. There is no WTO definition of a “developing country”. The status of “developing country Member” is based to a large extent on self-selection. Members announce for themselves whether they are “developed” or “developing” countries. Developing country Members benefit from special and differential treatment under many of the WTO agreements and receive

²⁹ This chart can be found at www.wto.org.

WTO technical assistance.³⁰ Other members can, and occasionally do, challenge the decision of a Member to make use of special and differential treatment provisions available to developing countries.

In recent years, developing country Members have played an increasingly important role in the WTO. This increased importance was very clear at the Doha Session of the Ministerial Conference in November 2001 and is reflected in the WTO Work Programme adopted in Doha.

Least-developed countries

Among the developing country Members there were on 1 September 2002, 30 least-developed countries. The WTO recognizes as least-developed countries, those countries that have been designated as such by the United Nations.³¹ Least-developed countries benefit from additional special and differential treatment.³²

1.6.2 Accession Procedure

Article XI WTO

The *WTO Agreement* initially provided for two ways of becoming a WTO Member. The first, “original membership”, was provided for in Article XI of the *WTO Agreement*, and allowed Contracting Parties to the GATT 1947 (and the European Communities) to join the WTO by accepting the terms of the *WTO Agreement* and the Multilateral Trade Agreements and making concessions and commitments for both trade in goods and services (embodied in national schedules, annexed to the GATT 1994 and the GATS respectively). This way of becoming a WTO Member was only available until March 1997.

Article XII WTO

The second way of becoming a WTO Member is through accession and this way is open indefinitely. To become a WTO Member through accession, a country or customs territory has to negotiate the terms of membership with those countries and customs territories that are already Members. The candidate for membership always has to accept the terms of the *WTO Agreement* and all Multilateral Trade Agreements. This is not up for negotiation. The subjects of the accession negotiations are the market access commitments and concessions the candidate for membership has to make. A “ticket of admission” is negotiated. When a State or customs territory accedes to the WTO, it instantly benefits from all the efforts that WTO Members have undertaken to date to reduce barriers to trade and increase market access. In return for the access to the markets of current Members that a new Member will obtain, the new Member will itself have to open up its market to the current Members. The extent of the market access commitments and concessions that a candidate for

³⁰ See below, section 3.2 and section 5.

³¹ Currently the United Nations designate 49 countries as least-developed countries. The least-developed countries among the WTO Members are Angola, Bangladesh, Benin, Burkina Faso, Burundi, Central African Republic, Chad, Congo, Democratic Republic of the, Djibouti, Gambia, Guinea, Guinea Bissau, Haiti, Lesotho, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Niger, Rwanda, Senegal, Sierra Leone, Solomon Islands, Tanzania, Togo, Uganda, Zambia. Seven additional least-developed countries are in the process of accession to the WTO. They are: Cambodia, Cape Verde, Laos, Nepal, Samoa, Sudan and Vanuatu. Furthermore, Bhutan, Ethiopia and Yemen are WTO Observers.

³² See below, Section 3.2 and Section 5.

membership will be expected to make will depend on its economic development, financial and trade needs and its administrative and institutional capability. Even when no major problems are encountered, accession negotiations are usually long. The shortest accession process to date took just under three years. The accession negotiations with Algeria have now been going on since 1987. The slowness of the accession negotiations has drawn considerable criticism.

In 2002, there were 28 countries negotiating their accession. The most important ongoing accession negotiations, in both economic and political terms, are those with Russia and Saudi Arabia. The most difficult and most important accession negotiations ever conducted were those with China. The accession negotiations with China took almost 15 years and resulted in a legal text of some 900 pages. On 11 December 2001, China formally became a Member of the WTO. In order to join the WTO, China has agreed to undertake a series of important market access commitments and concessions and to offer a more predictable environment for trade and foreign investment in accordance with WTO rules.

1.7 Decision-Making by the WTO

With respect to decision-making by WTO bodies, there is a distinction between the normal decision-making procedure, which applies as the default procedure, and a number of special procedures for specific decisions.

1.7.1 Normal Procedure

Article IX:1 WTO

The normal decision-making procedure for WTO bodies is set out in Article IX: 1 of the *WTO Agreement*, which states:

The WTO shall continue the practice of decision-making by consensus followed under GATT 1947. Except as otherwise provided, where a decision cannot be arrived at by consensus, the matter at issue shall be decided by voting. At meetings of the Ministerial Conference and the General Council, each Member of the WTO shall have one vote. [...] Decisions of the Ministerial Conference and the General Council shall be taken by a majority of the votes cast, unless otherwise provided in this Agreement or in the relevant Multilateral Trade Agreement.

A WTO body is deemed to have decided by consensus on a matter submitted for its consideration, if no Member present at the meeting when the decision is taken, *formally* objects to the proposed decision.³³ In other words, unless a Member *explicitly* objects to the proposed decision, that decision is taken.

³³ Footnote 1 to Article IX of the *WTO Agreement*.

If consensus cannot be achieved, Article IX:1 of the *WTO Agreement* provides for voting on a one-country/one-vote basis.³⁴ Under the normal procedure, decisions are then taken by a majority of the votes cast. As under the old GATT, however, it is very exceptional for WTO bodies to vote.

1.7.2 Special Procedures

The *WTO Agreement* sets out a number of decision-making procedures that deviate from the normal procedure discussed above. For example, all decisions taken by the DSB are taken by consensus; resort to voting is not possible.³⁵ Decisions of the Ministerial Conference or the General Council to adopt an interpretation of provisions of the *WTO Agreement* or the multilateral trade agreements are taken by a three-fourths majority of the Members.³⁶ Decisions to waive an obligation imposed on a Member are taken by the same majority if Members do not reach a consensus within an agreed maximum time period of 90 days.³⁷ Decisions on accession are taken by a two-thirds majority of the Members.³⁸ Decisions on amendments require in most cases also a two-thirds majority of the Members, if Members do not succeed in reaching a consensus within a time period, which will normally be 90 days.³⁹ Finally, decisions on the budget and on financial regulations require a two-thirds majority of the votes comprising more than half of the Members.⁴⁰

1.8 Budget of the WTO

Article VII WTO

The total WTO budget for 2002 amounts to SF 143 m.⁴¹ In comparison with the annual budget of other international organizations, the WTO's annual budget is small and reflects the small size of the Secretariat and the relatively limited scope of the WTO's activities outside Geneva.

The contributions of Members to the WTO budget are established according to a formula based on their share of international trade in goods, services and intellectual property rights for the last three years for which data is available. There is a minimum contribution of 0.015 per cent for Members whose share in the total trade of all Members is less than 0.015 per cent. The Member States of the European Union are by far the largest contributors to the WTO budget.

³⁴ *Whereas each WTO Member has one vote, Article IX:1 of the WTO Agreement provides that when the European Communities exercises its right to vote, it shall have a number of votes equal to the number of the EU Members States which are Members of the WTO.*

³⁵ *Article 2.4 of the DSU.*

³⁶ *Article IX:2 of the WTO Agreement.*

³⁷ *Article IX:3 of the WTO Agreement.*

³⁸ *Article XII:2 of the WTO Agreement.*

³⁹ *Article X of the WTO Agreement.*

⁴⁰ *Article VII:3 of the WTO Agreement.*

⁴¹ *The 2002 Budget represents an increase of almost seven per cent over the 2001 budget to allow the WTO Secretariat to give more technical assistance to developing countries and contribute more to capacity building in these countries as mandated at the Doha Session of the Ministerial Conference.*

1.9 Test Your Understanding

- 1. What are the historical origins of the WTO and to which extent are these origins still relevant today?**
- 2. How many different agreements make up the *WTO Agreement*? Which agreement prevails in case of conflict? What is the difference between the multilateral and the plurilateral trade agreements annexed to the *WTO Agreement*?**
- 3. What are the WTO's policy objectives according to the Preamble of the *WTO Agreement* and what are the two main instruments to achieve these objectives?**
- 4. Which are the five key functions of the WTO? To which of these functions does the Doha Development Round relate? What is the objective of the trade policy review mechanism? Does the WTO involve in any way NGOs in its activities?**
- 5. What are the main bodies of the WTO? Are all Members represented in these bodies? Does the frequency of meetings raise particular problems for developing country Members?**
- 6. Is membership of the WTO limited to States? Is accession to the WTO comparable to accession to the United Nations? How does a State become a member of the WTO?**
- 7. How do WTO bodies normally take decisions? When does a WTO body resort to voting? Do the United States, the European Communities, India, Costa Rica and Burkina Faso have the same number of votes?**

2. BASIC RULES OF WTO LAW AND POLICY

Objectives

On completion of this section, the reader will be able to identify the basic rules of WTO law and policy that are the foundation of what is commonly referred to as the *multilateral trading system*.

2.1 Non-Discrimination

There are two principles of non-discrimination in WTO law: the most-favoured-nation (MFN) treatment obligation and the national treatment obligation.⁴²

MFN Treatment

The MFN treatment obligation requires a WTO Member that grants certain favourable treatment to another country, to grant that same favourable treatment to all other WTO Members. A WTO Member is not allowed to discriminate between its trading partners by giving some countries more favourable treatment than others in terms of, for example, market access or the application of domestic regulation. The MFN treatment obligation is the single most important rule in WTO law. Without this rule the multilateral trading system would and could not exist. It applies both to trade in goods (Article I of the GATT 1994) and to trade in services (Article II of the GATS).⁴³

National Treatment

The national treatment obligation requires a WTO Member to treat “like” foreign and domestic products, services or service suppliers equally. Where the national treatment obligation applies, foreign products, services or service suppliers may, once they have entered the domestic market, not be subject to less favourable taxation or regulation than “like”⁴⁴ domestic products, services or service suppliers. Pursuant to the national treatment obligation, a WTO Member is not allowed to discriminate between its own products, services or service suppliers *and* foreign products, services or service suppliers. For trade in goods, the national treatment obligation has *general* application (Article III:2 and III:4 of the GATT 1994). For trade in services, the national treatment obligation applies to the extent WTO Members have explicitly committed themselves in respect of specific services to treat foreign and domestic services and service suppliers equally (Article XVII of the GATS). Such commitments are made in a Member’s Schedule of Specific Commitments.⁴⁵

2.2 Market Access

WTO law contains three main groups of rules regarding market access: rules concerning customs duties, i.e., tariffs; rules concerning quantitative restrictions, such as quotas; and rules concerning (other) non-tariff barriers,

⁴² See also Modules 3.5, 3.6 and 3.8 of this Course.

⁴³ Also the TRIPS Agreement provides in Article 4 for a MFN treatment obligation.

⁴⁴ With respect to taxation, the national treatment obligation also applies to “directly competitive or substitutable” foreign and domestic products.

⁴⁵ The TRIPS Agreement provides in Article 3 for a national treatment obligation.

such as technical regulations and standards, sanitary and phytosanitary measures, customs formalities and government procurement practices. Furthermore, the principles of transparency and “justiciability” are important for effective market access.⁴⁶

Customs Duties

Under WTO law the imposition of customs duties on trade in goods is not prohibited but WTO law calls upon countries to negotiate the mutually beneficial reduction of customs duties. These negotiations result in tariff concessions or bindings, which are listed in a Member’s Schedule of Concessions. For those products for which such a tariff binding exists, the customs duties applied may no longer exceed the level at which they were bound (Article II:1 GATT 1994).⁴⁷

Quantitative Restrictions

While customs duties are in principle not prohibited (but may not exceed the level at which they are bound), quantitative restrictions (“QRs”) on trade in goods are, as a general rule, forbidden. Unless one of many exceptions applies, WTO Members are not allowed to ban the importation or exportation of goods or to subject them to quotas (Article XI:1 GATT 1994) With regard to trade in services, a Member who has undertaken market-access commitments with respect to a specific sector may generally speaking not maintain or adopt quantitative restrictions in that sector, unless otherwise specified in its Schedule (Article XVI:2 GATS).

Non-Tariff Barriers

Non-tariff barriers to trade (“NTBs”), such as technical regulations and standards, sanitary and phytosanitary measures, customs formalities and government procurement practices are today for many products and many countries more important barriers to trade than customs duties or quantitative restrictions. Rules on these and other non-tariff barriers are set out in a number of GATT provisions (e.g., Article VIII GATT 1994) and specific WTO agreements, such as the *Agreement on Sanitary and Phytosanitary Measures* (the “*SPS Agreement*”) and the *Agreement on Technical Barriers to Trade* (the “*TBT Agreement*”). The latter agreements not only prohibit measures that discriminate between “like” foreign and domestic products. The *TBT Agreement*, for example, also requires in respect of technical regulations that these regulations are *not more trade-restrictive than necessary* to fulfil one of the legitimate policy objectives mentioned in the Agreement (e.g., the protection of human health and safety).⁴⁸ The *SPS Agreement* requires *inter alia* that sanitary and phytosanitary measures are based on scientific principles and are not maintained without sufficient scientific evidence (except when the measures are only provisional in nature).⁴⁹

Transparency & justiciability

The obligation on Members to publish all trade laws, regulations and judicial decisions in such a manner as to allow governments and traders to become acquainted with them (the principle of transparency) is important to ensure

⁴⁶ See also Modules 3.5, 3.6 and 3.8 of this Course.

⁴⁷ Customs duties are not imposed on trade in services and the GATS therefore does not provide for rules on customs duties.

⁴⁸ See also Module 3.9 of this Course.

⁴⁹ See also Module 3.7 of this Handbook.

effective access to foreign markets.⁵⁰ Likewise, the obligation on Members to maintain or institute judicial, arbitral or administrative tribunals for the purpose, *inter alia*, of the prompt, objective and impartial review of administrative decisions affecting trade in goods or services is essential to guarantee security and predictability in international trade (the principle of “justiciability”).⁵¹ Generally, Members must ensure that all measures of general application affecting trade in goods and services are administered in a reasonable, objective and impartial manner.⁵²

2.3 Protection Against Unfair Trade

WTO law does not have general rules on unfair trade practices, but it does have some highly technical and complex rules that relate to specific forms of “unfair” trade. These rules concern dumping and subsidies.

Dumping

Dumping, i.e., to bring a product onto the market of another country at a price less than the normal value of that product, is condemned but not prohibited in WTO law. However, when the dumping causes or threatens to cause material injury to the domestic industry of a country, WTO law allows that country to impose anti-dumping duties on the dumped products in order to offset the dumping. The relevant rules are set out in Article VI of the GATT 1994 and the *Anti-Dumping Agreement*.⁵³

Subsidies

Subsidies, i.e., a financial contribution by a government or public body that confers a benefit, are subject to a complex set of rules. Some subsidies, such as export subsidies and subsidies contingent upon the use of domestic over imported products are, as a rule, prohibited. Other subsidies are not prohibited but when they cause adverse effects to the interests of other countries, the subsidizing country should withdraw the subsidy or take appropriate steps to remove the adverse effects. If the subsidizing country fails to do so, countermeasures commensurate with the degree and nature of the adverse effect may be authorized.⁵⁴

If a prohibited or other subsidy causes or threatens to cause material injury to the domestic industry of a country producing a “like” product, that country is authorized to impose countervailing duties on the subsidized products to offset the subsidization.

The rules applicable to subsidies and countervailing duties are set out in Articles VI and XVI of the GATT 1994 and the *Agreement on Subsidies and Countervailing Measures* (the “SCM Agreement”).⁵⁵ Subsidies relating to

⁵⁰ See, e.g., Article X:1 of the GATT 1994 and Article III:1 of the GATS.

⁵¹ See, e.g., Article X:3(b) of the GATT 1994 and Article VI:2(a) of the GATS.

⁵² See, e.g., Article X:3(a) of the GATT 1994 and Article VI:1 of the GATS.

⁵³ See also Module 3.11 of this Course.

⁵⁴ Until 1 January 2000, there was a third category of so-called “non-actionable subsidies” regulated in Articles 8 and 9 of the SCM Agreement. However, the WTO Members failed to agree on the extension of the application of these provisions and these provisions therefore lapsed (see Article 31 of the SCM Agreement).

⁵⁵ See also Module 3.12 of this Course.

agricultural products are subject to different (more lenient) rules set out in the *Agreement on Agriculture*.

2.4 Trade and Competing Interests and Values

Apart from the above basic rules and principles, WTO law also provides for a number of general exceptions to these basic rules and disciplines to allow countries in certain circumstances to take account of economic and/or non-economic interests and values that compete with free trade.⁵⁶

2.4.1 *Competing Non-Economic Interests and Values*

The non-economic interests and values include the protection of the environment, public health, public morals and national security. Pursuant to Article XX of the GATT 1994 or Article XIV of the GATS, Members may take measures that are “necessary”, for example, to protect public health, provided the application of these measures does not constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Article XXI of the GATT 1994 and Article XIV *bis* of the GATS allow Members to take measures to protect national security interests. It also allows the taking of measures to give effect to UN mandated trade embargoes or sanctions.

2.4.2 *Competing Economic Interests and Values*

Economic interests that may compete with trade include the protection of a domestic industry from serious injury inflicted by an unexpected and sharp surge in imports. Article XIX of the GATT 1994 and the *Agreement on Safeguards* allow Members to take safeguard measures (in the form of the imposition of customs duties above the binding or the imposition of quotas) giving temporary protection to the domestic industry.⁵⁷ Other economic interests that may compete with trade are the safeguarding of the balance of payments⁵⁸ and the pursuit of regional economic integration.⁵⁹ These exceptions may be invoked by all countries and will allow these countries, if they meet certain specific conditions, to deviate from the basic rules and disciplines.

2.5 Test Your Understanding

1. Which basic rules of WTO law and policy constitute the foundation of the multilateral trading system?
2. What do the MFN treatment obligation and the national treatment obligation have in common? In what do they differ?

⁵⁶ See also Module 3.5, 3.6, 3.8 and 3.13 of this Course.

⁵⁷ For safeguard measures relating to trade in services, see Article X of the GATS.

⁵⁸ See Article XII of the GATT 1994 and Article XII of the GATS.

⁵⁹ See Article XXIV of the GATT 1994 and Article V of the GATS.

- 3. How do the basic WTO rules on customs duties and quantitative restrictions differ? Do WTO rules on non-tariff barriers only prohibit discrimination between domestic and foreign products?**
- 4. Do WTO rules prohibit dumping or subsidization of imported products? Do WTO rules allow Members to take action against dumped or subsidized imports?**
- 5. Generally speaking, in which circumstances may WTO law justify deviation from the basic rules of non-discrimination and market access? Does free trade prevail over the protection of public health under WTO law?**

3. DEVELOPING COUNTRIES IN THE WTO SYSTEM

Objectives

This section shows how and to which extent WTO law and policy take account of the special interests and needs of developing country Members and least-developed country Members and assist them in their efforts to integrate into the multilateral trading system. It also covers the special and differential treatment that is currently already bestowed on developing and least-developed country Members.

3.1 Recognition of the Interests and Needs of Developing Countries

Preamble WTO

In the Preamble of the *WTO Agreement*, WTO Members explicitly recognize the need for positive efforts designed to ensure that developing countries, and especially the least developed countries, are integrated into the multilateral trading system and secure a share in the growth in international trade commensurate with the needs of their economic development.⁶⁰ As noted above, a large majority of the WTO Members are developing countries and 30 of them are least-developed countries. In the Doha Ministerial Declaration adopted at the close of the Fourth Session of the Ministerial Conference in Doha in November 2001, the WTO Members noted:

Doha Ministerial Declaration

International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. The majority of WTO members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration. Recalling the Preamble to the Marrakesh Agreement, we shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainable financed technical assistance and capacity-building programmes have important roles to play.

We recognize the particular vulnerability of the least-developed countries and the special structural difficulties they face in the global economy. We are committed to addressing the marginalization of least-developed countries in international trade and to improving their effective participation in the multilateral trading system. We recall the commitments made by ministers at our meetings in Marrakesh, Singapore and Geneva, and by the international community at the Third UN Conference on Least-Developed Countries in Brussels, to help least-developed countries secure beneficial and meaningful integration into the multilateral trading system and the global economy. We are determined that the WTO will play its part in building effectively on these commitments under the Work Programme we are establishing.⁶¹

⁶⁰ *WTO Agreement, Preamble, second paragraph.*

⁶¹ *Doha Ministerial Declaration, 14 November 2001, WT/MIN(01)/DEC/1, paras. 2 and 3.*

The interests and needs of developing countries, and, in particular, least-developed countries are, since the 2001 Doha Session of the Ministerial Conference, more than ever before at the heart of the WTO's activities and concerns. At the Doha Session itself, the WTO Members adopted a *Decision on Implementation Related Issues and Concerns*, addressing problems developing country Members have experienced with the implementation of the WTO agreements resulting from the Uruguay Round.⁶² WTO Members also adopted in Doha a *Declaration on the TRIPS Agreement and Public Health*, in which they affirmed, against the background of the gravity of the public health problems afflicting many developing and least-developed countries, that the *TRIPS Agreement* can and should be interpreted and implemented in a manner supportive of WTO Members' right to promote access to medicines for all.⁶³ In the Doha Development Round, and the broader Work Programme for the WTO, agreed to in Doha, the interests and needs of developing countries are central. The integration of developing countries, and especially least developed countries, in the multilateral trading system and efforts to secure them a bigger share in international trade are high on the WTO's agenda.

3.2 Special and Differential Treatment for Developing Country Members

To ensure that developing countries, and especially the least developed countries, are integrated into the multilateral trading system and increase their share in international trade, WTO law already provides for many special provisions in favour of developing and least-developed countries, taking into account their particular needs and interests. In general, these provisions provide, in many areas, for fewer or less demanding obligations, longer periods for implementation and technical assistance. This section describes the special and differential treatment provided for *all* developing country Members. The following section focuses on the *additional* special and differential treatment provided for the least-developed countries.

In the Doha Decision on Implementation Issues of 14 November 2001, Members agreed as follows:

The Committee on Trade and Development is instructed:

(i) to identify those special and differential treatment provisions that are already mandatory in nature and those that are non-binding in character; to consider the legal and practical implications for developed and developing Members of converting special and differential treatment measures into mandatory provisions, to identify those that Members consider should be made mandatory, and to report to the General Council



⁶² Decision of the Ministerial Conference on Implementation-related Issues and Concerns, 14 November 2001, WT/MIN(01)/DEC/17.

⁶³ Declaration of the Ministerial Conference on the TRIPS Agreement and Public Health, 14 November 2001, WT/MIN(01)/DEC/2.

with clear recommendations for a decision by July 2002;

(ii) to examine additional ways in which special and differential treatment provisions can be made more effective, to consider ways, including improved information flows, in which developing countries, in particular the least-developed countries, may be assisted to make best use of special and differential treatment provisions, and to report to the General Council with clear recommendations for a decision by July 2002; and

(iii) to consider, in the context of the work programme adopted at the Fourth Session of the Ministerial Conference, how special and differential treatment may be incorporated into the architecture of WTO rules.⁶⁴

In this section, we distinguish between provisions aimed at increasing trade opportunities; provisions allowing flexibility for developing countries in the use of measures in support of their economic development; provisions allowing longer periods for implementation; provisions limiting the possibility to take action against products originating in developing country Members; and provisions concerning technical assistance.

3.2.1 Increasing Trade Opportunities

Part IV GATT 1994

Pursuant to Article XXXVII:1 of Part IV of the GATT 1994, entitled *Trade and Development*,⁶⁵ WTO Members must “to the fullest extent possible” give high priority to the reduction and elimination of barriers to trade in products currently or potentially of particular export interest to developing country Members and refrain from imposing higher tariff or non-tariff barriers to trade with developing country Members. Furthermore, Article XXXVI:8 of Part IV of the GATT 1994 incorporates into WTO law the principle of non-reciprocity in trade negotiations between developed and developing country Members. This provision states:

The developed country Members do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing country Members.

Enabling Clause

The 1979 *Decision on Differential and More Favourable Treatment*, commonly referred to as the Enabling Clause, further elaborates the provisions of Part IV of the GATT 1994.⁶⁶ The Enabling Clause allows developed country Members to depart from the MFN treatment obligation in their trade relations with developing countries and to grant these countries “differential and more favourable treatment. The Enabling Clause states in relevant part:

Notwithstanding the provisions of Article I of the General Agreement, Members may accord differential and more favourable treatment to developing countries, without according such treatment to other Members.

⁶⁴ Para. 12.1 of the Decision, WT/MIN(01)/EC/17.

⁶⁵ Part IV was not part of the original GATT 1947 but was added in 1965.

⁶⁶ BISD 26S/203.

Developed country Members are thus allowed to grant preferential tariff treatment to developing country Members. Most developed country Members have done so under the Generalized System of Preferences (the “GSP”), first adopted as a policy by UNCTAD in 1968. A high percentage of the exports of developing countries is covered by GSP schemes and thus benefits from preferential tariff treatment. The Enabling Clause also provides for differential and more favourable treatment with respect to non-tariff measures and allows developing country Members to enter into regional or global arrangements amongst themselves for the mutual reduction or elimination of tariffs and, under certain conditions, non-tariff barriers to trade.

Article IV GATS

Article IV of the GATS, which is entitled “Increasing Participation of Developing Countries”, calls for the negotiation of specific commitments to facilitate the increasing participation of developing country Members in world trade in services. Article IV refers *inter alia* to specific commitments relating to access to technology on a commercial basis; access to distribution channels and information networks; and, more generally, the liberalization of market access for services of export interest to developing country Members. Under Article IV:2, developed country Members must establish contact points to facilitate the access of service suppliers of developing country Members to information relating to the supply of services in their respective markets.

3.2.2 Measures in Support of Economic Development

Article XVIII GATT 1994

Article XVIII of the GATT 1994, entitled “Government Assistance to Economic Development”, recognizes that it may be necessary for developing country Members “to take protective or other measures affecting imports” in order to implement their programmes and policies of economic development. More specifically, Sections A, C and D of Article XVIII, the “infant industry” sections, allow, under certain conditions, developing country Members to modify or withdraw tariff concessions or to take other GATT inconsistent measures in order to promote the establishment of a particular industry. Furthermore, Section B of Article XVIII, the “balance of payments” section, allows, again under certain conditions, developing country Members to impose quantitative restrictions on imports in order to safeguard their external financial position and to ensure a level of reserves adequate for the implementation of their programmes and policies of economic development.⁶⁷

Subsidies

The *SCM Agreement* recognizes that subsidies may play an important role in economic development programmes of developing country Members. This agreement thus provides that the general prohibition on export subsidies does not apply to developing country Members that have a *per capita* income below \$ 1000 per annum.⁶⁸

Safeguard Measures

The *Safeguards Agreement* allows developing country Members to extend the period of application of a safeguard measure for a period of up to two

⁶⁷ See also the Uruguay Round Understanding on the Balance-of-Payments Provisions of GATT 1994.

⁶⁸ Article 27.2 and Annex VII of the *SCM Agreement*.

years beyond the normal maximum period of eight years. Developing country Members may also apply a safeguard measure *again* to the import of a product that has been subject to such a measure, earlier than developed country Members are allowed.⁶⁹

Agriculture

The *Agreement on Agriculture* imposes on developing country Members less demanding requirements regarding the reduction of, for example, agricultural export subsidies and tariffs on agricultural imports. Developing country Members are required to reduce the budgetary outlays for export subsidies and the quantities benefiting from such subsidies by 24 and 14 per cent respectively. Developed countries must reduce by 36 and 21 per cent respectively. The required average reduction of tariffs of developing country Members was 24 per cent, while developed country Members had to reduce their tariff by 36 per cent.

GATS

Article XII:1 of the GATS recognizes that particular pressures on the balance of payments of a Member in the process of economic development “may necessitate the use of restrictions to ensure, *inter alia*, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development”. As under Article XVIII of the GATT 1994, the use of restrictions for balance of payments purposes is, therefore, allowed subject to specific conditions.

Article XIX:2 of the GATS provides that the process of liberalization of trade in services must take place with due respect for national policy objectives and the level of development of individual Members. For developing country Members there must be “appropriate flexibility” for opening *fewer* sectors, liberalizing *fewer* types of transactions, *progressively* extending market access in line with their development situation, and attaching to such market access *conditions* aimed at achieving the objectives of increasing their participation in world trade in services.

3.2.3 Longer Periods for Implementation

Additional Time

Many WTO agreements provide that developing country Members have longer periods to implement the obligations under those agreements. The *TRIPS Agreement*, for example, granted developing country Members a delay of application of the TRIPS provisions until 1 January 2000; developed country Members had to apply the TRIPS provisions as of 1 January 1996. Under the *Agreement on Agriculture*, developing country Members have ten years, instead of the “normal” six years, to implement their reduction commitments.⁷⁰

The Decision of 14 November 2001 of the Ministerial Conference at the Doha Session on Implementation Issues includes a number of provisions to make “additional time” provisions in the WTO agreements more specific.

⁶⁹ Article 9.2 of the *Safeguards Agreement*.

⁷⁰ Article 15.2 of the *Agreement on Agriculture*.

3.2.4 Limitations on action Against Products Originating in Developing Country Members

Anti-Dumping Measures

Several WTO agreements that allow action against fair and unfair trade of Members, such as the *Anti-Dumping Agreement*, the *SCM Agreement* and the *Safeguards Agreement*, limit the possibility to take action against developing country Members. *The Anti-Dumping Agreement* requires developed country Members considering the application of anti-dumping measures to give “special regard” to “the special situation of developing countries”.⁷¹ Before applying anti-dumping duties affecting the essential interests of developing country Members, developed country Members must first explore the possibilities of constructive remedies provided for by the *Anti-Dumping Agreement*.⁷² Under the *Safeguards Agreement* safeguard measures shall normally not be applied against a product originating in a developing country Member as long as that Member’s share of imports of the product concerned in the importing Member does not exceed three per cent.⁷³ The *SCM Agreement* requires developed country Members to terminate any countervailing duty investigation of a product originating in a developing country as soon as it has been determined that the overall level of subsidies granted upon the product concerned does not exceed two per cent of its value; or the volume of the subsidized imports represents less than four per cent of the total imports of the like product in the importing Member.⁷⁴

Safeguard Measures

Countervailing Duties

3.2.5 Technical Assistance

Many WTO agreements, including the *SPS Agreement*, the *TBT Agreement*, the *TRIPS Agreement*, the *Customs Valuation Agreement* and the *DSU*, specifically provide for technical assistance to developing country Members. This technical assistance may be given, on a bilateral basis, by developed country Members, or may be given by the WTO Secretariat.

At the Doha Session of the Ministerial Conference in November 2001, developing country Members made their participation in a new round of trade liberalisation negotiations “conditional” upon a significant increase in technical assistance and capacity building efforts in order to enable them to participate effectively in the new Round and to allow them to benefit fully from the results. The WTO has therefore embarked on a programme of greatly enhanced support for developing countries. Thus far, this has resulted in a notable increase in the WTO’s budget and generous donations from developed country Members to the Doha Development Agenda Global Trust Fund. Since 1998, available

⁷¹ Article 15, first sentence, of the *Anti-Dumping Agreement*. See also paras. 7.1 to 7.4 of the Doha Decision on Implementation Issues, WT/MIN(01)/DEC/17.

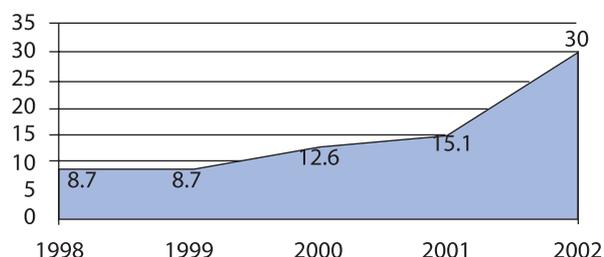
⁷² Article 15, second sentence, of the *Anti-Dumping Agreement*.

⁷³ Article 9.1 of the *Safeguards Agreement*. However, if the imports of all developing country Members with less than three per cent import share collectively account for more than nine per cent of the total imports of the product concerned, safeguard measures may be applied.

⁷⁴ Article 27.10 of the *SCM Agreement*. However, if imports from developing country Members whose individual share of total imports represents less than four per cent collectively account for more than nine per cent of the total imports of the like product in the importing Member than the countervailing duty investigation must not be terminated.

funds for technical assistance have risen by 340 per cent to a projected CHF 30 million in 2002.

Funding for technical cooperation activities in CHF million ⁷⁵



The WTO has also significantly improved coordination with other international organizations (World Bank, IMF, UNCTAD, etc.) in the so-called Integrated Framework, with regional banks and regional organizations and with bilateral governmental donors. The WTO considers that “[a]ssisting officials from developing countries in their efforts to better understand WTO rules and procedures — and how these rules and procedures can benefit developing countries — is among the most important aspects of the organization’s work.”⁷⁶

The WTO Secretariat, and, in particular, the Technical Cooperation Division, organizes, mostly in response to a specific request from one or more developing country Members, *general seminars* on the multilateral trading system and the work of the WTO; *technical seminars and workshops* focussing on a particular area of trade law or policy; and *technical missions* to assist developing country Members on specific tasks related to the implementation of obligations under the WTO agreements (such as the adoption of trade legislation or notifications). In 2002 the WTO Secretariat organized 514 technical cooperation activities as compared with 349 in 2001.⁷⁷

Furthermore, the WTO Secretariat, and in particular, the WTO Training Institute, which was established in 2001, also organizes training courses. These training courses, held at WTO headquarters in Geneva, run for as long as 12 weeks and cover the full range of WTO issues. In 2002, 300 government officials of developing country Members will receive in this way an intensive training in WTO law and policy.⁷⁸ The WTO also organizes a programme known as Geneva Week, which is a special week-long event bringing together representatives of WTO member countries who do not have permanent missions in Geneva. Geneva Week covers all WTO activities and includes presentations by other international organizations based in Geneva. In 2002 Geneva Week will be organized twice.

⁷⁵ 2002 figure projected. See WTO Secretariat, *Factsheet on Technical Cooperation*, 28 March 2002, at www.wto.org

⁷⁶ *Ibid.*

⁷⁷ *Ibid.*

⁷⁸ In 2001 the number of government officials participating in these training seminars was only 116. *Ibid.*

Since 1997, the WTO Secretariat has also been installing Reference Centres in developing countries.⁷⁹ These Reference Centres allow government officials to access essential documents instantly via the WTO website. As of March 2002, 109 reference centres had been established in 88 countries including 54 in Africa, 16 in the Caribbean, 17 in Asia, 10 in the Middle East, 10 in the Pacific, three in Latin America, and two in Eastern Europe.⁸⁰

Shaded Areas Are Those Serviced By WTO Reference Centres.



3.3 Special and Differential Treatment for Least-Developed Country Members

For least-developed country Members, WTO law provides *additional* special and differential treatment.

3.3.1 *Increased Trade Opportunities*

With regard to trade in goods, the Enabling Clause provides that developed country Members must exercise the utmost restraint in seeking any concessions or contributions in trade negotiations from the least-developed country Members. At the First Session of the Ministerial Conference in 1996 in Singapore, developed country Members agreed to examine how they could improve access to their markets for products originating in least-developed country Members, including the possibility of removing tariffs completely.

With regard to trade in services, the GATS provide that developed country Members must take account of the serious difficulty of the least-developed countries in accepting specific commitments.

⁷⁹ The WTO Secretariat provides governments with computer and other hardware, software and the training required for the operation of these Reference Centres.

⁸⁰ See WTO Secretariat, *Factsheet on Technical Cooperation*, 28 March 2002, at www.wto.org

3.3.2 Measures in Support of Economic Development

The prohibition on export subsidies under the *SCM Agreement* does not apply to least-developed country Members.⁸¹ Moreover, the *Agreement on Agriculture* exempts the least-developed country Members from the obligation to reduce tariffs on agricultural imports and agricultural domestic and export subsidies.⁸²

3.3.3 Longer Periods for Implementation

In view of the special needs and requirements of least-developed country Members, their economic, financial and administrative constraints, and their need for flexibility to create a viable technological base, least-developed country Members may delay the application of most obligations under the *TRIPS Agreement* for a period of 11 years, i.e., until 1 January 2006.⁸³ Pursuant to the *SCM Agreement*, the prohibition on subsidies contingent on the use of domestic over imported goods shall not apply to least-developed countries for a period of eight years, i.e., until 1 January 2003.⁸⁴

3.4 Test Your Understanding

- 1. Does WTO law and policy recognize the particular interests and needs of developing country Members? If so, has there been a positive or negative evolution in the extent of this recognition?**
- 2. What special and differential treatment for developing country Members does WTO law provide with respect to access to the markets of developed country Members?**
- 3. Does WTO law give developing country Members significantly more leeway than developed country Members to apply trade-restrictive or trade-distorting measures adopted in support of domestic economic development?**
- 4. Which of the provisions of WTO law providing developing country Members with extra time to implement their obligations are still relevant in 2003?**
- 5. Are developed country Members restrained from applying anti dumping, countervailing or safeguard measures against imports of products originating from developing country Members? If so, to what extent?**
- 6. In which respect do least-developed countries receive additional special and differential treatment under WTO law?**

⁸¹ Article 27.2 of the *SCM Agreement*.

⁸² Article 15.2 of the *Agreement on Agriculture*.

⁸³ Article 66.1 of the *TRIPS Agreement*. However, the *MFN treatment obligation* and the *national treatment obligation* do apply.

⁸⁴ Article 27.3 of the *SCM Agreement*.

4. GENERAL FEATURES OF THE WTO DISPUTE SETTLEMENT SYSTEM

Objectives

On completion of this section, the reader will be able to identify and assess the general features of the dispute settlement system of the WTO.

4.1 Past and Present

The WTO dispute settlement system, as it has been operating since 1 January 1995, did not fall out of the blue. It is not a novel system. On the contrary, this system is based on, and has absorbed, almost fifty years of experience with the resolution of trade disputes in the context of the GATT 1947.⁸⁵ Article 3.1 of the DSU states:

Members affirm their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures as further elaborated and modified herein.

4.1.1 GATT Dispute Settlement (1948-1995)

GATT 1947

As explained above, the GATT 1947 was not conceived as an international organization for trade.⁸⁶ The GATT 1947 therefore did not provide for an elaborate dispute settlement system. In fact, the GATT 1947 contained only two brief provisions relating to dispute settlement: Articles XXII and XXIII.

Under the GATT 1947, a dispute, which parties failed to resolve through consultations, was in the early years of the GATT “handled” by working parties set up pursuant to Article XXIII:2. These working parties consisted of representatives of all interested Contracting Parties, including the parties to the dispute, and made decisions on the basis of consensus. From the 1950s however, a dispute was usually first heard by a so-called “panel” of three to five independent experts from GATT Contracting Parties not involved in the dispute. This panel then reported to the GATT Council, consisting of all Contracting Parties, which would have to adopt by consensus the recommendations and rulings of the panel before they would become legally binding on the parties to the dispute. The dispute settlement procedures and practices, which were developed over the years in a pragmatic *ad hoc* manner, were progressively codified and supplemented by decisions and understandings on dispute settlement adopted by the Contracting Parties. In 1983, a GATT Legal Office was established within the GATT Secretariat, to help panels, often composed of trade diplomats without legal training, with the drafting of panel reports. As a result, the legal quality of panel reports improved and the

⁸⁵ See Article 3.1 of the DSU but also Article XVI:1 of the WTO Agreement.

⁸⁶ See above, Section 1.1.

confidence of the Contracting Parties in the panel system increased.⁸⁷ During the 1980s, previous panel reports were increasingly used as a sort of “precedent” and the panels started using customary rules of interpretation of public international law.

Legalization

In view of these developments in the GATT dispute settlement system since the 50s, Bob Hudec speaks of the increasing “legalisation” of the GATT’s “diplomat’s jurisprudence”. The GATT dispute settlement system evolved from a power-based system of dispute settlement through diplomatic negotiations into a system that had many features of a rules-based system of dispute settlement through adjudication.

Success & Failure

While the GATT dispute settlement has generally been considered as quite successful in fully or partially resolving disputes to the satisfaction of the complaining party, the system had some serious shortcomings, which became ever more acute in the 1980s and the early 1990s. The most important shortcoming of the system was that the decision on the establishment of a panel, the decision on the adoption of the panel report and the decision to authorize the suspension of concessions, were to be taken by the GATT Council by consensus. The responding party could thus delay or block any of these decisions and thus paralyse or frustrate the operation of the dispute settlement system. In particular, the adoption of panel reports became a real problem from the late 1980s onwards. The fact that the losing party could prevent the adoption of the panel report meant that panels were often tempted to arrive at a conclusion that would be acceptable to all parties. Whether that conclusion was legally sound and convincing was not a prime concern. Furthermore, the Contracting Parties regarded the dispute settlement process as unable to handle many of the politically sensitive trade disputes since the assumption was that the respondent would refuse to agree to the establishment of a panel or the losing party would prevent the adoption of the panel report. As a result, some Contracting Parties, and, in particular, the United States, resorted increasingly to unilateral action against measures they considered in breach of GATT law.

4.1.2 The WTO Dispute Settlement Understanding

Uruguay Round

The improvement of the GATT dispute settlement system was high on the agenda of the Uruguay Round negotiations. The 1986 Punta del Este Ministerial Declaration on the Uruguay Round stated with regard to dispute settlement:

In order to ensure prompt and effective resolution of disputes to the benefit of all contracting parties, negotiations shall aim to improve and strengthen the rules and the procedures of the dispute settlement process, while recognizing the contribution that would be made by more effective and enforceable GATT rules and disciplines. Negotiations shall include the development of adequate arrangements for overseeing and monitoring of the procedures that would facilitate compliance with adopted recommendations.

⁸⁷ Hudec, R. e.a., “A Statistical Profile of GATT Dispute Settlement Cases: 1948-1989”, *Minnesota Journal of Global Trade*, 1993, 138.

Already in 1989, the negotiators were able to reach agreement on a number of improvements to the GATT dispute settlement system. These improvements included the recognition of the right to a panel and strict timeframes for panel proceedings. No agreement was reached, however, on the most difficult issue of the adoption of panel reports by consensus. This issue was only resolved in the final stages of the Round and was linked to the introduction of appellate review of panel reports.

DSU

The *Understanding on Rules and Procedures Governing the Settlement of Disputes*, commonly referred to as the *Dispute Settlement Understanding* or DSU, is attached to the *WTO Agreement* as Annex 2 and constitutes an integral part of that Agreement. The DSU provides for an elaborate dispute settlement system and is often referred to as one of the most important achievements of the Uruguay Round negotiations. The most significant innovations to the GATT dispute settlement system concern: (1) the quasi-automatic adoption of requests for the establishment of a panel, of dispute settlement reports and of requests for the authorization to suspend concessions; (2) the strict timeframes for various stages of the dispute settlement process; and (3) the possibility of appellate review of panel reports. The latter innovation is closely linked to the quasi-automatic adoption of panel reports and reflects the concern of Members to ensure high-quality panel reports.

4.1.3 WTO Dispute Settlement to Date

Use made of the System

The WTO dispute settlement system has been operational for almost eight years now and in that period it has arguably been the most prolific of all international dispute settlement systems. Since 1 January 1995, a total of 268 disputes have been brought to the WTO system for resolution.⁸⁸ In more than one fifth of the disputes brought to the WTO system, the parties were able to reach a mutually agreed solution through consultations or the dispute was resolved otherwise without recourse to adjudication. In other disputes, parties have resorted to adjudication and, to date, such adjudication procedures have been completed in some 80 disputes.⁸⁹ There are currently 19 disputes pending before panels⁹⁰ and, very exceptionally, none before the Appellate Body.⁹¹ With different degrees of intensity, pre-adjudication consultations between parties to a dispute are currently being held in 209 disputes at the time of writing.⁹²

⁸⁸ Number 269 being *EC – Customs Classification of Frozen Boneless Chicken Cuts*, complaint by Brazil (WT/DS269) (filed 11 October 2002).

⁸⁹ For data on WTO dispute settlement cases, see www.wto.org and www.worldtradelaw.net.

⁹⁰ See www.wto.org, “Update of WTO Dispute Settlement Cases”, WT/DS/OV/6, dated 3 May 2001, p. 40-53. One of these disputes is a dispute currently before a panel pursuant to Article 21.5 of the DSU.

⁹¹ See www.wto.org, “Update of WTO Dispute Settlement Cases”, WT/DS/OV/6, dated 3 May 2002, p. 54.

⁹² See www.wto.org, “Update of WTO Dispute Settlement Cases”, WT/DS/OV/6, dated 3 May 2002, p. 1- 40.

4.2 Object and Purpose of the WTO Dispute Settlement System

Article 3.2 DSU

Article 3.2 of the DSU states:

The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.

Article 3.7 DSU

Article 3.7 of the DSU states in relevant part:

The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred.

Article 3.3 DSU

WTO Members have explicitly recognized that the prompt settlement of disputes arising under the covered agreements “is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.”⁹³ The declared object and purpose of the WTO dispute settlement system is to achieve “a satisfactory settlement” of disputes in accordance with the rights and obligations established by the covered agreements.⁹⁴ Furthermore, the object and purpose of the dispute settlement system is for Members to seek redress for a violation of obligations or other nullification or impairment of benefits through the *multilateral* procedures of the DSU, rather than through *unilateral* action.⁹⁵ Article 23.1 of the DSU states:

Article 3.4 DSU

Article 23 DSU

When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreement, they shall have recourse to, and abide by, the rules and procedures of this Understanding.

It should be recalled that concerns regarding unilateral actions by the United States against what it considered to be violations of GATT law, were one of the driving forces behind the negotiations of the DSU.

⁹³ Article 3.3 of the DSU.

⁹⁴ Article 3.4 of the DSU.

⁹⁵ See Article 23 of the DSU.

Article 3.7 DSU

The DSU expresses a clear preference for solutions mutually acceptable to the parties reached through negotiations, rather than solutions resulting from adjudication. Article 3.7, quoted above, states in relevant part that a solution mutually acceptable to the parties to a dispute is “clearly to be preferred”.

Accordingly, each dispute settlement proceeding must start with consultations between the parties to the dispute with a view to reaching a mutually agreed solution. To resolve disputes through consultations is obviously cheaper and more satisfactory for the long-term trade relations with the other party to the dispute than adjudication by a panel.

4.3 Jurisdiction

4.3.1 Scope of Jurisdiction

Article 1.1 DSU

The WTO dispute settlement system has jurisdiction over any dispute between WTO Members arising under what are called the covered agreements. The covered agreements are the WTO agreements listed in Appendix 1 to the DSU, including the *WTO Agreement*, the GATT 1994 and all other Multilateral Agreements on Trade in Goods, the GATS, the *TRIPS Agreement* and the DSU.⁹⁶ Article 1.1 of the DSU establishes “an integrated dispute settlement system” which applies to all of the covered agreements.⁹⁷ The DSU provides for a single, coherent system of rules and procedures for dispute settlement applicable to disputes arising under any of the covered agreements.

Article 1.2 DSU

However, some of the covered agreements provide for a few special and additional rules and procedures “designed to deal with the particularities of dispute settlement relating to obligations arising under a specific covered agreement”.⁹⁸ Pursuant to Article 1.2 of the DSU, these special or additional rules and procedures prevail over the DSU rules and procedures to the extent that there is a “difference”, i.e., a conflict, between the DSU rules and procedures and the special and additional rules and procedures.⁹⁹

4.3.2 Compulsory Jurisdiction

Article 23.1 DSU

The jurisdiction of the WTO dispute settlement system is compulsory in nature. Pursuant to Article 23.1 of the DSU, quoted above, a complaining Member is obliged to bring any dispute arising under the covered agreements to the WTO dispute settlement system.

⁹⁶ *Plurilateral Trade Agreements are covered agreements subject to the adoption of a decision by the parties to these agreements setting out the terms for the application of the DSU (Appendix 1 of the DSU). Of the two plurilateral agreements currently in force, only the Agreement on Government Procurement is a covered agreement.*

⁹⁷ *Appellate Body Report, Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico (“Guatemala – Cement I”), WT/DS60/AB/R, adopted 25 November 1998, para. 64.*

⁹⁸ *Ibid.*, para. 66.

⁹⁹ *As the Appellate Body ruled in Guatemala – Cement I, para. 65, “it is only where the provisions of the DSU and the special or additional rules and procedures of a covered agreement cannot be read as complementing each other that the special additional provisions are to prevail”.*

Article 6.1 DSU

As a matter of law a responding Member, on the other hand, has no choice but to accept the jurisdiction of the WTO dispute settlement system. With regard to the latter, we note that Article 6.1 of the DSU states:

If the complaining party so requests, a panel shall be established at the latest at the DSB meeting following that at which the request first appears as an item on the DSB's agenda, unless at that meeting the DSB decides by consensus not to establish a panel.

Unlike in other international dispute settlement systems, there is no need for the parties to a dispute arising under the covered agreements to accept in a separate declaration or separate agreement the jurisdiction of the WTO dispute settlement system to adjudicate that dispute. Accession to the WTO constitutes consent to and acceptance of the compulsory jurisdiction of the WTO dispute settlement system.

With regard the jurisdiction of the WTO dispute settlement system, it should also be noted that the system has only contentious, and no advisory, jurisdiction.

4.4 Access to WTO Dispute Settlement

Access to, that is, the use of, the WTO dispute settlement system is limited to Members of the WTO. The Appellate Body ruled in *US – Shrimp*:

It may be well to stress at the outset that access to the dispute settlement process of the WTO is limited to Members of the WTO. This access is not available, under the WTO Agreement and the covered agreements as they currently exist, to individuals or international organizations, whether governmental or non-governmental. Only Members may become parties to a dispute of which a panel may be seized, and only Members “having a substantial interest in a matter before a panel” may become third parties in the proceedings before that panel.¹⁰⁰ Thus, under the DSU, only Members who are parties to a dispute, or who have notified their interest in becoming third parties in such a dispute to the DSB, have a legal right to make submissions to, and have a legal right to have those submissions considered by, a panel.¹⁰¹

The WTO dispute settlement system is a government-to-government dispute settlement system for disputes concerning rights and obligations of WTO Members.

4.4.1 Causes of Action

Causes of Action

Each covered agreement contains one or more consultation and dispute settlement provisions. These provisions set out when a Member can have

¹⁰⁰ [Footnote in the quote] See Articles 4, 6, 9 and 10 of the DSU.

¹⁰¹ Appellate Body Report, *US – Shrimp*, para 101.

recourse to the WTO dispute settlement system. For the GATT 1994, the relevant provisions are Articles XXII and XXIII. Of particular importance is Article XXIII:1 of the GATT 1994, which states:

If any Member should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

- (a) the failure of another Member to carry out its obligations under this Agreement, or*
- (b) the application by another Member of any measure, whether or not it conflicts with the provisions of this Agreement, or*
- (c) the existence of any other situation, the Member may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other Member or Members which it considers to be concerned.*

In *India – Quantitative Restrictions*, the Appellate Body held:

This dispute was brought pursuant to, inter alia, Article XXIII of the GATT 1994. According to Article XXIII, any Member which considers that a benefit accruing to it directly or indirectly under the GATT 1994 is being nullified or impaired as a result of the failure of another Member to carry out its obligations, may resort to the dispute settlement procedures of Article XXIII. The United States considers that a benefit accruing to it under the GATT 1994 was nullified or impaired as a result of India's alleged failure to carry out its obligations regarding balance-of-payments restrictions under Article XVIII:B of the GATT 1994. Therefore, the United States was entitled to have recourse to the dispute settlement procedures of Article XXIII with regard to this dispute.¹⁰²

The consultation and dispute settlement provisions of most other covered agreements incorporate by reference Articles XXII and XXIII of the GATT 1994. For example, Article 11.1 of the *SPS Agreement*, entitled “Consultations and Dispute Settlement”, states:

The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein.

Nullification or Impairment

As was the case in *India – Quantitative Restrictions*, the nullification or impairment of a benefit or the impeding of the realization of an objective may, and most often will, be the result of a violation of an obligation prescribed by a covered agreement. Nullification or impairment or the impeding of the

¹⁰² Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* (“*India – Quantitative Restrictions*”), WT/DS90/AB/R, adopted 22 September 1999, para. 84.

attainment of objectives may however, also be the result of “the application by another Member of any measure, whether or not it conflicts with the provisions” of a covered agreement.¹⁰³ Nullification or impairment or the impeding of the attainment of objectives may equally be the result of “the existence of any other situation.”¹⁰⁴

Types of Complaints

Unlike other international dispute settlement systems, the WTO system thus provides for three types of complaints: “violation” complaints, “non-violation” complaints and “situation” complaints.¹⁰⁵ In the case of a “non-violation” complaint or a “situation” complaint, the complainant must demonstrate that there is nullification or impairment of a benefit or the achievement of an objective is impeded.¹⁰⁶ With regard to a “violation” complaint, however, Article 3.8 of the DSU states:

In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge.

Violation complaints are by far the most common type of complaints. To date, there have, in fact, been few non-violation complaints¹⁰⁷ and no situation complaints. The difference between the WTO system and other international dispute settlement systems on this point may therefore, be “of little practical significance”.¹⁰⁸

Broad Discretion

There is no explicit provision in the DSU requiring a Member to have a “legal interest” in order to have recourse to the WTO dispute settlement system. It has been held that such a requirement is not implied either in the DSU or any other provision of the WTO Agreement.¹⁰⁹ In *EC – Bananas III*, the Appellate Body held:

... we believe that a Member has broad discretion in deciding whether to bring a case against another Member under the DSU. The language of Article XXIII:1 of the GATT 1994 and of Article 3.7 of the DSU suggests, furthermore,



¹⁰³ Article XXIII:1 (b) of the GATT 1994 and Article 26.1 of the DSU

¹⁰⁴ Article XXIII:1 (c) of the GATT 1994 and Article 26.2 of the DSU.

¹⁰⁵ Pursuant to Article XXIII.3 of the GATS, situation complaints are not possible in disputes arising under the GATS. Pursuant to Article 64.2 of the TRIPS Agreement non-violation complaints and situation complaints were not possible in disputes arising under the TRIPS Agreement during a period of five years from the date of entry into force of the WTO Agreement. Article 64.3 provides that the Ministerial Conference can only extend this period by consensus. No such decision has been taken and, therefore, both types of complaint are now possible.

¹⁰⁶ Article 26 of the DSU.

¹⁰⁷ See, e.g., *Japan – Film and Korea – Government Procurement*.

¹⁰⁸ Feliciano, F. and Van den Bossche, P., “The Dispute Settlement System of the World Trade Organization: Institutions, Process and Practice”, in Blokker, M. and Schermers, H. (eds.), *Proliferation of International Organizations* (Kluwer Law International, 2001), p. 308.

¹⁰⁹ Appellate Body Report, *EC – Bananas III*, paras. 132 and 133.

*that a Member is expected to be largely self-regulating in deciding whether any such action would be “fruitful”.*¹¹⁰

The Appellate Body explicitly agreed with the statement of the Panel in *EC – Bananas III* that:

*... with the increased interdependence of the global economy, ... Members have a greater stake in enforcing WTO rules than in the past since any deviation from the negotiated balance of rights and obligations is more likely than ever to affect them, directly or indirectly.*¹¹¹

In *EC – Bananas III*, the Appellate Body considered in deciding whether the United States could bring a claim under the GATT 1994, the fact that the United States is a producer and a potential exporter of bananas, the effects of the EC banana regime on the United States internal market for bananas and the fact that the United States claims under the GATS and the GATT 1994 were inextricable interwoven. The Appellate Body subsequently concluded that “[t]aken together, these reasons are sufficient justification for the United States to have brought its claims against the EC banana import regime under the GATT 1994.”¹¹² The Appellate Body added, however, that “this does not mean though, that one or more of the factors we have noted in this case would necessarily be dispositive in another case.”¹¹³

4.4.2 Involvement of Non-State Actors

Amicus curiae

As noted above, the WTO dispute settlement system is a government-to-government dispute settlement system for disputes concerning rights and obligations of WTO Members. Individuals, companies, international organizations or non-governmental organizations, including environmental and human rights NGOs, labour unions and industry associations, have no access to the WTO dispute settlement system. They cannot bring claims of violation of WTO rights or obligations. Under the current rules, they do not have the *right* to be heard or the right to participate, in any way, in the proceedings. However, under Appellate Body case law, panels and the Appellate Body have the right to accept and consider written briefs submitted by individuals, companies or organisations. The acceptance by panels and the Appellate Body of these briefs, which are commonly referred to as *amicus curiae* briefs (“friend of the court” briefs), has been controversial and criticised by most WTO Members. A detailed discussion of this issue is included in Module 3.2 The Panel Process and 3.3 The Appellate Review Process.¹¹⁴

¹¹⁰ Appellate Body Report, *EC – Bananas III*, para. 135.

¹¹¹ Appellate Body Report, *EC – Bananas III*, para. 136.

¹¹² Appellate Body Report, *EC – Bananas III*, para. 138.

¹¹³ Ibid.

¹¹⁴ See Module 3.2, p. xx, and Module 3.3, p. xx.

4.5 Dispute Settlement Methods

The WTO dispute settlement system provides for more than one dispute settlement method. The DSU allows for the settlement of disputes through consultations (Article 4 of the DSU); through good offices, conciliation and mediation (Article 5 of the DSU); through adjudication by *ad hoc* panels and the Appellate Body (Articles 6 to 20 of the DSU) or through arbitration (Article 25 of the DSU).

Consultations

As discussed above, the DSU expresses a clear preference for solutions mutually acceptable to the parties to the dispute, rather than solutions resulting from adjudication. Therefore, resort to adjudication by a panel must be preceded by consultations between the complaining and responding parties to the dispute with a view to reaching a mutually agreed solution. Section 1 of Module 3.2 examines in detail this pre-litigation, diplomatic method of dispute settlement.

Adjudication

If consultations fail to resolve the dispute, the complaining party may resort to adjudication by a panel and, if either party to the dispute appeals the findings of the panel, the Appellate Body. Modules 3.2 and 3.3 examine in detail this quasi-judicial method of dispute settlement.

Arbitration

The dispute settlement methods set out in Articles 4 to 20 of the DSU (consultations and adjudication by panels and the Appellate Body) are by far the most frequently used methods. However, the WTO dispute settlement system provides for expeditious arbitration as an alternative means of dispute settlement. Pursuant to Article 25 of the DSU, parties to a dispute arising under a covered agreement may decide to resort to arbitration, rather than follow the procedure set out in Articles 4 to 20 of the DSU. In that case, the parties must clearly define the issues referred to arbitration and agree on the particular procedure to be followed.¹¹⁵ The parties must also agree to abide by the arbitration award.¹¹⁶ Pursuant to Article 3.5 of the DSU, the arbitration award must be consistent with the covered agreements. In the latter part of 2001, WTO Members used the Article 25 arbitration procedure for the first time.¹¹⁷

Good Offices, Conciliation and Mediation

The WTO dispute settlement system also provides, pursuant Article 5 of the DSU, for the possibility for the parties to a dispute — if they all agree to do so — to use good offices, conciliation or mediation to settle a dispute. To date, no use has been made of the dispute settlement methods provided for in Article 5 but in 2001 the Director-General reminded Members of his availability to help to settle disputes through good offices.

¹¹⁵ Articles 25.1 and 25.2 of the DSU.

¹¹⁶ Article 25.3 of the DSU.

¹¹⁷ Award of the Arbitrators, United States – Section 110(5) of the US Copyright Act, recourse to arbitration under Article 25 of the DSU, WT/DS160/ARB25/1, 9 November 2001.

4.6 Institutions of WTO Dispute Settlement

DSB

Among the institutions involved in WTO dispute settlement, there is a distinction between the political institutions of the WTO and, in particular, the Dispute Settlement Body, and independent, judicial-type institutions such as *ad-hoc* dispute settlement panels and the standing Appellate Body. While the WTO has entrusted the adjudication of disputes to panels at the first instance level and the Appellate Body at the appellate level, the Dispute Settlement Body continues to play an active role in the WTO dispute settlement system. The Dispute Settlement Body, or DSB, is an *alter ego* of the General Council of the WTO.¹¹⁸ The General Council convenes as the DSB to administer the rules and procedures of the DSU.¹¹⁹ Article 2.1 of the DSU states:

... the DSB shall have the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of rulings and recommendations, and authorize suspension of concessions and other obligations under the covered agreements.

Article 2.4 of the DSU stipulates that where the DSU provides for the DSB to take a decision, such a decision is always taken by consensus.¹²⁰ It is important to note, however, that for most key decisions, such as the decision on the establishment of a panel, the adoption of panel and Appellate Body reports and the authorization of suspension of concessions and other obligations, the consensus requirement is in fact a “reverse” or “negative” consensus requirement.¹²¹ The “reverse” consensus requirement means that the DSB is deemed to take a decision unless there is a consensus among WTO Members not to take the decision. Since there will usually be at least one Member with a strong interest in that the DSB takes the decision to establish a panel, to adopt the panel and/or Appellate Body reports or to authorize the suspension of concessions, it is very unlikely that there will be a consensus not to adopt these decisions. As a result, decision-making by the DSB on these matters is, for all practical purposes, automatic. Furthermore, it should be noted that the DSU provides for strict “timeframes” within which decisions on these matters need to be taken.¹²²

The DSB meets as often as necessary to carry out these functions within the time frames provided in the DSU. In practice, the DSB has one regularly scheduled meeting per month and, in addition, a number of special meetings are convened when the need for a meeting arises.

¹¹⁸ See above, Section 1.5.2.

¹¹⁹ Article IV:2 of the WTO Agreement and Article 2.1 of the DSU.

¹²⁰ Footnote 1 to the DSU states: “The DSB shall be deemed to have decided by consensus on a matter submitted for its consideration, if no Member, present at the meeting of the DSB when the decision is taken, formally objects to the proposed decision.”

¹²¹ See Articles 6.1, 16.4, 17.14 and 22.6 of the DSU. Other decisions of the DSB, such as the appointment of the Members of the Appellate Body, are taken by “normal” consensus.

¹²² For example, the decision to adopt an Appellate Body report shall be taken within 30 days following its circulation to the Members (see Article 17.14 of the DSU). If there is no meeting of the DSB scheduled during this period, such a meeting shall be held for this purpose (see footnote 8 to the DSU).

Panels

At the request of a complaining party, the DSB will establish a panel to hear and decide a dispute. The DSB will do so by reverse consensus. The establishment of a panel is therefore “automatic”. As a rule, panels consist of three persons, who are not nationals of the Members involved in the dispute. These persons are often trade diplomats or government officials but also academics and practising lawyers regularly serve as panellists. The terms of reference of the panel are determined by the request for the establishment of a panel, which identifies the measure at issue and the provisions of the covered agreements allegedly breached. It is the task of panels to make an objective assessment of the matter, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements. A detailed analysis of the process of the establishment and the composition of panels, their terms of reference, the applicable standard of review, rules of conduct for panellists, and the exercise of judicial activism and judicial economy by panels is included in Module 3.2.

Appellate Body

The Appellate Body hears appeals from the reports of dispute settlement panels. Unlike panels, the Appellate Body is a permanent, standing international tribunal. It is composed of seven persons, referred to as Members of the Appellate Body. Members of the Appellate Body are appointed by the DSB for a term of four years, once renewable. Only the complaining or responding party can initiate appellate review proceedings. Appeals are limited to issues of law covered in the panel report or legal interpretations developed by the panel. The Appellate Body may uphold, modify or reverse the legal findings and conclusions of the panel that were appealed. Details of all aspects of the appellate review process are given in Module 3.3.

Other Institutions

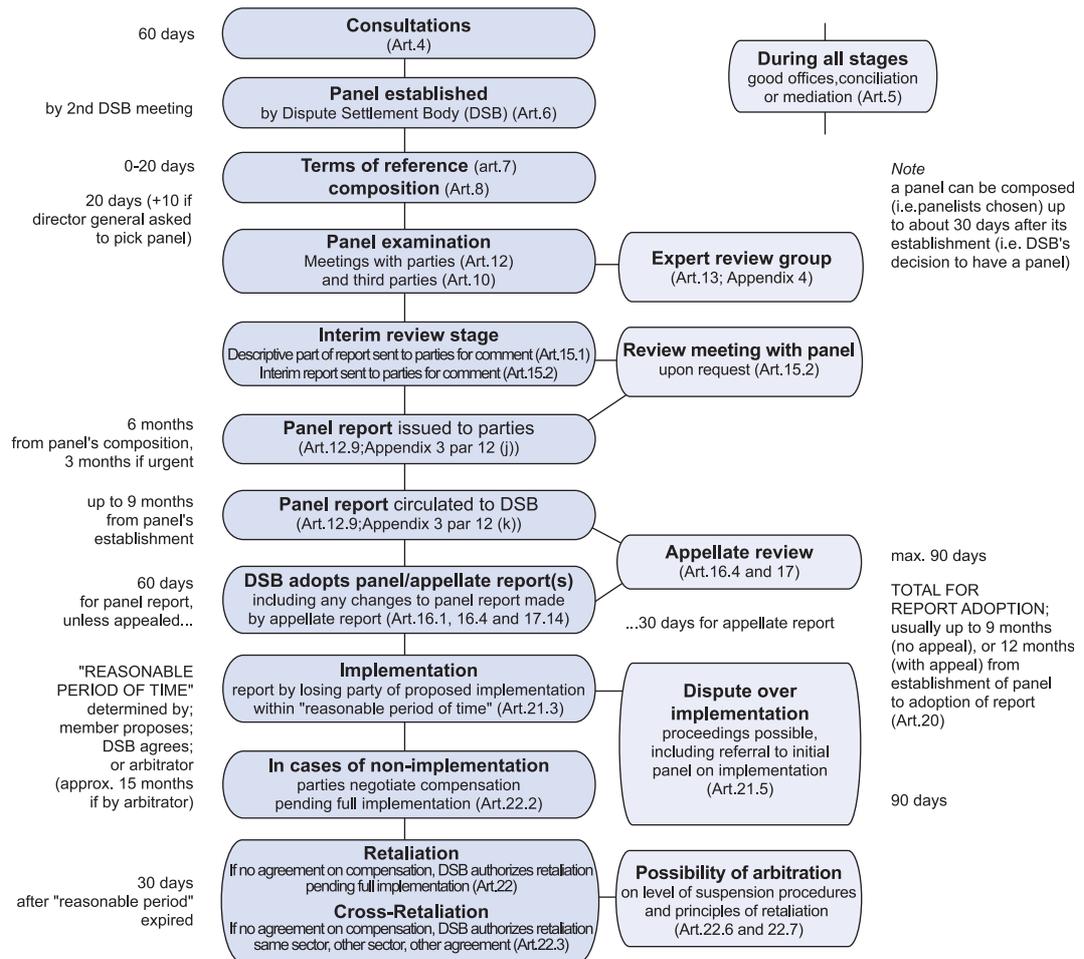
Apart from the DSB, panels and the Appellate Body, there are a number of other institutions and persons involved in the WTO’s efforts to resolve disputes between its Members. These institutions and persons include arbitrators under Articles 21.3, 22.6 or 25 of the DSU, the Textile Monitoring Body under the *ATC*, the Permanent Group of Experts under the *SCM Agreement*, Experts and Expert Review Groups under Article 13 of the DSU and Article 11.2 of the *SPS Agreement*, the Chairman of the DSB and the Director-General of the WTO.

Furthermore, the WTO Secretariat and the Secretariat of the Appellate Body play important roles in providing administrative and legal support to panels and the Appellate Body respectively.

4.7 WTO Dispute Settlement Proceedings

The flow-chart below indicates the major steps in the WTO dispute settlement proceedings.¹²³

¹²³ WTO, *Trading into the Future*, 41.



There are four stages in WTO dispute settlement proceedings: (1) consultations; (2) panel proceedings; (3) Appellate Body proceedings; and (4) implementation of the recommendations and rulings. Each of these stages is examined in detail in Modules 3.2, 3.3 and 3.4.

4.7.1 Time-frame for the Proceedings

Articles 12.8 & 12.9 DSU

One of the most striking features of the WTO dispute settlement system is the short time frames within which the proceedings of both panels and the Appellate Body must be completed.¹²⁴ The period in which a panel shall conduct its examination, from the date that the composition and terms of reference of the panel have been agreed upon until the date the final report is issued to the parties to the dispute, shall, as a general rule, not exceed six months.¹²⁵ When a panel considers that it cannot issue its report within six months, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it shall issue its report. In no case *should* the period from the establishment of the panel to the circulation of the report to the

¹²⁴ Note that the SCM Agreement provides for even shorter time frames in particular cases. See Module 3.12.

¹²⁵ Article 12.8 of the DSU. In cases of urgency, including those relating to perishable goods, the panel shall aim to issue its report to the parties to the dispute within three months and shall make every effort to accelerate the proceedings to the greatest extent possible (Articles 12.9 and 4.9 of the DSU).

Members exceed nine months.¹²⁶ Much shorter still is the time frame within which a panel has to rule on the WTO-consistency of measures taken to comply with the recommendations and rulings under Article 21.5 of the DSU. In such proceedings, the panel must circulate its report within 90 days after the date of referral of the matter to it.

Article 17.5 DSU

With regard to the Appellate Body proceedings, the DSU provides that, as a general rule, the proceedings shall not exceed 60 days from the date a party to the dispute formally notifies its decision to appeal to the date the Appellate Body circulates its report.¹²⁷ When the Appellate Body believes that it cannot render its report within 60 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case *shall* the proceedings exceed 90 days.

No other international court or tribunal operates under such severe time limits. These time limits, and in particular the time limits for the Appellate Body, have been criticized as excessively short and too demanding for both the parties to the dispute and the Appellate Body. As a result of these time limits, however, there is no backlog of cases either at the panel or appellate level. While panels frequently go beyond the time limits imposed on them by the DSU, the Appellate Body has thus far been able to complete all but four appeals within the maximum period of 90 days.¹²⁸

4.7.2 Confidentiality of the Proceedings

Submissions, meetings & hearings

The WTO dispute settlement proceedings are also characterized by their confidentiality. Consultations, panel proceedings and appellate review proceedings are all confidential. Meetings of the DSB and panels and the oral hearing of the Appellate Body take place behind closed doors. All written submissions to a panel or to the Appellate Body by the parties and third parties to the dispute are confidential.¹²⁹ Parties may make their *own* submissions available to the public. While a few Members do so in a systematic manner (e.g., the United States), most parties choose to keep their submissions confidential. The DSU provides that a party to a dispute must, upon request of any WTO Member, provide a non-confidential summary of the information contained in its submissions to the panel that could be disclosed to the public. However, this provision does not provide for a deadline by which such non-confidential summary must be made available and is, therefore, not very effective.

¹²⁶ Article 12.9 of the DSU.

¹²⁷ Article 17.5 of the DSU. In cases of urgency, including those which concern perishable foods, the Appellate Body shall make every effort to accelerate the proceedings to the greatest extent possible (Articles 17.5 and 4.9 of the DSU).

¹²⁸ Appellate Body Report, *EC – Hormones*; Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (“US – Lead and Bismuth II”)*, WT/DS138/AB/R, adopted 7 June 2000; Appellate Body Report, *EC – Asbestos*; and Appellate Body Report, *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland (“Thailand – H-Beams”)*, WT/DS122/AB/R, adopted 5 April 2001.

¹²⁹ Article 18.2, Article 17.10 and Appendix 3, para. 3 of the DSU.

Reports

The interim report of the panel and the final panel report as long as it is only issued to the parties to the dispute are also confidential. The final panel report only becomes a public document when it is circulated to all WTO Members. In reality, however, the interim report and the final report issued to the parties do not remain confidential very long and are usually “leaked” to the media. Unlike panel reports, Appellate Body reports are not first issued to the parties and then, weeks later, circulated to all WTO Members. In principle they are issued to the parties and circulated to all WTO Members at the same time and are as of that moment a public document.

4.8 Remedies for Breach of WTO Law

Article 3.7 DSU

What can or should be done if a panel and/or the Appellate Body conclude that a measure is inconsistent with WTO law? Article 3.7 of the DSU states:

In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure, which is inconsistent with a covered agreement. The last resort which this Understanding provides to the Member invoking the dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures.

Article 19.1 DSU

Article 19.1 of the DSU provides:

Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned¹³⁰ bring the measure into conformity with that agreement.¹³¹ In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations.

Article 21.1 DSU

Article 21.1 of the DSU adds to this:

Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.

Article 21.3 DSU

However, if it is impracticable to comply immediately with the recommendations and rulings of the DSB, the Member concerned shall have a

¹³⁰ The “Member concerned” is the party to the dispute to which the panel or Appellate Body recommendations are directed.

¹³¹ With respect to recommendations in cases not involving a violation of GATT 1994 or any other covered agreement, see Article 26.

reasonable period of time in which to do so.¹³² This reasonable period of time can either be agreed upon by the parties or be determined through binding arbitration. In those cases in which the reasonable period of time for implementation has been determined through arbitration, it has been set between six months and 15 months and one week.¹³³ With respect to compensation (for future damages) and retaliation in case of non-compliance, Article 22.1 states:

Article 22.1 DSU

Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements.

The DSU does not explicitly provide for the compensation of damage suffered.¹³⁴

4.9 Test Your Understanding

- 1. To what extent is dispute settlement under the GATT 1947 relevant to WTO dispute settlement? What are the most significant changes made to the GATT dispute settlement system by the DSU?**
- 2. What is according to the DSU, the object and purpose of the WTO dispute settlement system? To which disputes does the DSU apply?**
- 3. What are the consequences of the compulsory jurisdiction of the WTO dispute settlement system for the parties to a dispute?**
- 4. Who may make use of the WTO dispute settlement system? When can they make use of the system?**
- 5. Apart from consultations and adjudication, which other methods of dispute settlement does the WTO dispute settlement system provide for?**
- 6. What is the role of the Dispute Settlement Body in resolving a dispute between Members? Give a brief overview of the various stages of WTO dispute settlement proceedings. What can or should be done if a panel and/or the Appellate Body conclude that a measure is inconsistent with WTO law?**

¹³² Article 21.3 of the DSU.

¹³³ See Module 3.4.

¹³⁴ *Ibid.*

5. DEVELOPING COUNTRY MEMBERS

Objectives

This Section examines the use made of the WTO dispute settlement system by developing country Members and describes in general terms only, the special and differential treatment granted to developing country Members in WTO dispute settlement proceedings. More details of this special and differential treatment are given in Modules 3.2, 3.3 and 3.4. The Section also describes the support developing country Members involved in WTO dispute settlement may receive from the WTO Secretariat, the Advisory Centre for WTO Law and other sources.

5.1 Use Made of the Dispute Settlement System

The WTO dispute settlement system has been used intensively by the major trading powers, and, in particular, the United States and the European Communities. Developing country Members, however, have also had frequent recourse to the WTO dispute settlement system, both to challenge trade measures of major trading powers¹³⁵ and to settle trade disputes with other developing countries.¹³⁶ During the first six years of the WTO dispute settlement system (1995-2000) in 26 per cent of all cases brought to the WTO system for resolution developing countries were complainants and in 40 per cent they were respondents.¹³⁷ In 2000 and 2001, developing countries brought more disputes to the WTO system than did developed countries. The most active users of the dispute settlement system among developing country Members are Brazil, India, Mexico, Thailand and Chile. To date, no least-developed country has ever brought a complaint to the WTO or has been a respondent in WTO dispute settlement proceedings.

5.2 Special and Differential Treatment

The DSU recognises the special situation of developing and least-developed country Members. There are a number of DSU provisions that grant special rights to developing countries in the consultation and panel processes. Special rules for developing country Members are found in Article 3.12, Article 4.10,

¹³⁵ See for example: *United States – Standards of Reformulated and Conventional Gasoline* (“US – Gasoline”), complaints by *Venezuela (DS2)* and *Brazil (DS4)*, *United States – Restrictions on Imports of Cotton and Man-Made Fibre Underwear* (“US – Underwear”), complaint by *Costa Rica (DS24)*, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* (“US – Wool Shirts and Blouses”), complaint by *India (DS33)*, and *EC – Bananas III*, complaint by *Ecuador, Guatemala, Honduras, Mexico and the United States (DS27)*. In all these disputes the complainants successfully challenged the trade measure of a major trading power.

¹³⁶ See for example: *Brazil – Measures Affecting Desiccated Coconut* (“Brazil – Coconut”), complaint by the *Philippines (DS22)*; *Egypt – Definitive Anti-Dumping Measures on Steel Rebar from Turkey*, complaint by *Turkey (DS211)*; and *Turkey – Restrictions on Imports of Textile and Clothing Products*, complaint by *India (DS34)*.

¹³⁷ Park, Y.D. and Umbricht, G., “WTO Dispute Settlement 1995-2000: a Statistical Analysis”, *JIEL* 2001, 213-230, at 216.

Article 8.10, Article 12.10, Article 12.11, Article 24 and Article 27 of the DSU. For the most part, these special rules and procedures have not been much used to date. A detailed examination of these provisions is included in Modules 3.2, 3.3 and 3.4.

5.3 Legal Assistance

WTO Secretariat

The WTO Secretariat assists all Members in respect of dispute settlement when they so request. However, the DSU recognizes that there may be a need to provide additional legal advice and assistance to developing country Members.¹³⁸ To meet that additional need, Article 27.2 of the DSU requires the WTO Secretariat to make available qualified legal experts to help any developing country Member which so requests. The extent to which the Secretariat can assist developing country Members is, however, limited both by lack of manpower and by the requirement that the Secretariat's experts should give assistance in a manner "ensuring the continued impartiality of the Secretariat".¹³⁹ The experts can thus not act on behalf of a developing country Member in a dispute with another Member and their assistance is necessarily limited to the preliminary phases of a dispute.

Advisory Centre on WTO Law

Effective legal assistance to developing country Members in dispute settlement proceedings is given by the newly established, Geneva-based Advisory Centre on WTO Law.¹⁴⁰ At the occasion of the official opening of the Advisory Centre on WTO Law on 5 October 2001, Mr. Mike Moore, the then WTO Director-General, said that with the establishment of the Advisory Centre for "the first time a true legal aid centre has been established within the international legal system, with a view to combating the unequal possibilities of access to international justice as between States". The Advisory Centre is an independent intergovernmental organization (fully independent from the WTO), which will function essentially as a law office specialized in WTO law, providing legal services and training exclusively to developing country and economy-in-transition Members of the Advisory Centre and all least-developed countries. The Centre will provide support at all stages of WTO dispute settlement proceedings at discounted rates for its developing country Members and all least-developed countries. The current 32 Members (nine developed countries, 22 developing countries and one economy-in-transition) have pledged in total US\$ 9.8 million for the endowment fund and US\$6 million for the multi-year contributions.¹⁴¹ In the summer of 2001, the Advisory Centre assisted for the

¹³⁸ Article 27.2 of the DSU.

¹³⁹ Article 27.2, final sentence, of the DSU.

¹⁴⁰ In parallel with the third Ministerial Conference of the WTO in Seattle, on 1 December 1999, the Ministers of Bolivia, Canada, Colombia, Denmark, Dominican Republic, Ecuador, Egypt, Finland, Guatemala, Honduras, Hong Kong China, Ireland, Italy, Kenya, Netherlands, Nicaragua, Norway, Pakistan, Panama, Paraguay, Peru, Philippines, Sweden, Thailand, Tunisia, United Kingdom, Uruguay, Venezuela and Zimbabwe signed the "Agreement establishing the Advisory Centre on WTO Law". Thereafter India, Latvia and Senegal made use of the temporary option to join the Advisory Centre by signing the Agreement before 31 March 2000. The conditions for the entry into force of the Agreement were met on 15 June 2001 by the deposit of the twentieth instrument by Kenya while the threshold financial contributions for an amount of US\$ 12 million had already been met earlier.

¹⁴¹ Membership of the Centre remains open to all WTO Members and those in the process of accession to WTO through an accession procedure.

first time a WTO developing country Member in a dispute settlement procedure when it assisted Pakistan in the Appellate Body proceedings in *United States – Cotton Yarn*.

5.4 Test Your Understanding

- 1. Have developing country Members made much use of the WTO dispute settlement system to date?**
- 2. Does the DSU take account of the particular situation of developing country Members?**
- 3. Do developing country Members involved in WTO dispute settlement benefit from legal assistance? By whom and under which conditions is this assistance granted?**

6. NEGOTIATIONS ON THE DISPUTE SETTLEMENT SYSTEM

Objectives

During the first seven years of its operation, the WTO dispute settlement system has in many respects been a remarkable success and has become the “centrepiece” of the WTO. The relatively frequent recourse to the WTO dispute settlement system by developing and developed country Members is commonly taken as a reflection of the confidence of all WTO Members in this system and as one measure of its utility for such Members.¹⁴² However, the system as it currently operates is of course not perfect and can be further improved.

At the time of adoption of the WTO Agreement, it was agreed that the WTO Ministerial Conference would complete a full review of the DSU within four years after the entry into force of the *WTO Agreement*, and subsequently take a decision on whether to continue, modify or terminate the DSU. In the context of this review of the DSU, which took place in 1998 and 1999, Members made a large number of proposals and suggestions for further improvement of the dispute settlement system. In the run-up to and during the Seattle Session of the Ministerial Conference in December 1999, Members made a considerable but eventually unsuccessful effort to agree on modifications to be made to the DSU. In 2000 and 2001, informal efforts outside the DSB to reach agreement on DSU amendments were continued. Also these efforts, intensified in the run-up to the Doha Session of the Ministerial Conference in November 2001, did not lead to an agreement. At the Doha Session of the Ministerial Conference, it was agreed, however, to open in January 2002 formal negotiations with the aim of concluding by May 2003 an agreement on changes to the DSU. The negotiations are based on the work done so far and on new proposals by Members. The Ministerial Declaration states that the negotiations on the Dispute Settlement Understanding will not be part of the single undertaking — i.e. that they will not be tied to the overall success or failure of the other negotiations mandated by the Ministerial Declaration. Among the proposals for reform currently under negotiation, there is a proposal to introduce a system of permanent panelists, proposals regarding the composition and mandate of the Appellate Body, proposals concerning the transparency of the proceedings, proposals concerning the special and differential treatment for developing country Members and proposals to improve the WTO mechanism to ensure implementation of recommendations and rulings adopted by the DSB.

¹⁴² Feciliano, F. and Van den Bossche, P., *op.cit.*, 300.

7. CASE STUDIES

1. The Government of the Republic of Newland, a developing country, is confronted with mounting domestic protest against its membership of the WTO. In the words of one opposition leader, membership of the WTO has brought Newland “nothing but misery and neo-colonial oppression”. The opposition parties have asked for a debate in Parliament on this issue and Newland’s Prime Minister has agreed to this request. You have been instructed by the Prime Minister’s Office to prepare speaking notes for the PM outlining the objectives, functions, institutions and decision-making procedures of the WTO. The speaking notes also have to cover the basic rules and disciplines of WTO law. The Prime Minister wants to be briefed, in particular, on the question whether both from an institutional and a substantive perspective the WTO takes into account the special interests and needs of developing country Members, such as Newland.
2. Shortly before the WTO debate in the Parliament of Newland, the Kingdom of Richland announced that it had taken a number of trade measures to protect its domestic toy industry. Until the late 1980’s the Kingdom of Richland was a major producer and exporter of toys made of wood or high-quality plastic. At that time, over 100.000 people were employed in the toy industry in Richland. Since the early 1990’s, however, the sales of toys produced in Richland have dropped considerably both in Richland and in the export markets. Children worldwide seem to prefer computer games to miniature trucks or dolls. Moreover, low priced wooden and plastic toys produced in developing countries such as Newland constitute increasingly tough competition for toys produced in Richland. If domestic sales and exports of toys produced in Richland do not pick up quickly, many toy manufacturers in Richland, which still employ over 25.000 people, will either disappear or lay off many workers. To prevent this from happening, the Government of Richland increased customs duties on all toys to 30 per cent *ad valorem*. The customs duties applied before ranged from 0 per cent (for computer games) to 15 per cent (for wooden toys). During the Uruguay Round negotiations Richland agreed to limit customs duties on all toys (except wooden toys) to 10 per cent *ad valorem*. Richland does not apply the increase in customs duties to imports from the Republic of Friendland, a developing country with which Richland has close political and economic ties. Richland also limits the importation of computer games to 10.000 units per year. Finally, Richland enacts legislation imposing additional safety requirements on all imported toys. Under the new legislation, allegedly intended to protect the health of children, all imported toys will have to be made of non-toxic materials. In recent years Newland has become an important exporter of toys to Richland¹⁴³ and Newland’s export of toys are seriously affected by the measures now taken by Richland. No less than 50.000 jobs are, directly or indirectly, at risk. The Prime Minister would, therefore like you to make a rough first assessment of the WTO consistency of these measures.

¹⁴³ It should be noted that over the last three years Newland’s toy exports amounted on average to 12 per cent of the toy imports of Richland.

He also wants to know whether Newland or its main toy producer could have recourse to the WTO dispute settlement system or the International Court of Justice to challenge these measures. He furthermore wants to know whether Newland can count on any legal assistance to help it prepare its case at the WTO. Finally, he wants you to find out what remedies are available for Newland if Richland were found to have acted inconsistently with its WTO obligations. He expects you to brief him orally on your findings within the next 24 hours.

8. FURTHER READING

8.1 Books and Articles

- WTO Secretariat, *Guide to the Uruguay Round Agreements* (Kluwer Law International, 1999)
- WTO Secretariat, *Guide to Dispute Settlement* (Kluwer Law International, 2002)
- Das, B.L., *The World Trade Organisation: A Guide to the Framework for International Trade* (Third World Network, 1999)
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- Marceau, G., “Rules on Ethics for the New World Trade Organization Dispute Settlement Mechanism — The Rules of Conduct for the Understanding on Rules and Procedures Governing the Settlement of Disputes”, *Journal of World Trade*, 1998, 57 – 98
- Mavroidis, P., “Remedies in the WTO Legal System: Between a Rock and a Hard Place”, *European Journal of International Law*, 2000, 763 – 813.
- Feliciano, F. and Van den Bossche, P., “The Dispute Settlement System of the World Trade Organization: Institutions, Process and Practice”, in Blokker, M. and Schermers, H. (eds.), *Proliferation of International Organizations* (Kluwer Law International, 2001), 297-350.

8.2 Documents and Information

For information on WTO activities, see www.wto.org. Official WTO documents can be obtained by searching on the WTO’s online document database, available at: <http://docsonline.wto.org>. A very useful website on WTO dispute settlement is www.worldtradelaw.net.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.2 PANELS



UNITED NATIONS
New York and Geneva, 2003

NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

The *Understanding on Rules and Procedures for the Settlement of Disputes* (the “DSU”) of the World Trade Organization (the “WTO”) provides for several methods to resolve disputes that arise between WTO Members concerning their rights and obligations under the *WTO Agreement*. Of these dispute settlement methods, the most frequently used is adjudication by *ad hoc* panels and the Appellate Body. This Module gives an overview of the process of adjudication by the *ad hoc* panels, i.e., the panel process, and focuses on the process of adjudication by the Appellate Body, i.e., the appellate review process.

Since adjudication by panels must always be preceded by consultations between the parties to the dispute, the first Section of this Module addresses this preliminary consultation process and examines the object and purpose of consultations, the consultation procedure and the outcome of consultations. The second Section of this Module examines the establishment and composition of the *ad hoc* panels that may hear and decide disputes after unsuccessful consultations. The third Section on “The Mandate of a Panel” discusses the terms of reference of these panels and the standard of review applied by them. It also addresses the issues of judicial activism and judicial economy by panels, the rules of conduct applicable to panelists and the role of the WTO Secretariat. The fourth Section on “Special Features of Panel Proceedings” examines the access to panel proceedings, the confidentiality of the proceedings, and the rules of interpretation as well as the rules on evidence applied by panels. The fifth Section, which is entitled “The Panel Proceedings”, deals with the working procedures for panels and the time frame for the panel proceedings, and explains the various steps in the panel proceedings. Finally, this Module addresses, in a sixth Section, the use made by developing country Members of consultations and the panel process and highlights the DSU rules providing for special and differential treatment for developing country Members in this context.

1. CONSULTATIONS

Objectives

On completion of this section, the reader will be able to appraise why it is important that recourse to adjudication by a panel is preceded by consultations between the parties to the dispute, how these consultations are conducted and what the result of these consultations may be.

1.1 Object and Purpose

Article 3.7 DSU

The aim of the WTO dispute settlement system is to secure a *positive* solution to a dispute. The DSU expresses a clear preference for solutions mutually acceptable to the parties to the dispute, rather than solutions resulting from adjudication by a panel. Therefore, each panel process must be preceded by consultations between the complaining and responding parties to the dispute with a view to reaching a mutually agreed solution. The DSU provides that in the course of consultations and before resorting to further action, Members should attempt to obtain satisfactory adjustment of the matter. The DSU requires that Members engage in consultations in good faith in an effort to resolve the dispute amicably before the dispute can be referred to a panel.

Article 4.5 DSU

Article 3.10 DSU

To resolve disputes through consultations is obviously cheaper and more satisfactory for the long-term trade relations with the other party of the dispute than adjudication by a panel. The consultations enable the disputing parties to understand better the factual situation and the legal claims in respect of the dispute. Such understanding may allow then to resolve the matter without further proceedings and, if not, will allow a party to learn more about the facts and the legal arguments that the other party is likely to use when the dispute goes to adjudication. In this respect, the consultations may serve as an informal pre-trial discovery mechanism. Their primary object and purpose, however, is to settle the dispute amicably.

1.2 The Consultation Procedure

1.2.1 Request for Consultations

Article 4.2 DSU

Any WTO Member that considers that a benefit accruing to it under the *WTO Agreement* is being impaired or nullified by measures taken by another WTO Member may request consultations with that other Member. WTO Members are required to accord “sympathetic consideration” to and afford adequate opportunity for consultation regarding any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former. All such requests for consultations shall be notified to the Dispute Settlement Body (the “DSB”) and the relevant Councils and Committees by the Member, which requests consultations. Any request for consultations shall be submitted in writing and shall give the reasons

Article 4.4 DSU

for the request, including identification of the measures at issue and an indication of the legal basis for the complaint.

1.2.2 Consultation Process

Article 4.6 DSU

Parties have broad discretion as regards the manner in which consultations are to be conducted. The DSU provides few rules on the conduct of consultations. The consultation process is essentially a political-diplomatic process. Consultations are without prejudice to the rights of any Member in further legal proceedings. During consultations Members “should” give special attention to the particular problems and interests of developing country Members.

Article 4.10 DSU

Article 4.3 DSU

Unless otherwise agreed, the Member to which a request for consultation is made must *reply* to the request within 10 days after the date of its receipt and enter into consultations within a period of no more than 30 days after the date of receipt of the request. It must enter into consultations in good faith and with a view to reaching a mutually satisfactory solution. If the Member does not respond within 10 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, then the Member that requested the consultations may proceed directly to request the establishment of a panel.

Article 4.6 DSU

While the request for consultations is notified to the DSB, the consultations themselves are confidential. Generally, consultations are held in Geneva and involve Geneva-based diplomats as well as capital-based trade officials of the parties to the dispute. The WTO Secretariat is not present at, and is in no other way involved with, the consultations.

Articles XXII and XXIII GATT 1994

Consultations can be requested either pursuant to Article XXII of the GATT 1994, or the corresponding provisions in other covered agreements, or pursuant to Article XXIII of the GATT 1994, or the corresponding provisions in other covered agreements. The Member requesting consultations is free to choose either type of consultations. There is only one, albeit significant, difference between these two types of consultations. Only in the context of consultations pursuant to Article XXII, or corresponding provisions, can a Member other than the consulting Members be allowed to participate in the consultations. A Member that considers that it has a substantial trade interest may notify the consulting Members and the DSB of such interest within 10 days after the date of the circulation of the request for consultations. Provided that the responding party to the dispute agrees that the claim of substantial interest is well founded, this Member shall be joined in the consultations. If consultations are conducted pursuant to Article XXIII, or corresponding provisions, it is not possible for other Members to join in the consultations.

Article 4.11 DSU

Article 5 DSU

During the consultations, the parties may agree to request good offices, conciliation or mediation provided for in Article 5 of the DSU. The Director-General of the WTO may, acting in an *ex officio* capacity, offer good offices,

conciliation or mediation with the view to assisting Members to settle a dispute. To date, no use has ever been made of this possibility although in 2001 the Director-General explicitly invited Members to do so.

1.3 Outcome of Consultations

1.3.1 Mutually Agreed Solution

Since 1995, a significant number of disputes on which consultations were held have been resolved, or appear to have been resolved, by the parties without the need for recourse to adjudication by a panel. In some cases, the dispute was simply not pursued any further; in other cases, a mutually agreed solution to the dispute was reached.

Article 3.5 DSU

All mutually agreed solutions must be consistent with the WTO agreements and shall not nullify or impair benefits accruing to any Member under those agreements, nor impede the attainment of any objective of those agreements.

Article 3.6 DSU

All mutually agreed solutions must be notified to the DSB and the relevant Councils and Committees. Other Members may raise any point relating to the solutions reached in the DSB or other relevant WTO bodies. The requirement to notify a mutually agreed solution is, however, often not respected.

1.3.2 Resort to a panel

Article 4.7 DSU

If consultations between the parties fail to settle the dispute within 60 days of the receipt of the request for consultations, the complaining party may request the DSB to establish a panel to adjudicate the dispute. The complaining party may request a panel during the 60-day period if the consulting parties jointly consider that consultations have failed to settle the dispute. In many cases, however, the complaining party will not, immediately upon the expiration of the 60 day period, request the establishment of a panel, but will allow for considerably more time to settle the dispute through consultations. For consultations involving a measure taken by a developing country Member, the DSU explicitly provides that the parties may agree to extend the 60-day period. If after the 60 day period has elapsed, the consulting parties cannot agree that the consultations have concluded, the Chairman of the DSB shall decide, after consultation with the parties, whether to extend this period and, if so, for how long. To date the Chairman of the DSB has never been called upon to exercise this authority.

Article 12.10 DSU

Consultations between the parties with the aim of settling the dispute can, and do, continue during the panel process. The DSU provides that panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution. There have been a number of disputes in which a mutually agreed solution was reached while the dispute was already before a panel.¹

Article 11 DSU

¹ See e.g., *European Communities - Trade Description of Scallops, complaints by Canada, Peru and Chile, WT/DS7, WT/DS12 and WT/DS14* and *European Communities - Measures Affecting Butter Products, complaint by New Zealand, WT/DS72*.

Article 24.2 DSU

In dispute settlement cases involving a least-developed country Member, where a satisfactory solution has not been found in the course of consultations, the Director-General of the WTO or the Chairman of the DSB shall, upon request by a least-developed country Member, offer their good offices, conciliation and mediation with a view to assisting the parties to settle the dispute, before a request for a panel is made. The Director-General or the Chairman of the DSB, in providing this assistance, may consult any source, which either deems appropriate. Since, to date no least-developed country Member has been involved in a dispute as either a complainant or respondent, no use has yet been made of this possibility.

1.4 Test your understanding

- 1. What is the primary aim and object of consultations pursuant to Article 4 of the DSU? Can consultations also serve other purposes?**
- 2. Must parties to a dispute always hold consultations before requesting the establishment of a panel? Will consultations always last at least 60 days? Can consultations last longer than 60 days?**
- 3. May WTO Members resolve a dispute by *agreeing* to a solution, which deviates from the *WTO Agreement*?**
- 4. Does the DSU provide any special rules for developing country Members engaged in consultations?**

2. THE ESTABLISHMENT AND COMPOSITION OF A PANEL

Objectives

On completion of this section, the reader will be able:

- to explain how and by whom decisions on the establishment and the composition of panels are taken;
- to appreciate the importance of sufficiently precise panel requests;
- to appraise the qualifications that members of a panel have to possess.

2.1 Establishment of a Panel

2.1.1 Panel Request

Article 6.2 DSU

The request for establishment of a panel must be made to the DSB in writing and must indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In *EC - Bananas III*, the Appellate Body found that:

... It is important that a panel request be sufficiently precise for two reasons: first, it often forms the basis for the terms of reference of the panel pursuant to Article 7 of the DSU; and, second, it informs the defending party and the third parties of the legal basis of the complaint.²

Whether the “specific measures at issue” are sufficiently identified in the panel request relates to the ability of the responding party to defend itself given the actual reference to the measure complained about.³ With regard to the requirement that the request for a panel must “provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly”, the Appellate Body noted that the DSU demands only a brief summary of the legal basis of the complaint. The summary must, however, be one “sufficient to present the problem clearly”.⁴ The claims, but not the arguments, must all be specified sufficiently in the request for the establishment of a panel.⁵ In *EC – Bananas III*, the Appellate Body found that in view of the particular circumstances of that case, the listing of the articles of the agreements alleged to have been breached satisfied the minimum requirements of the DSU.⁶

² Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas (“EC – Bananas III”)*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 142.

³ Appellate Body Report, *European Communities – Customs Classification of Certain Computer Equipment (“EC – Computer Equipment”)*, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998, para. 70.

⁴ Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products (“Korea – Dairy”)*, WT/DS98/AB/R, adopted 12 January 2000, para. 120.

⁵ Appellate Body Report, *EC – Bananas III*, para. 143.

⁶ Appellate Body Report, *EC – Bananas III*, para. 141.

Whether the mere listing of the articles claimed to have been violated actually meets the standard must, however, be examined on a case-by-case basis.

2.1.2 *Decision by the DSB*

Article 6.1 DSU

The DSB establishes the panel *at the latest* at the DSB meeting following the meeting at which the request for the establishment first appears as an item on the agenda, unless at that meeting the DSB decides by consensus *not* to establish a panel (reverse consensus). It is clear that the latter is not likely to happen and that, therefore, the establishment of a panel by the DSB is “quasi-automatic”. If the responding party does not object, a panel can be established at the DSB meeting at which the request for the establishment first appears on the agenda.⁷ Usually, however, the responding party objects to the establishment of the panel at the first DSB meeting.

A practice has evolved whereby immediately after the DSB’s decision to establish the panel (or within 10 days of this decision) other Members notify their interest in the dispute and reserve their third party rights.⁸

Article 9.1 DSU

Where more than one Member requests the establishment of a panel related to the same matter, a single panel may be established to examine these complaints taking into account the rights of all Members concerned. Whenever feasible, a single panel should be established to examine such complaints.

2.2 *Composition of a Panel*

2.2.1 *Number of Panelists*

Article 8.5 DSU

Panels are normally composed of three persons. The parties to the dispute can agree, within 10 days from the establishment of the panel, to a panel composed of five panelists. However, to date, this has never occurred.

2.2.2 *Required Qualifications for Panelists*

Article 8.1 DSU

Pursuant to the DSU, panels must be composed of well-qualified governmental and/or non-governmental individuals. By way of guidance, the DSU indicates that these individuals can be:

... persons who have served on or presented a case to a panel, served as a representative of a Member or of a contracting party to GATT 1947 or as a representative to the Council or Committee of any covered agreement or its predecessor agreement, or in the Secretariat, taught or published on international trade law or policy, or served as a senior trade policy official of a Member.

⁷ This has in fact happened in a few cases.

⁸ See below, p. xx.

Article 8.2 DSU

The DSU stipulates that panel members should be selected with a view to ensuring the independence of the members, a sufficiently diverse background and a wide spectrum of experience. Citizens of Members whose governments are parties to the dispute or third parties as defined in paragraph 2 of Article 10 shall not serve on a panel concerned with that dispute, unless the parties to the dispute agree otherwise. While this is not common, parties have in some cases agreed on a panelist who is a national of one of the parties. When a dispute is between a developing country Member and a developed country Member the panel shall, if the developing country Member so requests, include at least one panelist from a developing country Member. In all but a few panels dealing with disputes involving a developing country Member, at least one of the panelists was a national of a developing country Member.

Article 8.3 DSU**Article 8.10 DSU****Article 8.9 DSU**

Panelists are mostly government trade officials with legal training, many among them Geneva-based diplomats of WTO Members not involved in the dispute before the panel. The DSU explicitly provides, however, that panelists shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Members shall therefore not give them instructions nor seek to influence them as individuals with regard to matters before a panel. In recent years, there has been an increase in the number of academics and legal practitioners serving as panelists. It is also significant that at least half of the panelists have already served on a GATT or WTO panel before their selection.

2.2.3 Panel Selection Process

Article 8.6 DSU

Once a panel is established by the DSB, the parties to the dispute will try to reach agreement on the composition of the panel. The Secretariat shall propose nominations for the panel to the parties to the dispute. The DSU requires the parties to the dispute not to oppose nominations except for compelling reasons. However, parties often reject the nominations initially proposed by the WTO Secretariat without much justification. In practice, the composition of the panel is often a difficult and contentious process, which may take many weeks. If the parties are unable to agree on the composition of the panel within 20 days of its establishment by the DSB, either party *may*, however, request the Director-General of the WTO to determine the composition of the panel. Within 10 days of such a request, the Director-General shall – after consulting the parties to the dispute and the Chairmen of the DSB and of the relevant Council or Committee – appoint the panelists whom he considers most appropriate. In recent years, the Director-General has determined the composition of almost half of the panels.

Article 8.7 DSU**Article 8.4 DSU**

To assist in the selection of panelists, the Secretariat maintains a list of governmental and non-governmental individuals possessing the required qualifications to serve as a panelist. Members periodically suggest names of individuals for inclusion on this list and those names shall be added to the list upon approval by the DSB. However, this list is merely indicative and individuals not included in this Indicative List may be selected as panelists. In

fact, most first-time panelists were not on the Indicative List at the time of their selection.

2.3 Test your understanding

- 1. Why is it important that the request for the establishment of a panel be sufficiently precise? How precise must the panel request be?**
- 2. Can a panel be established at the meeting of the DSB at which the panel request first appeared on the DSB's agenda? Is it correct to say that the establishment of a panel by the DSB is "quasi-automatic"? If so, why?**
- 3. What are the required qualifications for a member of a panel? Will the parties to the dispute always have the final say on the composition of the panel that will examine the dispute between them?**

3. THE MANDATE OF A PANEL

Objectives

On completion of this section, the reader will be able:

- to appraise the task of a panel and the scope and limits of the powers of a panel to carry out that task,
- to explain what the “terms of reference” of a panel are and what the standard of review is that a panel applies in assessing the WTO-consistency of a contested measure,
- to describe to which extent the DSU condones judicial activism and the exercise of judicial economy,
- to explain what rules of conduct are applicable to panelists and,
- to describe what the role of the WTO Secretariat is in panel proceedings.

3.1 Terms of Reference

3.1.1 Standard Terms

Article 7.1 DSU

Unless the parties agree otherwise within 20 days from the establishment of the panel, a panel is given the following standard terms of reference:

To examine in the light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document ... and make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement.

The document referred to in these standard terms of reference is usually the request for the establishment of a panel. Hence, a claim falls within the panel’s terms of reference only if that claim is identified in the request for the establishment of a panel.

As the Appellate Body stated in *Brazil – Desiccated Coconut*, the terms of reference of the panel are important for two reasons:

First, terms of reference fulfil an important due process objective — they give the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them an opportunity to respond to the complainant’s case. Second, they establish the jurisdiction of the panel by defining the precise claims at issue in the dispute.⁹

⁹ Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut* (“Brazil – Desiccated Coconut”), WT/DS22/AB/R, adopted 20 March 1997, DSR 1997:I, 167, p. xx.

A panel may consider only those claims that it has authority to consider under its terms of reference.¹⁰ A panel is bound by its terms of reference.¹¹ It is, therefore, important that a request for the establishment of a panel be sufficiently precise.¹²

In case of a “broadly phrased” request for the establishment of a panel, it may be necessary to examine closely the complainant’s submissions to the panel to determine precisely which claims have been made and fall under the terms of reference of the panel.¹³

3.1.2 Special Terms

Article 7.3 DSU

Within 20 days of the establishment of the panel, the parties to the dispute can agree on special terms of reference for the panel. This occurs rarely.¹⁴ In establishing a panel, the DSB may authorize its Chairman to draw up the terms of reference of the panel in consultation with the parties to the dispute. However, if no agreement on special terms of reference is reached within 20 days of the establishment of the panel, the panel shall have standard terms of reference.

Article 7.1 DSU

3.2 Standard of Review

Article 11 DSU

A panel is called upon to review the consistency with WTO law of a challenged measure. Both the measure at issue and the relevant provisions of WTO law allegedly violated are determined by the terms of reference of the panel. But what is the standard of review a panel has to apply in reviewing the WTO consistency of the challenged measure? Article 11 of the DSU stipulates:

The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements.

In *EC – Hormones*, the Appellate Body noted that Article 11 of the DSU:

*... articulates with great succinctness but with sufficient clarity the appropriate standard of review for panels in respect of both the ascertainment of facts and the legal characterization of such facts under the relevant agreements.*¹⁵

¹⁰Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* (“*India – Patents (US)*”), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9, para. 92. A panel cannot assume jurisdiction that it does not have (*Ibid.*).

¹¹Appellate Body Report, *India – Patents*, para. 93.

¹²See above, p. xx.

¹³Appellate Body Report, *Chile – Price Band*, para. 165.

¹⁴See e.g., in *Brazil – Desiccated Coconut*, complaint by the Philippines, WT/DS22.

¹⁵Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* (“*EC – Hormones*”), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135, para.116.

As far as fact-finding is concerned, the appropriate standard is neither a *de novo* review of the facts nor “total deference” to the factual findings of national authorities. Pursuant to Article 11 of the DSU, panels have rather “to make an objective assessment of the facts”. With regard to legal questions, i.e., the consistency or inconsistency of a Member’s measure with the specified provisions of the relevant agreement, Article 11 imposes the same standard on panels, i.e., “to make an objective assessment of ... the applicability of and conformity with the relevant covered agreement”.

In a number of appeals of panel reports, the Appellate Body addressed the question when a panel may be regarded as having failed to discharge its duty under Article 11 of the DSU to make an objective assessment of the facts before it. According to the Appellate Body, “not every error in the appreciation of the evidence ... may be characterised as a failure to make an objective assessment of the facts.”¹⁶ The Appellate Body stated in *EC-Hormones*:

*The duty to make an objective assessment of the facts is, among other things, an obligation to consider the evidence presented to a panel and to make factual findings on the basis of that evidence. The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with a panel’s duty to make an objective assessment of the facts. The wilful distortion or misrepresentation of the evidence put before a panel is similarly inconsistent with an objective assessment of the facts. “Disregard” and “distortion” and “misrepresentation” of the evidence, in their ordinary signification in judicial and quasi-judicial processes, imply not simply an error of judgement in the appreciation of evidence but rather an egregious error that calls into question the good faith of a panel.*¹⁷

An allegation that a panel has failed to conduct an objective assessment of the matter before it as required by Article 11 of the DSU is a very serious allegation. Such an allegation goes to “the very core of the integrity of the WTO dispute settlement process itself.”¹⁸ So far, in only a few cases the Appellate Body found that a panel violated its obligation under Article 11 of the DSU.¹⁹ In *US – Lamb Safeguard*, for example, the Appellate Body found that the Panel had not *applied* the appropriate standard of review, under Article 11 of the DSU, in examining whether the United States International Trade Commission had provided a reasoned and adequate explanation of how the facts support a

¹⁶ Appellate Body Report, *EC – Hormones*, para. 133.

¹⁷ Ibid. The Appellate Body considered that “a claim that a panel disregarded or distorted the evidence submitted to it is, in effect, a claim that the panel, to a greater or lesser degree, denied the party submitting the evidence fundamental fairness, or what in many jurisdictions is known as due process of law or natural justice.” Ibid.

¹⁸ Appellate Body Report, *European Communities – Measures Affecting the Importation of Certain Poultry Products* (“*EC – Poultry*”), WT/DS69/AB/R, adopted 23 July 1998, para. 133.

¹⁹ E.g., Appellate Body Report, *US – United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities* (“*US – Wheat Gluten*”), WT/DS166/AB/R, adopted 19 January 2001, paras. 161-162; and Appellate Body Report, *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia* (“*US – Lamb*”), WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001, para. 149.

determination of “threat of serious injury” under Article 4.2(a) of the *Agreement on Safeguards*. In reaching this conclusion the Appellate Body noted:

We wish to emphasize that, although panels are not entitled to conduct a de novo review of the evidence, nor to substitute their own conclusions for those of the competent authorities, this does not mean that panels must simply accept the conclusions of the competent authorities. To the contrary, in our view, in examining a claim under Article 4.2(a), a panel can assess whether the competent authorities’ explanation for its determination is reasoned and adequate only if the panel critically examines that explanation, in depth, and in the light of the facts before the panel. Panels must, therefore, review whether the competent authorities’ explanation fully addresses the nature, and, especially, the complexities, of the data, and responds to other plausible interpretations of that data. A panel must find, in particular, that an explanation is not reasoned, or is not adequate, if some alternative explanation of the facts is plausible, and if the competent authorities’ explanation does not seem adequate in the light of that alternative explanation. Thus, in making an “objective assessment” of a claim under Article 4.2(a), panels must be open to the possibility that the explanation given by the competent authorities is not reasoned or adequate.²⁰

Anti-Dumping Agreement

Article 11 of the DSU sets forth the appropriate standard of review for panels for all but one of the covered agreements. The only exception is the *Anti-Dumping Agreement*²¹ in which a specific provision, Article 17.6, sets out a special standard of review for disputes arising under that Agreement.²²

3.3 Panels Acting Ultra Petita?

If a panel makes a finding on a claim that does not fall within its terms of reference, the panel does not make an objective assessment *of the matter before it*, as required by Article 11. Rather, the panel makes a finding on a matter that was *not* before it. As the Appellate Body held in *Chile – Price Band* such panel acts *ultra petita* and inconsistently with Article 11 of the DSU.²³

However, if a panel makes a finding on a claim which does fall within its terms of reference, the Appellate Body ruled in *EC – Hormones* that:

... nothing in the DSU limits the faculty of a panel freely to use arguments submitted by any of the parties – or to develop its own legal reasoning – to support its own findings and conclusions on the matter under its consideration.²⁴

²⁰ Appellate Body Report, *US – Lamb*, paras. 106-107.

²¹ Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994.

²² Appellate Body Report, *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan* (“*US – Hot-Rolled Steel*”), WT/DS184/AB/R, adopted 23 August 2001, para. 54 ff. See in more detail in Chapter xx of this Handbook.

²³ Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, para. 173.

²⁴ Appellate Body Report, *EC – Hormones*, para. 156.

3.4 Judicial Activism and Judicial Economy

3.4.1 Judicial Activism

Articles 3.2 and 19.2 DSU

The WTO dispute settlement system and, therefore, panels, serve to preserve the rights and obligations of Members under the covered agreements *as well as to clarify* the existing provisions of these agreements. However, in two separate provisions, the DSU explicitly cautions panels against “judicial activism”. The DSU prohibits panels “to add to or diminish the rights and obligations provided in the covered agreements”.

3.4.2 Judicial Economy

Complaining parties often assert numerous violations, often under various agreements. It is well-established case law that panels are not required to examine each and every one of the legal claims that a complaining party makes. The aim of dispute settlement is to secure a positive solution to a dispute. Therefore, panels “need only address those claims which must be addressed in order to resolve the matter in issue in the dispute.”²⁵ A panel has discretion to determine the claims it must address in order actually and effectively to resolve the dispute between the parties.²⁶ The Appellate Body has, however, cautioned panels to be careful when applying the principle of judicial economy. To provide only a partial resolution of the matter at issue may be false judicial economy since the unanswered issues may well give rise to a new dispute. As the Appellate Body stated in *Australia-Salmon* a panel has to address:

... those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings ‘in order to ensure effective resolution of disputes to the benefit of all Members’.²⁷

3.5 Rules of Conduct

Para. II.1 RoC

In hearing and deciding a dispute panelists are subject to the *Rules of Conduct for the Understanding on Rules and Procedures Governing the Settlement of Disputes* (the “*Rules of Conduct*” or “*RoC*”).²⁸ These rules require that panelists

²⁵ Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* (“*US – Wool Shirts and Blouses*”), WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:1, 323, p. 19.

²⁶ Appellate Body Report, *India – Patents (US)*, para. 87.

²⁷ Appellate Body Report, *Australia – Measures Affecting Importation of Salmon* (“*Australia – Salmon*”), WT/DS18/AB/R, adopted 6 November 1998, para. 223. See also Appellate Body Report, *Japan – Measures Affecting Agricultural Products* (“*Japan – Agricultural Products II*”), WT/DS76/AB/R, adopted 19 March 1999, para. 111.

²⁸ WT/DSB/RC/1, 11 December 1996.

... shall be independent and impartial, shall avoid direct or indirect conflicts of interest and shall respect the confidentiality of proceedings.

Para. III.1 RoC

To ensure compliance with this “governing principle”, panelists are to disclose:

... the existence or development of any interest, relationship or matter that person could reasonable be expected to know and that is likely to affect, or give rise to justifiable doubts as to, that person’s independence or impartiality.

Annex 2 RoC

This disclosure obligation includes information on financial, professional and other active interests as well as considered statements of public opinion and employment or family interests. Parties can request the disqualification of a panelist on the ground of material violation of the obligations of independence, impartiality, confidentiality or the avoidance of direct or indirect conflicts of interests. The evidence of such material violation is provided to the Chairman of the DSB, who will, in consultation with the Director-General of the WTO and the chairpersons of the relevant WTO bodies, decide whether a material violation has occurred. If it has, the panelist is replaced. To date, no panelist has ever been found to have committed a material violation of the *Rules of Conduct*. However, in a few instances a panelist withdrew on his own initiative after a party raised concerns about a possible conflict of interests.

Para. VIII RoC

Article 8.11 DSU

Panelists’ expenses, including travel and subsistence allowances, are met from the WTO budget. Non-governmental individuals serving as panelists receive a fee for their service. However, this fee is low compared to fees ordinarily paid in international arbitration.

3.6 Role of the WTO Secretariat

Article 27.1 DSU

The WTO Secretariat shall have the responsibility of assisting panels, especially on the legal, historical and procedural aspects of the matters dealt with, and of providing secretarial and technical support. The Legal Affairs Division and the Rules Division are the main divisions of the WTO Secretariat that service dispute settlement panels. However, a significant number of staff from other “operational divisions” of the WTO Secretariat also assists panels. Depending on the agreement principally at issue in a particular dispute, a panel will often be assisted by a cross divisional, inter-disciplinary team (i.e., economists and lawyers) drawn from the Legal Affairs Division and other divisions of the WTO Secretariat. Panels considering cases relating to state trading, subsidies, countervailing duties and anti-dumping are assisted by the staff of the Rules Division, which specializes in these matters. Officials of the WTO Secretariat assigned to assist panels are also subject to the *Rules of Conduct* and bound by the obligations of independence, impartiality, confidentiality and the avoidance of direct or indirect conflicts of interests.

3.7 Test your understanding

- 1. What are, and where do we find, the terms of reference of a panel? Why are the terms of reference of a panel important?**
- 2. What is the standard of review a panel has to apply in reviewing the WTO consistency of a measure challenged by the complaining party? When does a panel not meet the requirement of Article 11 to make an objective assessment of the matter before it?**
- 3. Could a panel remedy an obvious lacuna in the *WTO Agreement* when this is necessary to resolve a dispute between the parties?**
- 4. Does a panel have to address, and decide on, every claim of the complaining party? Can the panel ignore an explicit request of the complaining part to rule on a particular claim?**
- 5. Can panelists be disqualified? If so, by whom and on which grounds?**
- 6. What is the role of the WTO Secretariat in panel proceedings?**

4. SPECIFIC FEATURES OF THE PANEL PROCESS

Objectives

On completion of this section, the reader will be able:

- to appreciate the limitations on the access to panel proceedings, with the issues raised by *amicus curiae* briefs and representation by private lawyers and, the various aspects of the confidentiality of panel proceedings;
- to explain the rules of interpretation and the rules on burden of proof applied by panels, as well as the rules on evidence and use of experts applicable in panel proceedings;
- to evaluate what requirements a panel report must meet under the DSU.

4.1 Access to Panel Proceedings

Only WTO Members that are parties to a dispute and, to a more limited extent, WTO Members that are third parties to the dispute, have a legal right to make submissions to, and have a legal right to have those submission considered by, a panel. In *US – Shrimp*, the Appellate Body ruled as follows:

It may be well to stress at the outset that access to the dispute settlement process of the WTO is limited to Members of the WTO. This access is not available, under the WTO Agreement and the covered agreements, as they currently exist, to individuals or international organizations, whether governmental or non-governmental. Only Members may become parties to a dispute of which a panel may be seized, and only Members “having a substantial interest in a matter before a panel” may become third parties in the proceedings before that panel. Thus, under the DSU, only Members who are parties to a dispute, or who have notified their interest in becoming third parties in such a dispute to the DSB, have a legal right to make submissions to, and have a legal right to have those submissions considered by, a panel.²⁹

Other Members, individuals, companies or organizations do not have such legal rights. They do not, as such, have a direct *right* of access to the panel proceedings.³⁰

4.1.1 Third Parties

Article 10 DSU

With regard to third parties, we note that any Member having a substantial interest in a matter before a panel and having notified its interest to the DSB at the time of the establishment of the panel, is given an opportunity to be heard by the panel and to make written submissions to the panel. Although this is

²⁹ Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (“*US – Shrimp*”), WT/DS58/AB/R, adopted 6 November 1998, para. 101.

³⁰ On the authority of panels and the Appellate Body to consider *amicus curiae* briefs, see below, p. xx.

not set out in the DSU, a practice has evolved whereby third parties notify their interest within 10 days of the establishment of a panel. It is generally up to the individual Member to decide for itself whether it has a substantial interest. The parties to the dispute do not seek to review the existence of the substantial interest. It is, in fact, not uncommon for a Member, and in particular for the United States or the European Communities, to become a third party because of a “systematic” interest in a case. The access of third parties to panel proceedings is, however, limited.³¹

4.1.2 Amicus Curiae briefs

The DSU does not provide any specific rules on whether panels may accept and consider in their deliberations unsolicited *amicus curiae* (i.e., friend of the court) briefs. The Appellate Body noted in *US - Shrimp*, however, the comprehensive nature of the authority of a panel under Article 13 of the DSU as well as the authority under Article 12.1 of the DSU to depart from, or to add to, the Working Procedures set forth in Appendix 3 of the DSU.³² The Appellate Body considered that:

*the thrust of Articles 12 and 13, taken together, is that the DSU accords to a panel ... ample and extensive authority to undertake and to control the process by which it informs itself both of the relevant facts of the dispute and of the legal norms and principles applicable to such facts.*³³

According to the Appellate Body, that authority, and the scope thereof, is indispensably necessary to enable a panel to discharge the duty imposed by Article 11 of the DSU to ‘make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements ...’.³⁴ The Appellate Body thus came to the conclusion that a panel has:

*... the discretionary authority either to accept and consider or to reject information and advice submitted to it, whether requested by a panel or not.*³⁵

This ruling of the Appellate Body is controversial and much criticized. Most WTO Members are of the view that under the current provisions of the DSU, panels do not have the authority to accept and consider unsolicited *amicus curiae* briefs. According to those Members, the WTO dispute settlement system is a state-to-state dispute settlement system in which there is no role for, in particular, non-governmental organizations. When the Appellate Body adopted an *ad hoc* procedure for the filing of *amicus curiae* briefs in the *EC – Asbestos* appeal proceedings, a special meeting of the General Council was convened

³¹ See below, p. xx.

³² Appellate Body Report, *US – Shrimp*, para. 105. Both the authority of panels under Articles 12 and 13 of the DSU is discussed below, at p. xx and p. xx respectively.

³³ Appellate Body Report, *US – Shrimp*, para. 106.

³⁴ Ibid.

³⁵ Appellate Body Report, *US – Shrimp*, para. 108.

on 22 November 2000 at the request of incensed WTO Members. At the conclusion of this meeting, the Chairman agreed to call upon the Appellate Body to exercise extreme caution in future cases until Members had considered what rules were needed regarding *amicus curiae* briefs.³⁶ While not specifically targeted by the DSB Chairman, it is clear that also panels are called upon to exercise similar caution. To date, only a few panels have in fact accepted and considered unsolicited briefs.

4.1.3 *Private Counsel*

The DSU does not explicitly address the issue of representation of the parties before panels. In *EC – Bananas III*, the issue arose whether private counsel, not employed by government, may represent a party or third party (such as Saint Lucia) before the Appellate Body. In its ruling, the Appellate Body noted that nothing in the *WTO Agreement* or the DSU, nor in customary international law or the prevailing practice of international tribunals, prevents a WTO Member from determining for itself the composition of its delegation in WTO dispute settlement proceedings.³⁷ A party can, therefore, decide that private counsel forms part of its delegation and will represent it before the panel. The Appellate Body also noted:

*... that representation by counsel of a government's own choice may well be a matter of particular significance — especially for developing-country Members — to enable them to participate fully in dispute settlement proceedings.*³⁸

While the ruling of the Appellate Body concerned the proceedings before this body, the reasoning of this ruling is equally relevant for panel proceedings and private counsel now routinely appear in panel proceedings as part of the delegation of a party or third party. The parties and third parties have the responsibility for all members of their delegations and shall ensure that all members of the delegation, including private counsel, act in accordance with the rules of the DSU and the Working Procedures of the panel, particularly in regard to the confidentiality of the proceedings.³⁹

4.2 Confidentiality

4.2.1 *Confidentiality of written submissions and the panel report*

Article 18.2

Panel proceedings are characterized by their confidentiality. All written submissions to the panel by the parties and third parties to the dispute are

³⁶ See Chapter 3.3 of this Handbook on the “Appellate Review Process”.

³⁷ *EC – Bananas III*, para. 10.

³⁸ *EC – Bananas III*, para. 12.

³⁹ In this respect, see Appellate Body Report, *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland* (“*Thailand – H-Beams*”), WT/DS122/AB/R, adopted 5 April 2001, para. 68.

**DSU & Appendix 3,
para. 3**

confidential. Parties may make their *own* submissions available to the public. While a few Members do so in a systematic manner, most parties choose to keep their submissions confidential. The DSU provides that a party to a dispute must, upon request of any WTO Member, provide a non-confidential summary of the information contained in its submissions to the panel that could be disclosed to the public. However, this provision does not provide for a deadline by which such non-confidential summary must be made available. In the few instances in which WTO Members requested such a summary, it was usually made available too late to be of any practical relevance. The actual submissions remain confidential even after the dispute has been resolved.

The interim report of the panel and the final panel report as long as it is only issued to the parties to the dispute are also confidential. The final panel report only becomes a public document when it is circulated to all WTO Members. In reality, however, the interim report and the final report issued to the parties do not remain confidential very long and are usually “leaked” to the media.

4.2.2 Confidentiality of panel meetings

**Appendix 3,
para. 2 DSU**

The meetings of the panel with the parties and third parties take place behind closed doors. Nobody except the parties themselves and the officials of the WTO Secretariat assisting the panel are allowed to attend all meetings of the panel with the parties. Third parties are usually invited to attend only one session of the first substantive panel meeting.⁴⁰

4.2.3 Business Confidential Information

Recognizing that parties have a legitimate interest in protecting sensitive business confidential information submitted to a panel, the Panels in *Canada – Aircraft* and *Brazil – Aircraft* adopted special procedures governing business confidential information that go beyond the protection afforded by Article 18.2 of the DSU.⁴¹

Under the Procedures Governing Business Confidential Information adopted by the Panel in *Canada – Aircraft*, the business confidential information was to be stored in a safe in a locked room at the premises of the relevant Geneva missions, with restrictions imposed on access to the locked room and safe. The Procedures also provided for either party to visit the other party’s Geneva mission and review the proposed location of the safe and propose any changes. Finally, the Procedures provided for the return and destruction of the business confidential information after completion of the panel process. In spite of these Procedures adopted by the Panel, Canada nevertheless refused to submit certain business confidential information because these Procedures did not, according to Canada, provide the requisite level of protection.

⁴⁰ See below, p. xx.

⁴¹ Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* (“*Canada – Aircraft*”), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, WT/DS70/AB/R, Annex 1; and *Brazil – Export Financing Programme for Aircraft* (“*Brazil – Aircraft*”), WT/DS46/R, adopted 20 August 1999, as modified by the Appellate Body Report, WT/DS46/AB/R, Annex 1

4.3 Rules of Interpretation

Article 3.2 DSU

Article 32 Vienna Convention

Article 31 Vienna Convention

Panels must interpret the provisions of the covered agreements in accordance with customary rules of interpretation of public international law. As the Appellate Body found in *US – Gasoline* and *Japan – Alcoholic Beverages*, the rules embodied in Articles 31 and 32 of the Vienna Convention on the Law of Treaties (the “Vienna Convention”) form part of the customary rules of interpretation of public international law.⁴² Consequently, panels and the Appellate Body interpret provisions of the covered agreements in accordance with the ordinary meaning of the words of the provision taken in their context and in the light of the object and purpose of the agreement involved. Interpretation must start with and be based on the text of the agreement.⁴³ One of the corollaries of the general rule of interpretation in the Vienna Convention is that interpretation must give meaning and effect to all terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.⁴⁴ On the other hand, the general rule of treaty interpretation neither requires nor condones “the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended.”⁴⁵ The application of the general rule of interpretation set out in Article 31 of the *Vienna Convention* will usually allow the panel to establish the meaning of a term. However, if after applying Article 31 the meaning of the term remains ambiguous or obscure, or leads to a result, which is manifestly absurd or unreasonable, a panel may have recourse to the supplementary means of interpretation provided for in Article 32 of the *Vienna Convention*. These supplementary means of interpretation include “the preparatory work of the treaty and the circumstances of its conclusion”. With regard to “the circumstances of [the] conclusion” of a treaty, this permits, in appropriate cases, the examination of the historical background against which the treaty was negotiated.⁴⁶

4.4 Rules on Evidence

4.4.1 Submission of Evidence

The DSU does not establish precise rules or deadlines for the submission of evidence by a party to the dispute. In *Argentina – Textiles and Apparel*, the Appellate Body noted:

⁴² Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline* (“*US – Gasoline*”), WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3, p. 17; and 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, p. 10.

⁴³ See, for example, Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 11; and Appellate Body Report, *US – Shrimp*, para. 114.

⁴⁴ Appellate Body Report, *US – Gasoline*, p. 23. See also, for example, Appellate Body Reports: *Japan – Alcoholic Beverages II*, p. 12; and *Korea – Dairy*, para. 81.

⁴⁵ Appellate Body Report, *India – Patents*, para. 45. See also Appellate Body Report, *EC – Hormones*, para. 181.

⁴⁶ Appellate Body Report, *EC – Computer Equipment*, para. 86.

Article 11 of the DSU does not establish time limits for the submission of evidence to a panel. Article 12.1 of the DSU directs a panel to follow the Working Procedures set out in Appendix 3 of the DSU, but at the same time authorizes a panel to do otherwise after consulting the parties to the dispute. The Working Procedures in Appendix 3 also do not establish precise deadlines for the presentation of evidence by a party to the dispute. It is true that the Working Procedures “do not prohibit” submission of additional evidence after the first substantive meeting of a panel with the parties.⁴⁷

However, the DSU contemplates two distinguishable stages in a panel proceeding: a first stage during which the parties should set out their case in brief, including a full presentation of the facts on the basis of submission of supporting evidence; and a second stage which is generally designed to permit “rebuttals” by each party of the arguments and evidence submitted by the other party.⁴⁸ Nevertheless, unless specific deadlines for the submission of evidence are set out in the working procedures of the panel, parties can submit new evidence as late as the second meeting with the panel. The panel must of course constantly be careful to observe due process, which, inter alia, entails providing the parties adequate opportunity to respond to the evidence submitted.⁴⁹

4.4.2 Requesting Parties for Information

Article 13.1 DSU

The DSU provides panels with discretionary authority to request and obtain information from *any Member*, including *a fortiori* a Member who is a party to a dispute before the panel.⁵⁰ This is made very clear by the third sentence of Article 13.1 of the DSU, which states:

A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate.

Article 13.1 imposes *no conditions* on the exercise of this discretionary authority to seek and obtain information from the parties. This authority is, for example, *not* conditional upon the other party to the dispute having previously established, on a *prima facie* basis, such other party’s claim or defence.⁵¹ Furthermore, the Appellate Body ruled that the word “should” in the third sentence of Article 13.1, quoted above, is in the context of the whole of Article 13, used in a normative, rather than a merely exhortative, sense. Members are, in other words, under a duty and an obligation to “respond promptly and fully” to requests made by panels for information under Article 13.1 of the DSU.⁵² If a party refuses to give certain information to the Panel,

⁴⁹ Appellate Body Report, *Argentina – Textiles and Apparel*, paras. 80-81; and Appellate Body Report, *Australia – Salmon*, para. 272.

⁵⁰ Article 13.1 of the DSU.

⁵¹ Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft* (“Canada – Aircraft”), WT/DS70/AB/R, adopted 20 August 1999, para.185. See also *Thailand – H-Beams*, para. 135.

⁵² Appellate Body Report, *Canada – Aircraft*, para. 187.

the Panel may draw negative inferences from this refusal.⁵³

4.4.3 Use of Experts

Article 13 DSU

Disputes brought to panels for adjudication often involve complex factual, technical and scientific issues. Unlike in the context of the old GATT dispute settlement proceedings, factual, technical and scientific issues frequently play a central role in WTO dispute settlement proceedings. Article 13 of the DSU gives panels the authority to seek information and technical advice from any individual or body, which it deems appropriate. Panels may consult experts to obtain their opinion on certain aspects of the matter under consideration.

As the Appellate Body ruled in *Argentina - Textiles and Apparel*, “this is a grant of discretionary authority”.⁵⁴ In *US - Shrimp*, the Appellate Body further stated:

... a panel ... has the authority to accept or reject any information or advice which it may have sought and received, or to make some other appropriate disposition thereof. It is particularly within the province and the authority of a panel to determine the need for information and advice in a specific case, to ascertain the acceptability and relevancy of information or advice received, and to decide what weight to ascribe to that information or advice or to conclude that no weight at all should be given to what has been received.⁵⁵

This authority is “indispensably necessary” to enable a panel to discharge its duty imposed by Article 11 of the DSU to “make an objective assessment of the matter before it.”⁵⁶

Article 13.1 DSU

To date, panels have consulted experts in, for example, *EC – Hormones*, *Australia – Salmon*, *Japan – Agricultural Products II* and *EC - Asbestos*, all disputes involving complex scientific issues. The panels, in these cases, typically selected the experts in consultation with the parties, presented the experts with a list of questions to which each expert individually responded in writing, and finally called a special meeting with the experts at which these and other questions were discussed with the panelists and the parties. The panel report usually contained both the written responses of the experts to the panel’s questions as well as a transcript of the discussions at the meeting with the panel. Confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information.

Article 13.2 DSU

Apart from consulting individual experts, a panel can with respect to a factual issue concerning a scientific or other technical matter, request an advisory report in writing from an expert review group. Rules for the establishment of

⁵³ Appellate Body Report, *Canada – Aircraft*, para. 203.

⁵⁴ Appellate Body Report, *Argentina – Textiles and Apparel*, para. 84.

⁵⁵ Appellate Body Report, *US – Shrimp*, para. 104.

⁵⁶ Appellate Body Report, *US – Shrimp*, para. 106.

such a group and its procedures are set forth in Appendix 4 of the DSU. Expert review groups are under the authority of the panel and report to the panel. The panel decides their terms of reference. The report of an expert review group is advisory only; it does not bind the panel. To date, panels have made no use of this possibility to request an advisory report from an expert review group. Panels have preferred to seek information from experts directly and on an individual basis.⁵⁷

It should be noted that while a panel has broad authority to consult experts to help it to understand and evaluate the evidence submitted and the arguments made by the parties, a panel may not make the case for one or the other party on the basis of information provided by the experts. In *Japan – Agricultural Products II*, the Appellate Body ruled:

Article 13 of the DSU and Article 11.2 of the SPS Agreement suggest that panels have a significant investigative authority. However, this authority cannot be used by a panel to rule in favour of a complaining party, which has not established a prima facie case of inconsistency, based on specific legal claims asserted by it. A panel is entitled to seek information and advice from experts and from any other relevant source it chooses, pursuant to Article 13 of the DSU and, in an SPS case, Article 11.2 of the SPS Agreement, to help it to understand and evaluate the evidence submitted and the arguments made by the parties, but not to make the case for a complaining party.

In the present case, the Panel was correct to seek information and advice from experts to help it to understand and evaluate the evidence submitted and the arguments made by the United States and Japan with regard to the alleged violation of Article 5.6. The Panel erred, however, when it used that expert information and advice as the basis for a finding of inconsistency with Article 5.6, since the United States did not establish a prima facie case of inconsistency with Article 5.6 based on claims relating to the “determination of sorption levels”. The United States did not even argue that the “determination of sorption levels” is an alternative measure, which meets the three elements under Article 5.6.⁵⁸

Other WTO provisions

Apart from Article 13 of the DSU, discussed here, panels have either the possibility or the obligation to consult experts under a number of other covered agreements: *SPS Agreement*, Article 11.2; *TBT Agreement*, Article 14.2 and 3, Annex 2; *Agreement on Implementation of Article VII of the GATT 1994*; Article 19.3 and 4, Annex 2 and the *SCM Agreement*, Article 4.5 and 24.3.

Fact-finding compared

Overall, when compared with fact-finding procedures of national courts, the fact-finding procedures of panels are clearly less well developed. In *India – Patents*, the Appellate Body observed:

⁵⁷ The DSU also leaves it to the sound discretion of a panel to determine whether the establishment of an expert review group is necessary or appropriate (Appellate Body Report, *EC – Hormones*, para. 147).

⁵⁸ Appellate Body Report, *Japan – Agricultural Products II*, paras. 129 and 130.

It is worth noting that, with respect to fact-finding, the dictates of due process could better be served if panels had standard working procedures that provided for appropriate factual discovery at an early stage in panel proceedings.⁵⁹

More sophisticated fact-finding techniques will need to be adopted in the future.

4.5 Burden of Proof

The DSU does not contain any specific rules concerning the burden of proof in panel proceedings. However, in *US – Wool Shirts and Blouses*, the Appellate Body noted:

In addressing this issue, we find it difficult, indeed, to see how any system of judicial settlement could work if it incorporated the proposition that the mere assertion of a claim might amount to proof. It is, thus, hardly surprising 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.⁶⁰

These rules on the burden of proof also apply in panel proceedings. Precisely how much and precisely what kind of evidence will be required to establish a *presumption* that what is claimed is true, i.e., what is required to establish a *prima facie* case, will necessarily vary from measure to measure, provision to provision, and case to case.⁶¹

4.6 Characteristics of a Panel Report

A panel submits its findings in the form of a written report to the DSB. This report typically consists of an introductory section on the procedural aspects of the dispute, a section on factual aspects of the dispute (in which the measure at issue is discussed); a section setting out the claims of parties; sections summarizing the arguments of the parties and third parties, a section on the interim review, the section containing the panel's findings and, finally, the panel's conclusions. As of recently, a number of panels have opted not to include in their report sections summarizing the arguments of the parties and third parties but rather to attach all submissions of parties and third parties to the report. However, panels have only taken this approach when parties agreed to it.

⁵⁹ Appellate Body Report, *India – Patents*, para. 95.

⁶⁰ Appellate Body Report, *US – Wool Shirts and Blouses*, p. xx.

⁶¹ Ibid.

Article 12.7 DSU

A panel report must, at a minimum, set out the findings of fact, the applicability of relevant provisions and the basic rationale behind any findings and recommendations that it makes. In a few cases to date, parties have challenged a panel report before the Appellate Body for lack of a basic rationale behind the panel's findings and recommendations.⁶² In *Argentina – Footwear Safeguard (EC)*, the Appellate Body found as follows:

In this case, the Panel conducted extensive factual and legal analyses of the competing claims made by the parties, set out numerous factual findings based on detailed consideration of the evidence before the Argentine authorities as well as other evidence presented to the Panel, and provided extensive explanations of how and why it reached its factual and legal conclusions. Although Argentina may not agree with the rationale provided by the Panel, and we do not ourselves agree with all of its reasoning, we have no doubt that the Panel set out, in its Report, a “basic rationale” consistent with the requirements of Article 12.7 of the DSU.⁶³

Article 12.11 DSU

Where one or more of the parties to the dispute is a developing country Member, the panel's report shall explicitly indicate the form in which account has been taken of relevant provisions on differential and more-favourable treatment for developing country Members that form part of the covered agreements and which have been raised by the developing country Member in the course of the dispute settlement procedures. In *India – Quantitative Restrictions*, for example, the Panel specifically referred to this requirement and noted:

In this instance, we have noted that Article XVIII:B as a whole, on which our analysis throughout this section is based, embodies the principle of special and differential treatment in relation to measures taken for balance-of-payments purposes. This entire part G therefore reflects our consideration of relevant provisions on special and differential treatment, as does Section VII of our report (suggestions for implementation).⁶⁴

Article 19.1 DSU

Where a panel concludes that a Member's measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring that measure into conformity with that agreement. The recommendations and rulings of the panel are not legally binding by themselves. They become legally binding only when they are adopted by the DSB and thus have become the recommendations and rulings of the DSB. The DSB adopts the panel report, and its recommendations and rulings, by reverse consensus, i.e., the DSB

Article 16.4 DSU

⁶² Appellate Body Report, *Korea – Taxes on Alcoholic Beverages* (“Korea – Alcoholic Beverages”), WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, para. 168; Appellate Body Report, *Chile – Taxes on Alcoholic Beverages* (“Chile – Alcoholic Beverages”), WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, para. 78; and Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear* (“Argentina – Footwear (EC)”), WT/DS121/AB/R, adopted 12 January 2000, para. 149.

⁶³ Appellate Body Report, *Argentina – Footwear (EC)*, para. 149.

⁶⁴ Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* (“India – Quantitative Restrictions”), WT/DS90/R, adopted 22 September 1999, as upheld by the Appellate Body Report, WT/DS90/AB/R, para. 5.157.

adopts the report unless it decides by consensus *not* to adopt the report. It is clear that the latter is not likely to happen since the “winning” party will have a strong interest in the adoption of the report. Therefore, the adoption of panel reports by the DSB is “quasi-automatic”.

Article 19.1 DSU

In addition to making recommendations, the panel may suggest ways in which the Member concerned could implement those recommendations. These suggestions are not legally binding on the Member concerned but because the panel making the suggestions might later be called upon to assess the sufficiency of the implementation of the recommendations, such suggestions are likely to have a certain impact.⁶⁵ To date, few panels have made use of this authority to make suggestions regarding implementation of their recommendations.⁶⁶

Article 19.2 DSU

As already pointed out above, panels cannot in their findings and recommendations add to or diminish to the rights and obligations of Members provided for in the covered agreements. They are explicitly proscribed from doing so.

Article 14.3 DSU

Panelists can express in the panel report a separate opinion, be it dissenting or concurring. However, if they do, they must do so *anonymously*. To date, there have been very few panel reports setting out a separate opinion of one of the panelists.⁶⁷

Article 9.2 DSU

When a single panel examines complaints of multiple complainants, the panel must 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. If one of the parties to the dispute so requests, the panel shall submit separate reports on the dispute concerned. This happened in *EC – Bananas III* in which the panel issued four separate, be it in substance largely identical, reports.⁶⁸

Article 12.7 DSU

Occasionally parties have reached a mutually agreed solution to the dispute while a panel was already examining the matter.⁶⁹ Where parties settle the dispute before the panel circulates a report to the WTO Members, the report of the panel shall be confined to a brief description of the case and to reporting that a solution has been reached.

⁶⁵ See Chapter 3.4 of this Handbook.

⁶⁶ See, for example: Panel Report, *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear (“US – Underwear”)*, WT/DS24/R, adopted 25 February 1997, as modified by the Appellate Body Report, WT/DS24/AB/R, DSR 1997:I, 31, Panel Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico (“Guatemala – Cement I”)*, WT/DS60/R, adopted 25 November 1998, as modified by the Appellate Body Report, WT/DS60/AB/R, Panel Report, *India - Quantitative Restrictions*, Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (“US – Lead and Bismuth II”)*, WT/DS138/R and Corr.2, adopted 7 June 2000, as upheld by the Appellate Body Report, WT/DS138/AB/R.

⁶⁷ E.g., Panel Report, *European Communities – Measures Affecting the Importation of Certain Poultry Products (“EC – Poultry”)*, WT/DS69/R, adopted 23 July 1998, as modified by the Appellate Body Report, WT/DS69/AB/R.

⁶⁸ WT/DS27/R/ECU; WT/DS27/R/GTM & HND; WT/DS27/R/MEX; and WT/DS27/R/USA.

⁶⁹ In *European Communities - Measures Affecting Butter Products*, complaint by New Zealand, WT/DS72, the parties reached a mutually agreed solution after the panel had issued its report to the parties.

Panel reports are always circulated to the WTO Members and made available to the public in English, French and Spanish. No report is circulated until all three language versions are available. Most reports are written in English and then translated into French and Spanish, but in recent years there have been a few panel reports that were written in Spanish and at least one that was written in French.⁷⁰

4.7 Test your understanding

- 1. Who has a right of access to the panel proceedings? On what legal basis does the Appellate Body conclude that panels have the right to accept and consider unsolicited *amicus curiae* briefs? Under what conditions may private lawyers represent in a panel meeting a WTO Member that is a party or third party in the dispute before the panel?**
- 2. How do panels interpret the provisions of the *WTO Agreement*? Should panels when interpreting the provisions of the *WTO Agreement* take into account the “legitimate expectations” of the complaining party or the negotiating history of the *WTO Agreement*?**
- 3. Can parties submit new evidence to the panel at any stage of the panel proceedings? Are parties under a legal obligation to provide to the panel the documents and information that the panel requests of them? Upon which party does the burden of proof rest in panel proceedings?**
- 4. Are the recommendations, rulings and suggestions of a panel report legally binding? What are the requirements that a panel report must meet under the DSU?**

⁷⁰ E.g., Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (“EC – Asbestos”), WT/DS135/R, adopted 5 April 2001 as modified by the Appellate Body Report WT/DS135/AB/R.

5. THE PANEL PROCEEDINGS

Objectives

On completion of this section, the reader will be able: to identify the different steps in the panel proceedings; to interpret the DSU rules on working procedures for panels; and to recognize the time frames for the panel proceedings.

5.1 Working Procedures

Article 12.1 DSU

The basic rules governing panel proceedings are set out in Article 12 of the DSU. Article 12.1 of the DSU directs a panel to follow the Working Procedures contained in Appendix 3 of the DSU, but at the same time authorizes a panel to do otherwise after consulting the parties to the dispute. In *India – Patents*, however, the Appellate Body cautioned panels as follows:

... Although panels enjoy some discretion in establishing their own working procedures, this discretion does not extend to modifying the substantive provisions of the DSU. To be sure, Article 12.1 of the DSU says: “Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute”. Yet that is all that it says. Nothing in the DSU gives a panel the authority either to disregard or to modify other explicit provisions of the DSU.⁷¹

Article 12.2 DSU

The DSU requires that panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process. Since the Working Procedures contained in Appendix 3 are rudimentary, panels have often found it necessary to adopt additional procedures specific to the cases before them. These additional procedures are usually reported in an introductory section of the panel report on procedural aspects of the dispute.

Article 3.10 DSU

Generally speaking, WTO Members enjoy a high degree of discretion to argue dispute settlement claims in the manner they deem appropriate. This discretion, however, does not detract from their obligation under the DSU to engage in dispute settlement procedures “in good faith in an effort to resolve the dispute”. Both complaining and responding Members must comply with the requirements of the DSU in good faith. In *US – FSC* the Appellate Body stated:

By good faith compliance, complaining Members accord to the responding Members the full measure of protection and opportunity to defend, contemplated by the letter and spirit of the procedural rules. The same principle of good faith requires that responding Members seasonably and promptly bring claimed procedural deficiencies to the attention of the complaining Member, and to the DSB or the Panel, so that corrections, if needed, can be

⁷¹ Appellate Body Report, *India – Patents*, para. 92.

*made to resolve disputes. The procedural rules of WTO dispute settlement are designed to promote, not the development of litigation techniques, but simply the fair, prompt and effective resolution of trade disputes.*⁷²

The Appellate Body has noted repeatedly that detailed, standard working procedures for panels would help to ensure due process and fairness in panel proceedings.⁷³

The working languages of the WTO are English, French and Spanish. The parties may use any of the three languages in the proceedings. During the period 1995-2002, however, English was the language commonly used by the panel, the parties and third parties in panel proceedings.

5.2 Time Frame for the Panel Proceedings

Article 12.8 DSU

The period in which a panel shall conduct its examination, from the date that the composition of the panel has been agreed upon until the date the final report is issued to the parties to the dispute, shall, as a general rule, not exceed six months. In cases of urgency, including those relating to perishable goods, the panel shall aim to issue its report to the parties to the dispute within three months and shall make every effort to accelerate the proceedings to the greatest extent possible.

Articles 12.9 and 4.9 DSU

When a panel considers that it cannot issue its report within six months, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it shall issue its report. In no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months.

Article 12.9 DSU

Article 20 DSU

The period from the date of establishment of the panel by the DSB until the date the DSB considers the panel report for adoption shall as a general rule not exceed nine months where the panel report is not appealed or 12 months where the report is appealed. Where the panel has acted, pursuant to Article 12.9 of the DSU to extend the time for providing its report, the additional time taken shall be added to the above periods.

It should be noted that panels often find it impossible to complete their examination of the case within these nine months. They frequently go beyond this deadline. The reasons for delay vary but are often related to the complexity of the case and the need to consult experts, the availability of panelists, problems with scheduling meetings and the time taken up by the translation of the report.

Article 12.12 DSU

At the request of the complaining party, the panel may at any time during the panel proceedings suspend its work for a maximum period of 12 months. If

⁷² Appellate Body Report, *US – FSC*, para. 166. See also Appellate Body Report, *US – Lamb*, para. 115.

⁷³ See Appellate Body Report, *EC – Bananas III*, para. 144; Appellate Body Report, *India – Patents (US)*, para. 95; and Appellate Body Report, *Argentina – Textiles and Apparel*, para. 79, footnote 68.

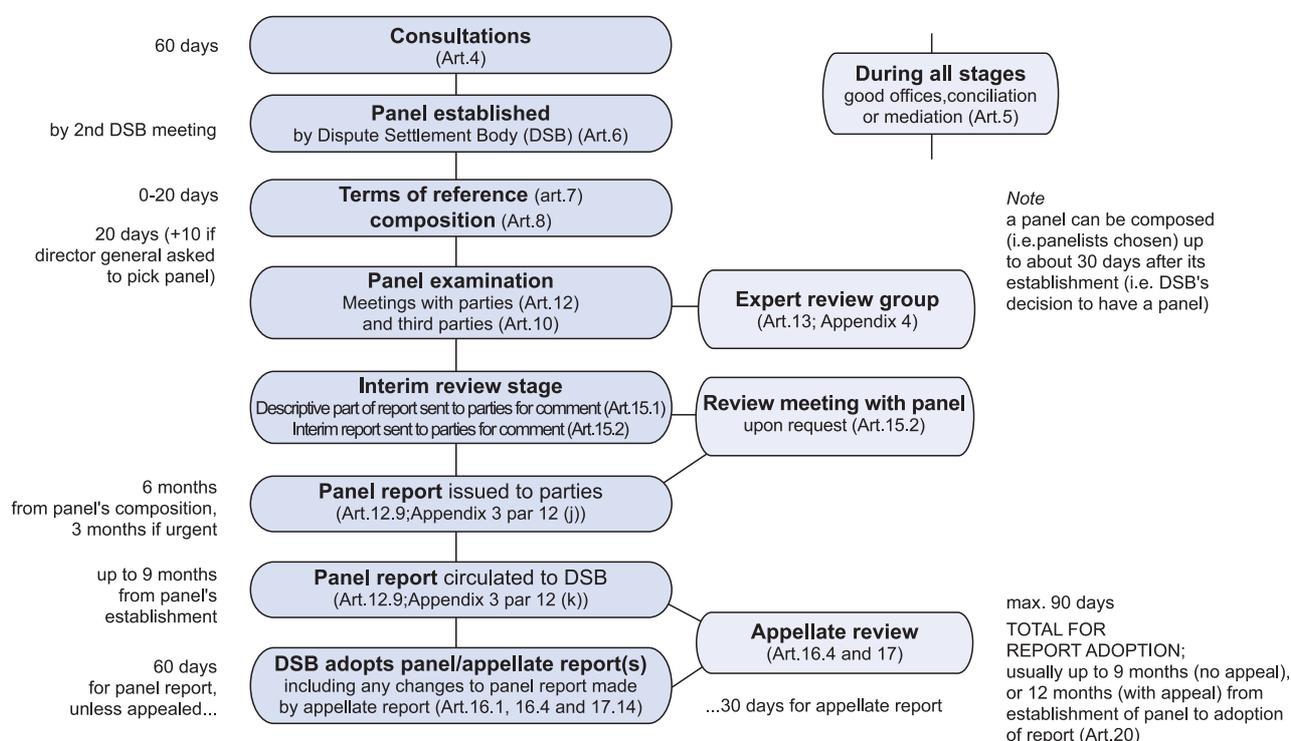
the work of the panel has been suspended for more than 12 months, the authority of the panel lapses.⁷⁴

Articles 4 and 7 SCM Agreement

Accelerated procedures with shorter time periods (generally half) apply with respect to disputes regarding prohibited subsidies under the *SCM Agreement*. Also disputes regarding actionable subsidies under the *SCM Agreement* are subject to some specific deadlines.⁷⁵

5.3 Steps in the Panel Proceedings

The following flow-chart indicates the major steps in the panel's proceedings:



5.3.1 Organizational Panel Meeting

Article 12.3 DSU

Shortly after its composition, a panel will call a “organizational” meeting with the parties to consult with them on the timetable for the panel process and the working procedures. Subsequently, the panel will fix the timetable, and adopt, where necessary, *ad hoc* working procedures. Whenever possible, this should be done within one week after the panel is composed. As already mentioned,

⁷⁴ See e.g., United States - The Cuban Liberty and Democratic Solidarity Act (*Helms-Burton Act*), complaint by the European Communities, WT/DS38; and European Communities - Measures Affecting Butter Products, complaint by New Zealand, WT/DS72.

⁷⁵ See for more detail, Chapter xx of this Handbook.

Article 12.4 DSU

the Working Procedures set out in Appendix 3 of the DSU provide for a proposed timetable for panel work. In determining the timetable for the panel process, the panel shall provide sufficient time for the parties to the dispute to prepare their submissions. The DSU explicitly stipulates that in examining a complaint against a developing country Member, the panel shall accord sufficient time for the developing country Member to prepare and present its argumentation.⁷⁶

Article 12.10 DSU**Article 9.2 DSU**

When a single panel examines complaints of multiple complainants, the panel must organize its examination 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.

5.3.2 Written Submissions and Substantive Panel Meetings

Article 12.5 DSU

As a rule, the parties to the dispute make two written submissions to the panel and the panel meets twice with the parties on the substance of this dispute. Exceptionally, panels convene additional meetings with the parties. The timetable for the panel process will set out precisely when the written submissions are due and when the panel meetings will take place. The parties are bound to respect the deadlines for their written submissions.

**DSU Appendix 3,
para. 12**

Generally, parties will be required to file within five to nine weeks from the composition of the panel, their first written submissions. Usually the complainant makes its first submission in advance of the respondent's first submission. In their first written submissions, the parties present the facts of the case and their arguments.

para. 4**para. 12**

After the filing of these first submissions of the parties, the panel holds, generally within one to two weeks of the filing of the written submission of the respondent, a first "substantive" (as opposed to "organizational") meeting with the parties. At this meeting, the panel asks the complainant to present its case. At the same meeting, the respondent is asked to present its own point of view. Third parties are invited to present their views during a special session of the first substantive meeting set aside for this purpose. As discussed above, the panel always meets with the parties in closed session.⁷⁷ Panel meetings are not open to the general public.

para. 5**para. 6****para. 2****para. 12**

Within two to three weeks of the first substantive meeting, the parties file simultaneously their rebuttal submissions. These submissions, in which each party replies to the arguments and evidence submitted by the other parties, are submitted simultaneously. However, it is not uncommon for novel arguments to be made in these submissions.⁷⁸

Article 12.6 DSU**DSU Appendix 3,
para. 12**

Generally, one to two weeks after the filing of the rebuttal submissions, the panel will have a second "substantive" meeting with the parties. The respondent

⁷⁶ E.g., *Panel Report, India – Quantitative Restrictions*, para. 5.10.

⁷⁷ See above, p. xx.

⁷⁸ See above, p. xx.

para. 7 shall have the right to take the floor first to be followed by the complaining party.

Article 18.1 DSU The panel may at any time put questions to the parties and ask them for explanations either in the course of a meeting or in writing. However, in the interest of due process and full transparency, the panel (or individual panelists) may not have any *ex parte* communications with any of the parties concerning matters under consideration by the panel. The panel may not meet with one of the parties without the other party or parties being present. All parties have the right to be present whenever another party presents its views to the panel. All written communications to and from the panel will always be copied, or otherwise made available, to all parties.

DSU Appendix 3, para. 10

Article 12.6 DSU Pursuant to the DSU each party to the dispute shall deposit its written submissions with the WTO Secretariat for immediate transmission to the panel and to the other party or parties. In practice, however, it is often agreed, and stipulated in the *ad hoc* working procedures for the panel, that each party shall serve its submissions directly on all other parties and confirm that it has done so at the time it provides its submission to the Secretariat.

Article 10.2 DSU As discussed above, any WTO Member having a substantial interest in a matter before a panel and having notified its interest to the DSB shall have an opportunity to be heard by the panel and to make written submissions to the panel. These third parties to the dispute are invited by the panel to present their views during a special session of the first substantive meeting and the written submissions of third parties are given to the parties to the dispute. These submissions are also reflected in, or attached to, the panel report. Third parties only receive the first written submissions of the parties. Overall, the rights of third parties are very limited. In some cases, however, third parties have sought and obtained expanded third-party rights. In *EC – Bananas III*, for example, third party developing country Members that had a major interest in the outcome of this case, were allowed to attend all of the first and the second substantive meetings of the panel with the parties as well as make statements at both meetings.

The panel may request parties to provide the Secretariat with an executive summary of the claims and arguments contained in their written submissions. These summaries shall only serve the purpose of assisting the Secretariat in drafting a concise arguments section of the panel report. Panels that opt for attaching the written submissions to the panel report have of course no need for such executive summaries.

5.3.3 Drafting of the Panel Report

Article 14.1 DSU The deliberations of panels are confidential. Panel reports are drafted without the presence of the parties to the dispute in the light of the information provided and the statements made. Generally, the panelists will meet one or more times in Geneva to discuss the subsequent drafts of the report. Officials of the WTO Secretariat assist the panelists in the drafting of the report. The extent of the

Article 14.2 DSU

involvement of the WTO Secretariat may be significant but tends to vary considerably depending on panelists.⁷⁹

The characteristics of a panel report have been discussed in detail above.⁸⁰

5.3.4 Interim Review

Article 15.1 DSU

Once the panel has completed a draft of the descriptive (i.e., the factual and arguments) sections of its report, the panel issues this draft to the parties for their comments within two weeks.⁸¹ Two to four weeks after the expiration of the time period for receipt of comments on the descriptive part, the panel subsequently issues to the parties an interim report, including both the descriptive sections and the panel's findings and conclusions. The parties are again invited to comment on the report, usually within one week. A party may submit a written request to the panel to review particular aspects of the interim report. At the request of a party, the panel may hold a further meeting with the parties on the issues identified in the written comments. Such interim review meetings are, however, rather exceptional.

Article 15.2 DSU

Article 15.3 DSU

The findings of the final panel report shall include a discussion of the arguments made at the interim review stage.

The comments made by parties at the interim review frequently give rise to corrections by the panel of technical errors or unclear drafting. However, panels have seldom changed the conclusions reached in their report in any substantive way as a result of the comments made by parties. Parties will sometimes also prefer to comment during the interim review stage only on minor factual issues, saving their legal arguments for a later appeal to the Appellate Body. This interim review is an unusual feature in judicial or quasi-judicial dispute settlement procedures. It is a clear left-over from by-gone times when trade dispute settlement was still more diplomatic in nature and the agreement of both parties was required for the panel report to become binding.

5.3.5 Issuance and Circulation of the Final Report

The final panel report is *first issued* to the parties to the dispute and some weeks *later*, once the report is available in the three working languages of the WTO, *circulated* to the general WTO Membership. Once circulated to WTO Members, the panel report is an unrestricted document available to the public. On the day of its circulation, a panel report is posted on the WTO website (www.wto.org). Panel reports are also included in the official WTO *Dispute Settlement Reports*, published by Cambridge University Press.

⁷⁹ See above, p. xx.

⁸⁰ See above, p. xx.

⁸¹ Where a panel decided to attach the written submissions of the parties to the report, the descriptive sections of its report become of course quite short.

5.3.6 *Adoption or Appeal*

Article 16.4 DSU

Within 60 days after the date of circulation of the panel report to WTO Members, the report is adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal, or the DSB decides by consensus not to adopt the report. In order to provide sufficient time for the Members to consider panel reports, the reports shall not be considered for adoption by the DSB until 20 days after they have been circulated.

Article 16.1 DSU

Since 1995 about three out of four panel reports have been appealed. During the first years of the WTO dispute settlement system the “appeals rate” was 100 per cent. In fact, all panel reports circulated before the end of March 1998 were appealed.⁸²

Article 16.4 DSU

If a panel report is appealed, it usually is not discussed in the DSB until the time the Appellate Body report is discussed. The panel report will then be adopted by the DSB, as upheld, modified or reversed by the Appellate Body. If a panel report is not appealed, the DSB will consider and adopt the report within the period between day 20 and day 60 after the circulation of the report. The DSB adopts the report by reverse consensus. The adoption is therefore quasi-automatic.

Footnote 7 DSU

The adoption of the report will be put on the agenda of DSB meeting scheduled within the period between day 20 and day 60 after the circulation of the report. If no DSB meeting is scheduled in that period, a meeting of the DSB is held specifically to consider and adopt the report. Only WTO Members, and not the WTO Secretariat, may put the adoption of a panel report on the agenda of a DSB meeting. If no Member puts the adoption of a report on the agenda, the report will not be adopted and will therefore not become legally binding. To date, this only happened once.⁸³

Article 16.3 DSU

When the DSB considers and debates the panel report, all Members, including the parties to a dispute, have the right to participate fully in the consideration of the report. Members that have objections to a panel report may give written reasons to explain their objections, which will be circulated to other Members.

Article 16.2 DSU

⁸⁴ Generally, the winning party will briefly praise the panel while the losing party will be more critical and lengthy, often repeating the legal and factual arguments submitted to, but rejected by, the panel. The views on the panel report expressed by the parties and other Members are fully recorded in the minutes of the meeting. The minutes of DSB meetings are initially restricted documents but are eventually made public.

Article 16.3 DSU

⁸² *The first panel report not appealed was the report in Japan – Measures Affecting Consumer Photographic Film and Paper (“Japan – Film”), WT/DS44/R, adopted 22 April 1998, DSR 1998:IV, 1179.*

⁸³ *Panel Report, European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 of the DSU by the European Communities (“EC – Bananas III (Article 21.5 – EC)”), WT/DS27/RW/EEC and Corr.1, 12 April 1999.*

⁸⁴ *Such circulation must take place at least 10 days prior to the DSB meeting at which the panel report will be considered.*

5.4 Test your understanding

- 1. Briefly outline, step by step, the panel proceedings.**
- 2. What is the time frame within which the panel proceedings must be concluded? Do the parties have to agree to those provisions in the Panel's detailed working procedures that deviate from Article 12 and Appendix 3 of the DSU?**
- 3. If the panel needs further information on a highly technical aspect of the challenged measure may the panel then meet with the responding party alone? Is a panelist allowed to meet with the parties without the other panelists being present?**
- 4. At what moment in time can a panel report be appealed? Is a panel report that is appealed considered by the DSB for adoption? Is such report considered for adoption after the appellate review process is concluded?**
- 5. Can the adoption of a panel report be blocked?**

6. DEVELOPING COUNTRY MEMBERS

Objectives

On completion of this section, the reader will be able to appreciate the use made by developing country Members of consultation and the panel process to date, and the special and differential treatment provisions relating to panel proceedings applicable to developing country Members.

6.1 Use of Consultations and the Panel Process

6.1.1 Use as Parties

The WTO dispute settlement system has been used intensively by the major trading powers, and, in particular, the United States and the European Communities. Developing country Members, however, have also had frequent recourse to the WTO dispute settlement system, both to challenge trade measures of major trading powers and to settle trade disputes with other developing countries.

In the following disputes, for example, developing country Members successfully challenged a trade measure of a major trading power: *US – Gasoline*, complaints by Venezuela (WT/DS2) and Brazil (WT/DS4), *US – Underwear*, complaint by Costa Rica (WT/DS24), *US – Wool Shirts and Blouses*, complaint by India (WT/DS33), and *EC – Bananas III*, complaint by Ecuador, Guatemala, Honduras, Mexico (and the United States) (WT/DS27).

In the following disputes, for example, developing countries challenged trade measures of other developing countries: *Brazil – Desiccated Coconut*, complaint by the Philippines (WT/DS22); *Egypt – Steel Rebar*, complaint by Turkey (DS211); and *Turkey – Textiles*, complaint by India (DS34).

During the first seven years of the WTO dispute settlement system (1995-2001) in over 36 per cent of all cases brought to the WTO for resolution developing countries were complainants and in 39 per cent they were respondents.⁸⁵ In 2001, developing country Members filed more requests for consultations than did developed country Members. Over two thirds of the requests for consultation filed in 2001 were filed by developing country Members. The most active users of the dispute settlement system among developing country Members are Brazil, India, Mexico, Thailand and Chile. To date, no least developed country has brought a complaint to the WTO nor has been a respondent in a WTO dispute settlement proceeding.

6.1.2 Use as Third Parties

Developing country Members have also frequently been third parties in panel

⁸⁵ See data on WTO dispute settlement at www.wto.org

proceedings. In *EC – Bananas III*, for example, Belize, Cameroon, Colombia, Costa Rica, Côte d’Ivoire, Dominica, Dominican Republic, Ghana, Grenada, Jamaica, Nicaragua, Saint Lucia, St. Vincent and the Grenadines, Senegal, Suriname and Venezuela, all participated in the panel proceedings as third parties. As already noted, these countries actually were granted extended third party rights in that they were entitled to attend all of the two substantive meetings with the panel and were allowed to make statements at these meetings.

Participation in the panel process as a third party may be a useful learning experience for developing country Members that have little expertise regarding the dispute settlement system.

6.2 Special Rules for Developing Country Members

The DSU recognises the special situation of developing and least-developed country Members. There are a number of DSU provisions that provide for special and differential treatment for developing country Members in the consultation and panel processes. Special rules for developing country Members in respect of consultations and the panel process are found in Articles 3.12, 4.10, 8.10, 12.10 and 12.11 of the DSU. Article 24 of the DSU provides for further special rules for the least developed among the developing country Members. Many of these provisions have already been referred to and discussed above and will only be addressed briefly in this section.⁸⁶

6.2.1 Developing Country Members

Article 3.12 DSU

1966 Decision

Article 3.12 of the DSU allows a developing country Member that brings a complaint against a developed country Member to invoke the provisions of the Decision of 5 April 1966 of the GATT Contracting Parties.⁸⁷ These provisions may be invoked as an “alternative” to the provisions contained in Articles 4, 5, 6 and 12 of the DSU. The 1966 Decision provides, first, that where consultations between the parties have failed, the Director General may, *ex officio*, use at the request of the developing country party to the dispute, his good offices and conduct consultations with a view to facilitating a solution to the dispute. Under the GATT 1947, developing country Members made use five times of the Director General’s good offices under the 1966 Decision. Second, if these consultations conducted by the Director-General do not result in a mutually satisfactory solution within a period of two months, the Director-General will, at the request of one of the parties, submit a report on the action undertaken by him to the DSB⁸⁸. The DSB will then forthwith appoint a panel in consultation with, and with the approval of, the parties. Third, the panel must take due account of all the circumstances and considerations relating to the application of the measures complained of, and their impact on the trade and economic development of the affected Members. Finally, the panel must submit its report to the DSB within a period of 60 days

⁸⁶ See above, p. xx, xx and xx.

⁸⁷ Decision of 5 April 1966 on Procedures under Article XXIII, BISD 14S/18.

⁸⁸ The 1966 Decision referred to the Contracting Parties and the GATT Council.

from the date the dispute was referred to it. However, the DSU provides that where the panel considers that this 60-day time frame is insufficient to provide its report, that time frame may, with the agreement of the complaining party, be extended. To the extent that there is a difference between the rules and procedures of Articles 4, 5, 6 and 12 and the corresponding rules and procedures of the Decision, the latter prevail.

Article 3.12 DSU

To date no developing country has invoked the provisions of the 1966 Decision. The reason for this lack of enthusiasm for the provisions of the 1966 Decision is undoubtedly that the DSU provisions afford developing country complaining parties treatment at least as favourable, if not more favourable, than the treatment afforded by the 1966 Decision.

Article 4.10 DSU

With regard to consultations with a view to reach a mutually acceptable solution, Article 4.10 of the DSU provides that during consultations WTO Members should give special attention to the particular problems and interests of developing country Members. Article 12.10 of the DSU adds to this that in consultations on a measure taken by a developing country Member, the parties to the dispute may agree to extend the 60-day time frame for consultations. If the parties cannot agree on such extension, the Chairman of the DSB shall decide, after consultation with the parties, whether to extend the relevant period and, if so, for how long.

Article 12.10 DSU

Article 8.10 DSU

With regard to the composition of panels, Article 8.10 of the DSU provides that in a dispute between a developed and a developing country Member, the panel must, if the developing country Member so requests, contain at least one panelist from a developing country. In the vast majority of disputes involving developing countries, nationals from developing country Members have served on the panel.⁸⁹

Article 12.10 DSU

With regard to the panel process, Article 12.10 of the DSU provides that in a dispute concerning a measure of a developing country Member, the panel shall accord sufficient time for a developing country Member to prepare and present its arguments. In *India – Quantitative Restrictions*, India requested from the Panel additional time in order to prepare its first written submission. Referring to the DSU's strict time frame for the panel process, the United States objected to this request. The Panel ruled as follows:

The Panel has carefully reviewed the arguments of the parties. The Panel notes that India could have raised several of the reasons mentioned in its letter during the organizational meeting held on 27 February 1998. However, pursuant to Article 12.10 of the DSU, "in examining a complaint against a developing country Member, the panel shall accord sufficient time for the developing country Member to prepare and present its argumentation." In light of this provision, and considering the administrative reorganization taking place in India as a result of the recent change in government, the Panel has decided to grant an additional period of time to India to prepare its submission.

⁸⁹ See above, p. xx.

However, bearing in mind also the need to respect the time frames of the DSU and in light of the difficulties of rescheduling the meeting of 7 and 8 May, the Panel considers that an additional period of ten days would represent “sufficient time” within the meaning of Article 12.10 of the DSU. India is therefore granted until 1 May 1998 (5 p.m.) to submit its first written submission to the Panel. The original date of the first meeting remains unchanged as 7 and 8 May.⁹⁰

Article 12.11 DSU

With regard to the panel report, Article 12.11 of the DSU provides that where one or more of the parties is a developing country Member, the report of the panel must explicitly indicate the form in which account has been taken of relevant WTO provisions on differential and more-favourable treatment for developing country Members which have been raised by the developing country Member in the course of the dispute settlement procedures.⁹¹

Article 27.2 DSU

As discussed in more detail in Module 3.1, “The World Trade Organization and its Dispute Settlement System”, the WTO Secretariat must make available a qualified legal expert to any developing country Member which so requests. This expert must, however, assist the developing country Member in a manner ensuring the continued impartiality of the Secretariat. The expert, therefore, can only be involved in pre-litigation phase of a dispute. Of much more use to developing countries during the consultation and panel processes will be the Advisory Centre on WTO Law, also discussed in detail in Module 3.1.

6.2.2 Least Developed Country Members

Article 24.1 DSU

With regard to the least developed countries, Article 24.1 of the DSU provides that particular consideration must be given at all stages of dispute settlement procedures and, therefore, also during the consultations and panel process, to the special situation of least developed countries. WTO Members are required to exercise due restraint in initiating dispute settlement proceedings against least developed countries. As noted above, to date no dispute settlement proceedings have been initiated against any least developed country Member.

Article 24.2 DSU

Also with regard to the least developed countries, Article 24.2 of the DSU provides, as already discussed above, that in a case in which consultations fail to result in a mutually agreed solution, the Director-General or the Chairman of the DSB must, at the request of the least developed countries involved, offer their good offices, conciliation and mediation to help the parties to the dispute to reach a mutually agreed solution.⁹²

6.2.3 Hortatory Provisions?

For the most part, the special and differential treatment provisions have not been much used to date, except for the right of developing country parties to

⁹⁰ *Ruling of the Panel, dated 15 April 1998, as reported in the Panel Report, para. 5.10.*

⁹¹ *See above, p. xx.*

⁹² *See above, p. xx.*

request that one member of a panel be from a developing country. Developing country Members have argued that there was no certainty that special and differential treatment would in fact be accorded to them under many of these provisions because they were considered to be hortatory only.

6.3 Test your understanding

- 1. What is the significance of the Decision of 5 April 1966 on Procedures under Article XXIII for WTO dispute settlement?**
- 2. Are developing country Members entitled under the DSU to extra time to prepare submissions and panel meetings?**
- 3. Are there any special rules for the least-developed country Members?**

7. CASE STUDIES

1. To protect its ailing steel industry from import competition, the Kingdom of Richland, a WTO Member, imposed a quota on imports of steel from the Republic of Newland, a developing country WTO Member. The Government of Newland decides to challenge the WTO consistency of this quota and, since it is important to act quickly, intends to put its request for the establishment of a panel on the agenda of the next meeting of the DSB. Does Newland act in accordance with the DSU by immediately requesting the establishment of a panel? If not, could the DSB refuse to establish the panel?
2. Richland's Permanent Representative to the WTO received instructions from his Government to block or, if that is impossible, to delay as much as possible, the establishment and composition of a panel. What can the Permanent Representative of Richland do? The Permanent Representative of Newland, on the contrary, received instructions not to accept any delay in the process of establishing and composing the panel. Her Government insists that the panel include five members of whom at least one is a national of Newland and two are nationals of other developing country Members. Among the five panelists, it wants two economists specialized in the economic development of developing countries. None of the panelists should be a former or current Geneva diplomat or a former or current official of the WTO Secretariat. The instructions of the Government of Newland are not to agree to a panel the composition of which does not meet these "requirements". What can the Permanent Representative of Newland do?
3. Five weeks after the Panel has started its work and shortly before it is to receive the first written submissions of Newland, the lawyers of Richland discover that the spouse of one of the panelists has shares in a holding company that has invested in a steel company established in Newland. They also discover that a few years ago another panelist had written a scholarly article on one of the legal questions at issue in this dispute. What steps, if any, can Richland undertake?
4. In its first written submission, Newland requests the Panel to examine not only the quotas on steel but also quotas on cement that were recently introduced by Richland. Newland also wants the Panel to find that the quotas on steel are not only in breach of Article XIX of the GATT 1994 and the *Agreement on Safeguards* (as it had stated in its panel request) but also in violation of the *Agreement on Import Licensing Procedures*. Finally, Newland calls upon the Panel to examine *de novo* whether the imports of steel from Newland did indeed cause or threaten to cause serious injury to the domestic steel industry of Richland. On the contrary, Richland wants the Panel to rule only on the consistency of the quota with the *Agreement on Import Licensing Procedures*. How should the Panel react to these demands by Newland and Richland?

5. *FerMetal*, the largest steel producer in Richland, *NASP*, the National Association of Steel Producers of Richland and *Fair Deal*, a non-governmental organization that focuses on the problems of developing countries, have all sent to the Chairman of the Panel an *amicus curiae* brief. The brief of *NASP* had been published in the *Financial Times* and the *Wall Street Journal* a week earlier and had received a lot of attention. What should the Panel do with these briefs?
6. Newland argues in its first written submission that the Panel should interpret the provisions of the *Safeguard Agreement* in the light of the object and purpose of the *WTO Agreement* and in the light of the alleged intention of the negotiators to limit the use of safeguard measures. After the second substantive meeting with the Panel, Newland submits to the Panel a 100-page document on the Uruguay Round negotiations, which it claims supports its position. The Panel would like to get the advice of a number of eminent international trade law scholars and of former Uruguay Round negotiators on this issue. What can the Panel do?
7. Newland argues before the Panel that since the introduction of quotas is inconsistent with the basic prohibition of quantitative restrictions set out in Article XI of the GATT 1994 and that Article XIX of the GATT 1994 therefore constitutes an exception to a basic prohibition, the burden is on Richland to demonstrate that it has acted consistently with its obligations under Article XIX of the GATT 1994. On whom does the burden of proof rest in this dispute?
8. At the request of Newland, the Panel provides in its Working Procedures that Newland, in recognition of its status of developing country Member, may bring new claims until the first substantive meeting with the Panel. The Panel also decides that, in view of the complexity of the matter, the time frame for the panel process will be 20 months from the date of the composition of the Panel. Richland challenges the first decision, Newland the second. Should the Panel revoke one or both of these decisions?
9. The Permanent Representative of Newland received instructions from her Government to use to the fullest all special and differential treatment provisions relating to consultations and the panel process. What can she hope for? Would the situation be different if Newland were the responding party? Will the use of the special and differential treatment provisions substantially change the panel process? Is there need and/or justification for special and differential treatment for developing country Members that would substantially change the panel process in their “favour”?

8. FURTHER READING

8.1 Articles

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- Appellate Body Report, *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items* (“*Argentina – Textiles and Apparel*”), WT/DS56/AB/R and Corr.1, adopted 22 April 1998, DSR 1998:III, 1003.
- Appellate Body Report, *Australia – Measures Affecting Importation of Salmon* (“*Australia – Salmon*”), WT/DS18/AB/R, adopted 6 November 1998.

- Appellate Body Report, *Brazil – Export Financing Programme for Aircraft* (“*Brazil – Aircraft*”), WT/DS46/AB/R, adopted 20 August 1999.
- Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut* (“*Brazil – Desiccated Coconut*”), WT/DS22/AB/R, adopted 20 March 1997, DSR 1997:I, 167.
- Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft* (“*Canada – Aircraft*”), WT/DS70/AB/R, adopted 20 August 1999.
- Appellate Body Report, *Chile – Taxes on Alcoholic Beverages* (“*Chile – Alcoholic Beverages*”), WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000.
- Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R.
- Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (“*EC – Asbestos*”), WT/DS135/AB/R, adopted 5 April 2001.
- Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas* (“*EC – Bananas III*”), WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591.
- Appellate Body Report, *European Communities – Customs Classification of Certain Computer Equipment* (“*EC – Computer Equipment*”), WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998.
- Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* (“*EC – Hormones*”), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135.
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- Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* (“*India – Patents (US)*”), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9.
- Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* (“*India – Quantitative Restrictions*”), WT/DS90/AB/R, adopted 22 September 1999.
- Appellate Body Report, *Japan – Measures Affecting Agricultural Products* (“*Japan – Agricultural Products II*”), WT/DS76/AB/R, adopted 19 March 1999.
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8.3 Panel Reports

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- Panel Report, *Brazil – Export Financing Programme for Aircraft* (“Brazil – Aircraft”), WT/DS46/R, adopted 20 August 1999, as

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- Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* (“*Canada – Aircraft*”), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, WT/DS70/AB/R.
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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.3 APPELLATE REVIEW



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

Module 3.2 in this Course deals with the panel process of the WTO dispute settlement system, i.e., the process of adjudication of international trade disputes by the WTO panels. This Module deals with the process of appellate review of the reports of those panels by the Appellate Body of the WTO.

The first Section of this Module concerns the establishment and composition of the Appellate Body, the appointment of the Members and the requirements concerning professional qualifications, nationality, availability and impartiality and independence. It also deals with the institutional structure of the Appellate Body, i.e., its divisions and their composition, its chairperson and its Secretariat. The second Section addresses the central issue of the scope of appellate review in WTO dispute settlement. It covers who may appeal, what can be appealed and what the mandate of the Appellate Body is. The third Section deals with some key features of Appellate Body proceedings, such as the time frame for the proceedings and their confidential nature. It also addresses the controversial issue of *amicus curiae* briefs. The fourth Section describes the various steps of the Appellate Body proceedings, from the notice of appeal to the circulation of the report. Finally, the fifth Section deals with the use made by developing country Members of the appellate review process and examines whether there are any rules providing for special and differential treatment for developing country Members in this context.

1. THE APPELLATE BODY

Objectives

On completion of this section, the reader will be able:

- **to describe the composition and institutional structure of the WTO's highest judicial organ, the Appellate Body.**
- **to list the criteria which the DSB will apply in deciding on the appointment of Appellate Body Members.**
- **to enumerate the requirements of availability, independence and impartiality which Members have to meet throughout their term in office.**
- **to discuss the role of divisions of the Appellate Body in the appellate review process.**

1.1 Establishment of the Appellate Body

Article 17.1 DSU

The Appellate Body was established in February 1995 by the WTO Dispute Settlement Body (the "DSB") as a standing international tribunal to hear appeals from WTO panel reports.¹ The establishment of the Appellate Body was provided for in Article 17.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), which is an integral part of the 1994 *Marrakesh Agreement Establishing the World Trade Organization*.² The establishment of the Appellate Body, and with it the introduction of the possibility of appellate review of panel reports, is one of the main innovations to the old GATT dispute settlement system brought about by the Uruguay Round of Multilateral Trade Negotiations.³

1.2 Composition of the Appellate Body

Article 17.1 DSU

Article 17.1 of the DSU provides that the Appellate Body shall be composed of seven persons. These persons are commonly referred to as Members of the Appellate Body.

1.2.1 Appointment

The Appellate Body Members are appointed by the Dispute Settlement Body (the "DSB"), a political body in which all WTO Members are represented. The decision to appoint persons to the Appellate Body is taken by consensus among all WTO Members. Appellate Body Members are appointed for a term of four years which can be renewed once.

¹ Decision Establishing the Appellate Body, *Recommendations by the Preparatory Committee for the WTO approved by the Dispute Settlement Body on 10 February 1995, WT/DSB/1, dated 19 June 1995.*

² See Module 3.1.

³ Ibid.

1.2.2 Required Professional Qualifications

Article 17.3 DSU

With regard to the qualifications of the Members of the Appellate Body, Article 17.3 of the DSU provides:

The Appellate Body shall comprise persons of recognized authority, with demonstrated expertise in law, international trade and the subject matter of the covered agreements generally.

The DSU does not specifically state that Appellate Body Members must be trained as lawyers. They can be from any professional background as long as they have demonstrated expertise in law, international trade and/or the subject matter of the covered agreements generally. To date, most Appellate Body Members have been senior government officials, university professors, practising lawyers or senior judges before joining the Appellate Body. All but two Members thus far had a professional and academic background in law.

1.2.3 Broadly Representative of Membership in the WTO

Article 17.3 DSU

Article 17.3 of the DSU also provides that the Appellate Body membership shall be “broadly representative of membership in the WTO”. Reflecting this requirement, the first Appellate Body Members, appointed in 1995, were from Egypt, Japan, Germany, New Zealand, the Philippines, the United States and Uruguay. There have always been three or four nationals of developing country Members among the seven Members of the Appellate Body. The composition of the Appellate Body in 2002 is as follows:

Professor Georges Michel Abi-Saab, Egypt, appointed 2000.
Mr. James Bacchus, United States, appointed 1995.
Professor Luiz Baptista, Brazil, appointed 2001.
Mr. A V Ganesan, India, appointed 2000.
Mr. John Lockhart, Australia, appointed 2001.
Professor Giorgio Sacerdoti, Italy, appointed 2001.
Professor Yasuhei Taniguchi, Japan, appointed 2000.

1.2.4 Availability

Article 17.3 DSU

Article 17.3 of the DSU provides:

All persons serving on the Appellate Body shall be available at all times and on short notice, and shall stay abreast of dispute settlement activities and other relevant activities of the WTO.

The position of Member of the Appellate Body is, in theory, not a full-time

position. Appellate Body Members are remunerated on a part-time basis.⁴ They are commonly not resident in Geneva, where the WTO has its headquarters and where Appellate Body proceedings take place. Members travel from their respective countries of residence whenever they have to hear and decide an appeal. The part-time employment arrangement of Appellate Body Members reflects the expectation in 1995 on the part of WTO Members that the Appellate Body would not be that busy and that a full-time employment arrangement for its Members was, therefore, not justified. In recent years, however, the workload of the Appellate Body has been such that membership of the Appellate Body is a *de facto* full-time job. The demands of the job are such that it is very difficult, if not impossible, for Appellate Body Members to pursue other professional activities.

1.2.5 Impartiality and Independence

Article 17.3 DSU

Although candidates for positions on the Appellate Body are nominated by their respective governments, Appellate Body Members serve in an individual capacity and do not represent any WTO Member or geographical entity. Article 17.3 of the DSU requires of Appellate Body Members that they shall be unaffiliated with any government. Appellate Body Members are prohibited from accepting or seeking instructions from third sources in the exercise of their office. They are equally prohibited from accepting any employment or undertaking any professional activity that is inconsistent with their duties and responsibilities.

Article 17.3 of the DSU furthermore requires that:

Members shall not participate in the consideration of any disputes that would create a direct or indirect conflict of interest.

Rules of Conduct

Like panelists, Members of the Appellate Body are subject to the *Rules of Conduct for the Understanding on Rules and Procedures Governing the Settlement of Disputes* (the “*Rules of Conduct*”) apply to panelists.⁵ Rule II, paragraph 1 of the *Rules of Conduct* states:

Each person covered by these Rules (as defined in paragraph 1 of Section IV below and hereinafter called “covered person”) shall be independent and impartial, shall avoid direct or indirect conflicts of interest and shall respect the confidentiality of proceedings of bodies pursuant to the dispute settlement mechanism, so that through the observance of such standards of conduct the integrity and impartiality of that mechanism are preserved. These Rules shall in no way modify the rights and obligations of Members under the DSU nor the rules and procedures therein.

⁴ The remuneration of Appellate Body Members consists of a monthly retainer plus a fee for actual days worked either in their home country or in Geneva.

⁵ WT/DSB/RC/1.

To ensure compliance with these principles, an Appellate Body Member must disclose the existence or the development of any interest, relationship or matter that he/she could reasonably be expected to know and that is likely to affect, or give rise to justifiable doubts as to his/her independence or impartiality. This disclosure obligation includes information on financial, professional and other active interests as well as considered statements of public opinion and employment or family interests.

1.3 Institutional Structure of the Appellate Body

1.3.1 Divisions of the Appellate Body

Article 17.1 DSU

Article 17.1 of the DSU provides that the Appellate Body:

... shall be composed of seven persons, three of whom shall serve on any one case. Persons serving on the Appellate Body shall serve in rotation. Such rotation shall be determined in the working procedures of the Appellate Body.

Rule 6(1) WP

Rule 6(1) of the *Working Procedures for Appellate Review* (“*Working Procedures*” or “WP”) further provides:

In accordance with paragraph 1 of Article 17 of the DSU, a division consisting of three Members shall be established to hear and decide an appeal.

Rule 6(2) WP

The Appellate Body does not hear and decide appeals from panel reports *in plenum* but in divisions of three Members. With respect to the composition of divisions, Rule 6(2) of the *Working Procedures* provides that the Members constituting a division are to be selected

... on the basis of rotation, while taking into account the principles of random selection, unpredictability and opportunity for all Members to serve regardless of their national origin.

Unlike for panels, national origin therefore does not play a role in composing an Appellate Body division.

Rule 7 WP

The Members of a division select their Presiding Member.⁶ Pursuant to Rule 7(2) of the *Working Procedures*, the responsibilities of the Presiding Member shall include: (a) coordinating the overall conduct of the appeal proceeding; (b) chairing all oral hearings and meetings related to that appeal; and (c) coordinating the drafting of the appellate report.

Rules 3 and 4 WP

Decisions relating to an appeal are taken solely by the division assigned to that appeal.⁷ However, to ensure consistency and coherence in its case law,

⁶ Rule 7 of the *Working Procedures*.

and to draw on the individual and collective expertise of all seven Members, the division responsible for deciding an appeal exchanges views with the other Members on the issues raised by the appeal.⁸ This exchange of views, which usually takes up two to three days, is held before the division has come to any definitive views on the issues arising in the appeal.

Rule 3(2) WP

A division shall make every effort to take its decision on the appeal by consensus. During the course of appellate proceedings, a division will meet frequently to deliberate on the issues raised in an appeal. However, if a decision cannot be reached by consensus, the Working Procedures provide that the matter at issue shall be decided by a majority vote.⁹

Article 17.11 DSU

Members of the division may express individual opinions in the Appellate Body report but they must do so anonymously.¹⁰ To date, only once - in *EC – Asbestos* - did an Appellate Body Member express an individual opinion in an Appellate Body report.¹¹

1.3.2 Chairman of the Appellate Body

Rule 5 WP

At the beginning of each year, the Members of the Appellate Body elect one of their number to be the Chairman of the Appellate Body for the coming year. The Chairman is responsible for the overall direction of the business of the Appellate Body, including the supervision of the internal functioning of the Appellate Body.

1.3.3 Appellate Body Secretariat

Article 17.7 DSU

Article 17.7 of the DSU states:

The Appellate Body shall be provided with appropriate administrative and legal support as it requires.

The Appellate Body has its own Secretariat, which is separate and independent from the WTO Secretariat¹² and made up of lawyers and a full complement of administrative and secretarial staff. In addition, as will be seen subsequently, whenever an oral hearing is held, professional court reporters are hired to produce a full transcript of the oral hearing.¹³ The Appellate Body Secretariat has its offices in the Centre William Rappard, rue de Lausanne 154, Geneva, where also all meetings of the Appellate Body and its divisions and oral hearings in appeals are also held.

⁷ Rule 3(1) of the Working Procedures

⁸ Rule 4(3) of the Working Procedures. *Each Member shall receive all documents filed in an appeal. A Member, who has a conflict of interest, shall not take part in the exchange of views.*

⁹ Rule 3(2) of the Working Procedures.

¹⁰ Article 17.11 of the DSU.

¹¹ *Appellate Body Report, European Communities - Measures Containing Asbestos and Asbestos-Containing Products* (“EC – Asbestos”), adopted 5 April 2001, paras. 149-154.

¹² Paragraph 17 of WT/DSB/1.

¹³ Article 17.7 of the DSU.

1.4 Test Your Understanding

- 1. Which criteria does the DSB use in deciding on the appointment of Members of the Appellate Body?**
- 2. Who hears and decides a specific appeal? What is the function of the “exchange of views”?**
- 3. Does nationality play a role in the composition of a division of the Appellate Body?**

2. SCOPE OF APPELLATE REVIEW

Objectives

On completion of this section the reader will be able:

- to explain the scope of appellate review in WTO dispute settlement.
- to identify who may appeal and what can be appealed.
- to distinguish between issues of law and issues of fact and to assess when a panel's assessment of factual evidence may be subject to appellate review.
- to explain what the Appellate Body may do with a panel's legal findings and conclusions that are appealed (i.e., uphold, modify or reverse) and,
- to appraise in which circumstances the Appellate Body may decide to "complete the legal analysis" in order to resolve the dispute between the parties.

2.1 Who may appeal?

Article 17.4 DSU

Article 17.4 of the DSU provides that only parties to the dispute may appeal a panel report. Third parties which have notified the DSB of a substantial interest in the matter at the time of the establishment of the panel, cannot appeal the panel report but may participate in the appellate review process. They may make written submissions to, and be given an opportunity to be heard by, the Appellate Body.¹⁴

It is possible for the respondent, as well as the complainant, to appeal a finding of a panel. At the appellate review stage, the parties are referred to as participants. The participant that appeals a panel report is called the appellant, while the participant responding to an appeal is called the appellee. Often, both participants appeal certain aspects of the panel's findings. In this case, each participant is both an appellant and an appellee, as each has to respond to the other's appeal. Third parties that choose to participate by filing a submission are referred to as third *participants*.

2.2 What can be appealed?

2.2.1 Issues of Law and Legal Interpretations

Article 17.6 DSU

Article 17.6 of the DSU provides:

An appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel.

¹⁴ See below, Sections 4.2.4 and 4.3.2.

As the Appellate Body stated in *EC – Hormones*:

Under Article 17.6 of the DSU, appellate review is limited to appeals on questions of law covered in a panel report and legal interpretations developed by the panel. Findings of fact, as distinguished from legal interpretations or legal conclusions, by a panel are, in principle, not subject to review by the Appellate Body.¹⁵

Thus, as a general rule, the Appellate Body does not review factual findings, that is, findings on issues of fact. Appellate review is in principle limited to legal findings, that is, findings on issues of law.

2.2.2 *Distinction between Issues of Law and Issues of Fact*

Issues of Fact

The distinction between issues of law and those of fact is one that has engaged many domestic appellate courts, and it is not surprising to find that a number of Appellate Body reports refer to this issue. In some cases, the characterization of specific panel findings as findings of fact, rather than as findings of law or legal interpretations, is fairly straightforward. In *EC – Bananas III*, for example, the Appellate Body considered that the panel’s findings regarding the nationality, ownership and control of certain companies, as well as their respective market shares, were findings of fact and, therefore, were excluded from the scope of appellate review.¹⁶ In *EC – Hormones* the Appellate Body ruled that a panel’s «determination of whether or not a certain event did occur in time and space is typically a question of fact”. The Appellate Body therefore found that the panel’s findings regarding whether or not international standards had been adopted by *Codex Alimentarius* were findings of fact and, therefore, were not subject to appellate review.¹⁷

Issues of Law

However, the question of whether a finding concerns an issue of fact or one of law is not always straightforward. There are many instances when panel findings involve both issues of fact and of law. When such findings are appealed, the task of distinguishing between fact and law can be a complex exercise. Although the Appellate Body has said that this is an exercise that must be made on a case by case basis, some general guidance as to what an appellant can challenge on appeal may be found in some of the Appellate Body reports adopted to date. Thus, the Appellate Body has said that findings involving the application of a legal rule to a specific fact or a set of facts are findings of law, and fall within the scope of appellate review. In *EC – Hormones*, the Appellate Body ruled:

¹⁵ *Appellate Body Report*, EC Measures Concerning Meat and Meat Products (Hormones) (“EC – Hormones”), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135, para. 132.

¹⁶ *Appellate Body Report*, European Communities – Regime for the Importation, Sale and Distribution of Bananas (“EC – Bananas III”), WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 239.

¹⁷ *Appellate Body Report*, EC - Hormones, para. 132.

*...The consistency or inconsistency of a given fact or set of facts with the requirements of a given treaty provision is...a legal characterization issue. It is a legal question. ...*¹⁸

2.2.3 Appeal of a Panel's Assessment of Evidence

Parties have frequently appealed a panel finding on the basis that the panel failed to consider all the evidence before it, or that the panel wrongly assessed the weight to be accorded to a particular piece of evidence. The Appellate Body has been loath to entertain such appeals, stating that this issue is a factual matter which, as a general rule, falls outside the scope of appellate review. In *Korea – Alcoholic Beverages*, the Appellate Body ruled:

*The Panel's examination and weighing of the evidence submitted fall, in principle, within the scope of the Panel's discretion as the trier of facts and, accordingly, outside the scope of appellate review. . . .We cannot second-guess the Panel in appreciating either the evidentiary value of [market] studies or the consequences, if any, of alleged defects in those studies. Similarly, it is not for us to review the relative weight ascribed to [the evidence before the panel] . . .*¹⁹

Article 11 DSU

Panels thus have wide-ranging discretion to consider and weigh the facts before them. However, such discretion is not unlimited. A panel's factual determinations must be consistent with Article 11 of the DSU. Article 11 of the DSU reads in relevant part:

... [A] panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. (emphasis added)

As the Appellate Body stated in *EC – Hormones*, the issue of whether or not a panel has made an objective assessment of the facts before it, as required by Article 11 of the DSU, is a legal question which, if properly raised on appeal, would fall within the scope of appellate review.²⁰

In several appeals since, the Appellate Body has stated that it will not “interfere lightly” with the Panel’s appreciation of the evidence. It will not intervene solely because it might have reached a different factual finding from the one the panel reached. The Appellate Body ruled that it will intervene only if it was

¹⁸Ibid.

¹⁹Appellate Body Report, *Korea – Taxes on Alcoholic Beverages* (“Korea – Alcoholic Beverages”), WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, para.161.

²⁰Appellate Body Report, *EC - Hormones*, para. 132. See also *Korea – Alcoholic Beverages*, para. 162.

satisfied that the panel has exceeded the bounds of its discretion, as the trier of facts, in its appreciation of the evidence.²¹

In *EC – Hormones*, the Appellate Body stated:

Clearly, not every error in the appreciation of the evidence (although it may give rise to a question of law) may be characterized as a failure to make an objective assessment of the facts. [...] The duty to make an objective assessment of the facts is, among other things, an obligation to consider the evidence presented to a panel and to make factual findings on the basis of that evidence. The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with a panel's duty to make an objective assessment of the facts. The wilful distortion or misrepresentation of the evidence put before a panel is similarly inconsistent with an objective assessment of the facts. "Disregard" and "distortion" and "misrepresentation" of the evidence, in their ordinary signification in judicial and quasi-judicial processes, imply not simply an error of judgment in the appreciation of evidence rather an egregious error that calls into question the good faith of a panel.²²

In *US – Wheat Gluten*, the Appellate Body ruled:

We consider that the Panel's conclusion is at odds with its treatment and description of the evidence supporting that conclusion. We do not see how the Panel could conclude that the USITC Report did provide an adequate explanation of the allocation methodologies, when it is clear that the Panel itself saw such deficiencies in that Report that it placed extensive reliance on clarifications that were not contained in the USITC Report.. By reaching a conclusion regarding the USITC Report, which relied so heavily on supplementary information provided by the United States during the Panel proceedings – information not contained in the USITC Report – the Panel applied a standard of review which falls short of what is required by Article 11 of the DSU.²³

2.3 Mandate of the Appellate Body

2.3.1 Uphold, Modify or Reverse Legal Findings and Conclusions

Article 17.13 DSU

Article 17.13 of the DSU states:

²¹*Appellate Body Report, United States – Definitive Safeguard Measure on Imports of Wheat Gluten from the European Communities ("US – Wheat Gluten"), WT/DS166/AB/R, adopted 19 January 2001, para. 151. See also, e.g., in Appellate Body Report, European Communities – Trade Description of Sardines ("EC – Sardines"), WT/DS231/AB/R, adopted 23 October 2002, para. 299.*

²²*Appellate Body Report, EC – Hormones, para. 133.*

²³*Appellate Body Report, US – Wheat Gluten, paras. 161-162.*

The Appellate Body may uphold, modify or reverse the legal findings and conclusions of the panel.

When the Appellate Body agrees with both the panel's reasoning and the conclusion regarding the existence of a violation or non-violation of a provision of the covered agreements, it upholds. If the Appellate Body agrees with the conclusion but not with the reasoning leading to that conclusion, it modifies. If the Appellate Body disagrees with the conclusion regarding the existence of a violation or non-violation, it reverses.

The Appellate Body has found that not every statement made by a panel when it addresses a legal issue can necessarily be characterized as a "legal finding or conclusion" which the Appellate Body may uphold, modify or reverse. When parties have challenged comments made by panels that cannot be characterized as either a "legal finding or a conclusion", the Appellate Body has found that such comments cannot be addressed on appeal. In *US – Wool Shirts and Blouses*, the Appellate Body observed with respect to one particular "finding" of the Panel that was appealed by India that:

...this statement by the Panel is purely a descriptive and gratuitous comment providing background concerning the Panel's understanding of how the TMB functions. We do not consider this comment by the Panel to be "a legal finding or conclusion" which the Appellate Body "may uphold, modify or reverse".²⁴

Whether a statement by the panel amounts to a legal finding or conclusion which can be upheld, modified or reversed will have to be determined by the Appellate Body on a case by case basis considering the statement and the context in which it is made.

2.3.2 *Absence of Remand Authority*

Many national appellate courts, and some international tribunals, are authorized, in defined circumstances, to send a case back to a court of lower instance for reconsideration. The DSU does not, however, authorize the Appellate Body to remand a case to a panel. Rather, Article 17.13 of the DSU empowers the Appellate Body only to "uphold, modify or reverse the legal findings and conclusions of the panel".

2.3.3 *Completing the Legal Analysis*

It has often been the case that a complaining party makes several claims of violation, under multiple provisions of different covered agreements, and that

²⁴*Appellate Body Report, United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India ("US – Wool Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, DSR 1997:I, 323 at 338.*

the panel finds a violation in respect of one or some of these provisions. A panel may decide, for reasons of judicial economy, not to make further findings of violation. Thus, in these circumstances, if the Appellate Body reverses the panel's finding or findings of violation, the question arises: how is the Appellate Body to resolve the dispute? The clearly obvious solution would be for the Appellate Body to send the case back to the panel, and request that it examine the claims of violation that it did not address.

However, as has been clarified, this is not possible: the Appellate Body does not have remand authority. Thus, in the absence of a remand power, the Appellate Body is left with two options: to either leave the dispute unresolved, or go on to complete the legal analysis. In *Australia – Salmon* the Appellate Body noted:

*In certain appeals, when we reverse a panel's finding on a legal issue, we may examine and decide an issue that was not specifically addressed by the panel, in order to complete the legal analysis and resolve the dispute between the parties.*²⁵

In this and a number of other cases, the Appellate Body has thus “completed the legal analysis” to avoid that the dispute between the parties would remain unresolved. However, the Appellate Body has only done so in cases in which there were sufficient factual findings in the panel report or undisputed facts in the panel record to enable it to carry out the legal analysis.²⁶ In the absence of sufficient factual findings or undisputed facts, the Appellate Body declined to complete the legal analysis. The Appellate Body has also declined to complete the analysis in circumstances where a legal analysis to be completed concerned a “novel issue”. In *EC – Asbestos*, the Appellate Body found:

*The need for sufficient facts is not the only limit on our ability to complete the legal analysis in any given case. In this appeal, Canada's outstanding claims were made under Articles 2.1, 2.2, 2.4 and 2.8 of the TBT Agreement. [...] As the Panel decided not to examine Canada's four claims under the TBT Agreement, it made no findings, at all, regarding any of these claims. Moreover, the meaning of the different obligations in the TBT Agreement has not previously been the subject of any interpretation or application by either panels or the Appellate Body. Similarly, the provisions of the Tokyo Round Agreement on Technical Barriers to Trade, which preceded the TBT Agreement and which contained obligations similar to those in the TBT Agreement, were also never the subject of even a single ruling by a panel. In light of their novel character, we consider that Canada's claims under the TBT Agreement have not been explored before us in depth. As the Panel did not address these claims, there are no “issues of law” or “legal interpretations” regarding them to be analyzed by the parties, and reviewed by us under Article 17.6 of the DSU. We also observe that the sufficiency of the facts on the record depends on the reach of the provisions of the TBT Agreement claimed to apply – a reach that has yet to be determined.*²⁷

2.4 Test Your Understanding

1. **May a third party to a dispute that is directly affected by the findings of a panel, appeal these findings to the Appellate Body?**
2. **Give some examples of findings of fact and findings of law, illustrating the difference between both types of findings. Is a finding in which a panel applies a legal rule to a specific set of facts subject to appellate review?**
3. **Can a factual finding ever be subject to appellate review?**
4. **When and why does the question arise whether the Appellate Body should “complete the legal analysis”? When will the Appellate Body decline to “complete the legal analysis”?**

²⁵ *Appellate Body Report, Australia – Measures Affecting Importation of Salmon* (“Australia – Salmon”), *WT/DS18/AB/R*, adopted 6 November 1998, para. 117.

²⁶ *Ibid.*, para. 187.

²⁷ *Appellate Body Report, EC - Asbestos*, paras 79-83.

3. GENERAL FEATURES OF APPELLATE BODY PROCEEDINGS

Objectives

On completion of this section, the reader will be able:

- to discuss the general features of the proceedings before the Appellate Body and, in particular, the time frame for and the confidential nature of these proceedings.
- to assess the controversial issue of the acceptance and consideration by the Appellate Body of *amicus curiae* briefs.

3.1 Working Procedures for Appellate Review

Article 17.9 DSU

The proceedings before the Appellate Body are governed by the rules set out in the DSU, and in particular, Article 17 thereof, and in the *Working Procedures for Appellate Review* (“*Working Procedures*” or “*WP*”). Unlike panels, the Appellate Body has detailed standard working procedures. These *Working Procedures* were, pursuant to Article 17.9 of the DSU, developed by the Appellate Body in consultation with the Chairman of the DSB and the Director-General of the WTO. The Appellate Body adopted its *Working Procedures* in February 1996, and amended them in February 1997, January 2002 and September 2002.²⁸ This latest amendment took effect on 27 September 2002 on a provisional basis, awaiting a final decision on amendment of the *Working Procedures* to be adopted in early 2003. The *Rules of Conduct*, already referred to above, are incorporated into the *Working Procedures*, and are attached as Annex 2 to the *Working Procedures*.

Rule 16(1) WP

Of particular interest in this context is Rule 16(1) of the *Working Procedures* which allows under certain circumstances an Appellate Body division to adopt appropriate procedures for a specific appeal. Rule 16(1) provides:

In the interests of fairness and orderly procedure in the conduct of an appeal, where a procedural question arises that is not covered by these Rules, a division may adopt an appropriate procedure for the purposes of that appeal only, provided that it is not inconsistent with the DSU, the other covered agreements and these Rules. Where such a procedure is adopted, the Division shall immediately notify the participants and third participants in the appeal as well as the other Members of the Appellate Body.

3.2 Time Frame for Appellate Body Proceedings

3.2.1 Overall Time Frame

The Appellate Body operates under very strict time frames. Pursuant to Article 17.5 of the DSU, appellate review proceedings shall, as a general rule, not exceed 60 days from the date of the filing of a notice of appeal to the date of

²⁸ *WT/AB/WP/4*, dated 24 January 2002 and *WT/AB/WP/5*, dated 19 December 2002, Annex B (for the September 2002 amendment)

the circulation of the Appellate Body report. Article 17.5 provides, furthermore, that when the Appellate Body considers that it cannot complete the appellate review proceedings and circulate its report within 60 days, it is required to inform the DSB of the reasons for the delay and give an estimate of the period within which it will circulate its report. Pursuant to Article 17.5, “in no case shall the proceedings exceed 90 days”. In most appeals thus far, the Appellate Body has circulated its report on day 90 of the appellate review process. In a few cases, in which exceptional circumstances were present, the Appellate Body has, with the agreement of the parties, circulated its reports after day 90.²⁹

3.2.2 Detailed Timetable for Appeals

Annex I WP

To ensure the smooth functioning of the appellate review process within the strict time frames mandated by the DSU, the Working *Procedures* set out time limits for the filing of the submissions. Consequently, the appellant’s submission must be filed within 10 days, the other appellant’s submission(s) within 15 days and the appellee’s and third participant’s submission(s) within 25 days from the date of the notice of appeal.³⁰ The oral hearing is usually held between days 30 and 45 of an appellate proceeding although occasionally, it has been held later.³¹

Timetable for Appeals

<i>Action</i>	<i>Day</i>
<i>Notice of Appeal</i>	0
<i>Appellant’s Submission</i>	10
<i>Other Appellant(s) Submission(s)</i>	15
<i>Appellee(s) Submission(s)</i>	25
<i>Third Participant(s) Submission(s)</i>	25
<i>Oral Hearing</i>	30
<i>Circulation of Appellate Body Report</i>	60 - 90
<i>DSB Meeting for Adoption</i>	90 – 120

Rule 16(2) WP

Pursuant to Rule 16(2) of the Working *Procedures*, a party or a third party to the dispute may, in *exceptional circumstances*, where strict adherence to a time period set out in the Working *Procedures* would result in a manifest

²⁹ E.g., *Appellate Body Report, EC – Hormones and Appellate Body Report, EC – Asbestos*.

³⁰ Rules 21-24 of the Working *Procedures*.

³¹ Rule 27 of the Working *Procedures*. As set out in Rule 31 of the Working *Procedures*, a different, and “accelerated”, timetable applies in appeals relating to prohibited subsidies under Part II of the Agreement on Subsidies and Countervailing Measures. Article 4.9 of that Agreement states that appellate review proceedings involving such prohibited subsidies shall “in no case ...exceed 60 days”.

unfairness, request the division hearing the appeal to modify a time period set out in the *Working Procedures* for the filing of documents or the date set out in the working schedule for the oral hearing.

Thus far, there have been few cases in which the division hearing the appeal has modified a date set out in the working schedule at the request of a party or a third party. In *EC – Bananas III*, the five complainants, all but one developing country Members, jointly requested a two-day extension of time to file appellee’s submissions, as they believed that strict adherence to the deadline set out in the *Working Procedures* would result in “manifest unfairness”. They argued that extra time was needed to absorb and respond to what they termed the “extraordinarily” lengthy submission of the European Communities. The division hearing the appeal decided to grant this request for the extension despite the objection of the European Communities. In doing so, it noted:

*The Division would like to take this opportunity to stress that the time limits provided for in the Working Procedures are established for the benefit of all parties and third participants involved in an appeal. All participants have a mutual interest in seeing these time limits respected. However, in view of the complexity and the number of issues raised in this particular appeal, as well as the large number of parties and third parties involved, an extension of the time limits is justified to allow the appellees and the third parties best to coordinate and articulate their positions.*³²

3.3 Confidentiality of Appellate Body Proceedings

3.3.1 Scope of Confidentiality Obligations

Article 17.10 DSU

Article 17.10 of the DSU provides:

The proceedings of the Appellate Body shall be confidential. The reports of the Appellate Body shall be drafted without the presence of the parties to the dispute and in the light of the information provided and the statements made.

Article 18.2 DSU

Article 18.2 of the DSU also contains rules protecting the confidentiality of written submissions and information submitted to the Appellate Body:

Written submissions to the panel or the Appellate Body shall be treated as confidential, but shall be made available to the parties to the dispute. Nothing in this Understanding shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential. A party to a dispute shall also, upon request of a Member, provide a non-confidential summary of the information contained in its written submissions that could be disclosed to the public.

³² Decision communicated in a letter from the Presiding Member of the division to the participants and third participants, dated 4 July 1997.

In *Canada – Aircraft*, the Appellate Body ruled:

With respect to appellate proceedings, in particular, the provisions of the DSU impose an obligation of confidentiality which applies to WTO Members generally as well as to Appellate Body Members and staff. In this respect, Article 17.10 of the DSU states, without qualification, that “[t]he proceedings of the Appellate Body shall be confidential.” [...] The word “proceeding” has been defined as follows:

In a general sense, the form and manner of conducting juridical business before a court or judicial officer. Regular and orderly progress in form of law, including all possible steps in an action from its commencement to the execution of judgment.

More broadly, the word “proceedings” has been defined as “the business transacted by a court”. In its ordinary meaning, we take “proceedings” to include, in an appellate proceeding, any written submissions, legal memoranda, written responses to questions, and oral statements by the participants and the third participants; the conduct of the oral hearing before the Appellate Body, including any transcripts or tapes of that hearing; and the deliberations, the exchange of views and internal workings of the Appellate Body.³³

In *Thailand – H-Beams*, allegations of breach of the confidentiality obligations in the DSU arose as a result of references made in an *amicus curiae* brief submitted to the Appellate Body by an industry association. Thailand alleged that this *amicus curiae* brief made direct, and accurate, references to its appellant’s submission, which was a confidential document in the appellate proceedings. In order to clarify whether or not a breach of the confidentiality obligations in the DSU had occurred, Thailand requested that the Appellate Body make inquiries, to determine how the references to its appellant’s submission came to be made in the *amicus curiae* brief. The Appellate Body addressed questions to the participants and the third participants. It reported later that it was satisfied with the responses it had received, and that, in view of the actions taken by Poland, there was no need to take further action. Poland terminated the relationship with the law firm which was thought to be at the origin of the breach of the confidentiality obligations in the DSU. The Appellate Body emphasized that the confidentiality obligations were to be taken seriously and noted:

The terms of Article 17.10 of the DSU are clear and unequivocal: “[t]he proceedings of the Appellate Body shall be confidential”. Like all obligations under the DSU, this is an obligation that all Members of the WTO, as well as the Appellate Body and its staff, must respect. WTO Members who are participants and third participants in an appeal are fully responsible under the DSU and the other covered agreements for any acts of their officials as well as their representatives, counsel or consultants.³⁴

³³ *Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft (“Canada – Aircraft”), WT/DS70/AB/R, adopted 20 August 1999, para. 143.*

³⁴ *Appellate Body Report, Thailand - Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland (“Thailand – H-Beams”), WT/DS122/AB/R, adopted 5 April 2001, para. 74.*

3.3.2 *Protection of Business Confidential Information*

Trade disputes will often involve the submission to panels and the Appellate Body of sensitive business information. The issue of the protection of business confidential information arose in the *Brazil – Aircraft* and *Canada – Aircraft* disputes. In these disputes, the panels adopted, after consultation with the parties, additional procedures for the protection of information that the parties to these disputes considered to be business confidential information. In the appeal in that dispute, Canada and Brazil requested the Appellate Body to apply, *mutatis mutandis*, the special procedures adopted by the panel to protect business confidential information. The Appellate Body declined to adopt the special procedures adopted by the panel, on the grounds that the existing rules were sufficient to protect the confidentiality of business information. In *Canada – Aircraft*, the Appellate Body stated:

In our view, the provisions of Articles 17.10 and 18.2 apply to all Members of the WTO, and oblige them to maintain the confidentiality of any submissions or information submitted, or received, in an Appellate Body proceeding. Moreover, those provisions oblige Members to ensure that such confidentiality is fully respected by any person that a Member selects to act as its representative, counsel or consultant. [...]

Finally, we wish to recall that Members of the Appellate Body and its staff are covered by Article VII:1 of the Rules of Conduct, which provides:

Each covered person shall at all times maintain the confidentiality of dispute settlement deliberations and proceedings together with any information identified by a party as confidential. (emphasis added)³⁵

3.4 *Amicus Curiae Briefs*

One of the most contentious issues among WTO Members with respect to WTO dispute settlement is the issue of *amicus curiae* (friend of the court) briefs submitted to panels or to the Appellate Body by non-governmental organizations or other entities that are not a party to the dispute. As the Appellate Body has observed “neither the DSU nor the Working Procedures specifically address this issue”.

3.4.1 *Amicus Curiae Briefs Attached to a Participant’s Submission*

The question of whether the Appellate Body could accept and consider unsolicited *amicus curiae* briefs first arose in the appeal in *US – Shrimp*. In that case, the United States appended to its appellant’s submission three exhibits containing *amicus curiae* briefs. The appellees, India, Pakistan, Malaysia and Thailand objected to these briefs and requested that the Appellate Body not consider them. The Appellate Body dismissed the appellees’ objection as follows:

³⁵ *Appellate Body Report, Canada – Aircraft, paras. 145 and 146. See also Appellate Body Report, Brazil – Aircraft, paras. 123 and 124.*

We consider that the attaching of a brief or other material to the submission of either appellant or appellee, no matter how or where such material may have originated, renders that material at least prima facie an integral part of that participant's submission. . . . [A] participant filing a submission is properly regarded as assuming responsibility for the contents of that submission, including any annexes or other attachments.

We admit, therefore, the briefs attached to the appellant's submission of the United States as part of that appellant's submission. At the same time, considering that the United States has itself accepted the briefs in a tentative and qualified manner only, we focus in the succeeding sections below on the legal arguments in the main U.S. appellant's submission.³⁶

3.4.2 *Amicus Curiae Briefs Submitted Directly to the Appellate Body*

In *US – Lead and Bismuth II*, the Appellate Body for the first time addressed the question whether it could accept and consider unsolicited *amicus curiae* briefs submitted directly to it. In that case, the Appellate Body received two *amicus curiae* briefs from American steel industry associations. The European Communities, the appellee, and Brazil and Mexico, the third participants, argued that the Appellate Body does not have the authority to accept or consider *amicus curiae* briefs.

In addressing this issue the Appellate Body first emphasized that individuals and organizations have no legal *right* to file briefs, and that the Appellate Body has no obligation to consider them. The Appellate Body noted:

*We wish to emphasize that in the dispute settlement system of the WTO, the DSU envisages participation in panel or Appellate Body proceedings, as a matter of legal right, only by parties and third parties to a dispute. And, under the DSU, only Members of the WTO have a legal right to participate as parties or third parties in a particular dispute. . . . Individuals and organizations, which are not Members of the WTO, have no legal right to make submissions to or to be heard by the Appellate Body. The Appellate Body has no legal duty to accept or consider unsolicited *amicus curiae* briefs submitted by individuals or organizations, not Members of the WTO.³⁷*

Having ruled that individuals or organizations did not have a right to be heard, the Appellate Body then ruled that it had the *authority* to accept and consider any information it considered pertinent and useful in deciding an appeal. The Appellate Body stated:

³⁶*Appellate Body Report, United States – Import Prohibition of Certain Shrimp and Shrimp Products (“US – Shrimp”), WT/DS58/AB/R, adopted 6 November 1998, paras. 89 and 91.*

³⁷*Appellate Body Report, United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (“US – Lead and Bismuth II”), WT/DS138/AB/R, adopted 7 June 2000, paras. 40-41.*

....[Article 17.9 of the DSU] makes clear that the Appellate Body has broad authority to adopt procedural rules which do not conflict with any rules and procedures in the DSU or the covered agreements.³⁸ Therefore, we are of the opinion that as long as we act consistently with the provisions of the DSU and the covered agreements, we have the legal authority to decide whether or not to accept and consider any information that we believe is pertinent and useful in an appeal.³⁹

In *US – Lead and Bismuth II*, the Appellate Body did not consider the briefs submitted to it to be pertinent and useful in the appeal, and, for that reason, did not consider them.

3.4.3 Additional Procedure to Handle Amicus Curiae Briefs

In *EC – Asbestos*, the Appellate Body recognized the possibility that it might receive a large number of *amicus curiae* briefs and was therefore of the view that the fair and orderly conduct of this appeal could be facilitated by the adoption of an appropriate additional procedure pursuant to Rule 16(1) of the *Working Procedures*, to deal with any possible *amicus curiae* briefs received. Under this Additional Procedure, adopted for the purposes of the *EC – Asbestos* appeal only, persons other than the parties and third parties wishing to file a written submission were required to apply for leave to file a submission.⁴⁰ The Additional Procedure set forth criteria that such an application should meet. The Additional Procedure also set out the criteria that written submissions for which leave to file was granted should meet.

Pursuant to the Additional Procedure, the Appellate Body received 17 applications requesting leave to file a written brief in this appeal. 11 of these applications were received within the time limits specified in the Additional Procedure. The Appellate Body carefully reviewed and considered each of these applications in accordance with the Additional Procedure and, in each case, decided to deny leave to file a written brief.⁴¹

On 22 November 2000, the WTO's General Council met to discuss this Additional Procedure. The majority of the WTO Members that spoke at that meeting expressed the view that it was not acceptable for the Appellate Body to accept and consider *amicus curiae* briefs. The Appellate Body was requested to exercise «extreme caution» in the future in dealing with this issue.

3.4.4 Amicus Curiae Briefs Submitted by WTO Members

In *EC – Sardines* the Appellate Body was recently again confronted with the question whether it may accept and consider unsolicited *amicus curiae* briefs. One brief was filed by a private individual, and the other by Morocco, a WTO

³⁹ *Appellate Body Report*, *US – Lead and Bismuth II*, para. 43.

⁴⁰ For the full text of the Additional Procedure, see *Appellate Body Report*, *EC – Asbestos*, para. 52.

⁴¹ *Appellate Body Report*, *EC – Asbestos*, paras. 55-56.

Member that did not exercise its third party rights in this dispute. Peru, the complainant in this dispute, objected to the acceptance and consideration of these briefs by the Appellate Body. With respect to the brief submitted by a private individual, the Appellate Body, after referring to its case law on this matter, ruled that it has the authority to accept and consider this brief but found that the brief did not assist it in this appeal.⁴² With respect to the brief submitted by Morocco, the Appellate Body stated:

We have been urged by the parties to this dispute not to treat Members less favourably than non-Members with regard to participation as amicus curiae. We agree. We have not. And we will not. As we have already determined that we have the authority to receive an amicus curiae brief from a private individual or an organization, a fortiori we are entitled to accept such a brief from a WTO Member, provided there is no prohibition on doing so in the DSU. We find no such prohibition.⁴³

The Appellate Body thus found that it is entitled to accept the *amicus curiae* brief submitted by Morocco, and to consider it. The Appellate Body emphasized, however, that:

*... in accepting the brief filed by Morocco in this appeal, we are not suggesting that each time a Member files such a brief we are required to accept and consider it. To the contrary, acceptance of any amicus curiae brief is a matter of discretion, which we must exercise on a case-by-case basis. We recall our statement that:
The procedural rules of WTO dispute settlement are designed to promote ... the fair, prompt and effective resolution of trade disputes.⁴⁴
Therefore, we could exercise our discretion to reject an amicus curiae brief if, by accepting it, this would interfere with the “fair, prompt and effective resolution of trade disputes.” This could arise, for example, if a WTO Member were to seek to submit an amicus curiae brief at a very late stage in the appellate proceedings, with the result that accepting the brief would impose an undue burden on other participants.⁴⁵*

3.5 Test your Understanding

- 1. Where are the rules governing Appellate Body proceedings set out? In which circumstances can a division decide to deviate from these rules?**
- 2. How long will an Appellate Body proceeding last? How do the *Rules of Procedure* help the Appellate Body to remain within the overall timeframe provided in Article 17.5 of the DSU?**

⁴² Appellate Body Report, EC – Sardines, para. 160.

⁴³ Appellate Body Report, EC – Sardines, para. 164.

⁴⁴ Footnote in the quote refers to Appellate Body Report, US – FSC, para. 166.

⁴⁵ Appellate Body Report, EC – Sardines, para. 167.

- 3. How much of an Appellate Body proceeding is confidential and to whom do the obligations of confidentiality apply? Does the Appellate Body provide for specific protection for business confidential information? Why?**
- 4. May the Appellate Body accept and consider unsolicited *amicus curiae* briefs submitted to it?**

4. STEPS IN THE APPELLATE BODY PROCEEDINGS

Objectives

On completion of this section, the reader will be able:

- to outline all steps in the Appellate Body proceedings.
- to detail how Appellate Body proceedings are initiated, how written submissions to the Appellate Body are filed, how oral hearings of the Appellate Body are conducted and how the division hearing the appeal deliberates and comes to a decision on the appeal.

4.1 Initiation of Appellate Body Proceedings

4.1.1 Notice of Appeal

Article 16.4 DSU

A panel report may be appealed at any time after it is circulated to the WTO Members, and before it is adopted by the DSB.⁴⁶ The appellate process commences with the filing by an appellant of a notice of appeal.⁴⁷ In practice, a notice of appeal is often filed the day before the DSB meeting at which the report was to be on the agenda for adoption. Simultaneously with the filing of a notice of appeal, the appellant informs the DSB of its decision to appeal.

Rule 20(1) WP

Rule 20(2) (d) WP

Rule 20(2)(d) of the *Working Procedures* stipulate that a notice of appeal must 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. The notice of appeal is filed with the Appellate Body Secretariat.

In *US - Shrimp*, the Appellate Body was called upon to determine whether the notice of appeal filed in that appeal by the United States was sufficient to meet the requirements set out in Rule 20(2)(d) of the *Working Procedures*. The appellees contended that the notice of appeal filed by the United States was vague and cursory and, therefore, was not in compliance with the requirements of Rule 20(2)(d) of the *Working Procedures*. The appellees requested that the entire appeal be dismissed on this basis. The Appellate Body rejected the request of the appellees to dismiss the appeal, and ruled that it was sufficient for the Notice of Appeal to identify adequately the findings or legal interpretations appealed. The Appellate Body held:

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



⁴⁶ Article 16.4 of the DSU.

⁴⁷ Rule 20(1) of the Working Procedures.

*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.*⁴⁸

4.1.2 Panel Record

Rule 25 WP

Pursuant to Rule 25 of the *Working Procedures*, the WTO Secretariat transmits the complete panel record to the Appellate Body Secretariat as soon as a notice of appeal is filed. The panel record includes all the written submissions made by the parties to the panel, as well as any written responses to questions, and any exhibits introduced as evidence.

4.1.3 Selection of the Division

Rule 6 WP

As soon as a notice of appeal is filed, an Appellate Body division to hear the appeal is selected through the process outlined above.⁴⁹ To avoid the possibility of conflict of interest, once a notice of appeal has been filed, each Appellate Body Member must review the factual portion of the relevant panel report and complete the disclosure form attached as Annex 3 to the *Rules of Conduct*. Once three of the Appellate Body Members have confirmed that they are on a division, the selected Members elect one of their number to be a Presiding Member for the Division. This information is then transmitted to the parties, together with a working schedule for that particular appeal.

4.1.4 Working Schedule for the Appeal

Rule 26 WP

Shortly after the commencement of the appeal, the Appellate Body Secretariat sends the parties and third parties to the dispute the working schedule for the appeal drawn up by the Division.⁵⁰ This working schedule sets out the precise dates for the filing of the submissions based on the timetable set out in the *Working Procedures*. The working schedule usually also sets out the precise date for the oral hearing.

4.1.5 Withdrawal of Appeal

Rule 30(1) WP

Rule 30(1) of the *Working Procedures* allows an appellant to withdraw its appeal at any time. Indeed, this is in line with the DSU which, in Article 3.7 unequivocally states that “[t]he aim of the dispute settlement mechanism is to secure a *positive solution* to a dispute. A solution mutually *acceptable to the parties* to a dispute and consistent with the covered agreements is clearly to be preferred.”

⁴⁸ *Appellate Body Report, US - Shrimp, para. 95.*

⁴⁹ *See above, Section 1.3.1.*

⁵⁰ *Rule 26 of the Working Procedures.*

In only a few appeals to date has Rule 30(1) been invoked. In *US – FSC*, the appellant withdrew the appeal for scheduling reasons and, a couple of weeks later, brought its appeal back to the Appellate Body.⁵¹ In *India – Measures Affecting the Automotive Sector*, India withdrew its appeal on the day before the oral hearing.⁵² On 14 March 2002, the Appellate Body received a letter from India, in which India stated that:

*Pursuant to Rule 30(1) of the Working Procedures for Appellate Review, this is to inform the Appellate Body that India is withdrawing the above-mentioned appeal; oral hearing on this is scheduled for 15 March 2002. Inconvenience caused to the Appellate Body, Secretariat, the other parties and the third participants is deeply regretted.*⁵³

As the Appellate Body stated in its very brief Report in this case, India's withdrawal of the appeal completed Appellate Body's work in this appeal.

Most recently, in *EC – Sardines*, Peru challenged the notice of appeal filed by the European Communities as insufficiently clear and specific on a number of points. In response to this challenge, the European Communities withdrew its notice of appeal, conditionally upon the right to file a new notice, and subsequently filed a new notice. Peru then challenged the right of the European Communities to withdraw a notice of appeal conditionally and to file another notice. The Appellate Body ruled:

*... we see no reason to interpret Rule 30 as granting a right to withdraw an appeal only if that withdrawal is unconditional. Rather, the correct interpretation, in our view, is that Rule 30(1) permits conditional withdrawals, unless the condition imposed undermines the "fair, prompt and effective resolution of trade disputes", or unless the Member attaching the condition is not "engag[ing] in [dispute settlement] procedures in good faith in an effort to resolve the dispute."*⁵⁴

4.2 Written Submissions

4.2.1 Appellant's Submission

Rule 21 WP

The appellant has 10 days after the notice of appeal is submitted to file its written submission.⁵⁵ This may seem like a short period of time, but one should keep in mind that the appellant was able to begin formulating its appeal as soon as it saw the panel report, an interim version of which it received

⁵¹ *Appellate Body Report*, United States – Tax Treatment for "Foreign Sales Corporations" ("US – FSC"), WT/DS108/AB/R, adopted 20 March 2000, para. 4.

⁵² *Appellate Body Report*, India – Measures Affecting the Automotive Sector, WT/DS146/AB/R, WT/DS175/AB/R, adopted 5 April 2002, para 15.

⁵³ *Ibid.*

⁵⁴ *Appellate Body Report*, EC – Sardines, para. 141.

⁵⁵ Rule 21(1) of the Working Procedures.

many months earlier.⁵⁶ The *Working Procedures* set out what an appellant’s submission is to contain.

[An appellant’s submission] shall:

(a) be dated and signed by the appellant; and

(b) set out

(i) a precise statement of the grounds for the appeal, including the specific allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel, and the legal arguments in support thereof;

(ii) a precise statement of the provisions of the covered agreements and other legal sources relied on; and

(iii) the nature of the decision or ruling sought.⁵⁷

Like *all* the documents that are filed by a party or third party to the dispute, the appellant’s submission is to be served on each of the other parties or third parties to the dispute.⁵⁸

4.2.2 Other Appellant’s Submission

Rule 23 WP

After a panel report has been appealed by one party, any other party to the dispute may subsequently also decide to appeal the panel report.⁵⁹ This is sometimes referred to as a “cross appeal”. Usually, the grounds for the appeal of this “other appellant” will differ from the grounds of appeal of the first appellant. An “other appellant” that “cross appeals” does not need to file a notice of appeal. It need only file an “other appellant’s submission”, in which it sets out in detail the grounds for its appeal. The requirements for an other appellant’s submission are substantially the same as those for an appellant’s submission.⁶⁰ A party wishing to submit an other appellant’s submission must do so within 15 days of the filing of the notice of appeal.

4.2.3 Appellee’s Submission

Rule 22 WP

The appellee then has until the 25th day after the filing of the notice of appeal, to file its own written submission.⁶¹ Where there is a “cross-appeal”, each participant will file an appellee’s submission in response to the other participant’s appellant’s submission.⁶² The *Working Procedures* set out what an appellee’s submission is to contain.

⁵⁶ See Module 3.2 of this Handbook.

⁵⁷ Rule 21(2) of the *Working Procedures*.

⁵⁸ Rule 18(2) of the *Working Procedures*.

⁵⁹ Rule 23 (1) of the *Working Procedures*.

⁶⁰ Rule 23(2) of the *Working Procedures*.

⁶¹ Rule 22(1) of the *Working Procedures*.

⁶² Rule 23(3) of the *Working Procedures*.

[An appellee's submission shall]:

(a) be dated and signed by the appellee; and

(b) set out

(i) a precise statement of the grounds for opposing the specific allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel raised in the appellant's submission, and the legal arguments in support thereof;

(ii) an acceptance of, or opposition to, each ground set out in the appellant's submission;

(iii) a precise statement of the provisions of the covered agreements and other legal sources relied on;

(iv) the nature of the decision or ruling sought.⁶³

4.2.4 Third Participant's Submission

Rule 24 WP

It is possible for third parties to participate in an appellate proceeding. Those parties who reserved their third party rights by notifying their interest to the DSB when the panel was established, may file a third participant's submission.⁶⁴ In this submission, a third party must state its intention to participate as a third participant in the appeal and must include the grounds and legal arguments in support of its position, within 25 days after the date of the filing of a notice of appeal.

4.2.5 Additional Memoranda

Rule 28 WP

The *Working Procedures* allow an Appellate Body division to request additional memoranda from any participant or third participant, and to specify the time periods by which such memoranda shall be received.⁶⁵

In a few appeals to date, divisions have requested additional memoranda on *preliminary issues* raised by a participant or a third participant before the oral hearing. This was the case, for example, in *EC – Bananas III* on the private legal counsel issue and in *US – Shrimp* on the *amicus curiae* briefs issue. Occasionally, the Appellate Body has also requested additional post-hearing memoranda to clarify issues that were not sufficiently addressed by the parties in their written submissions and at the oral hearing.

Divisions that requested additional memoranda to be submitted, have always given the other participants and third participants an opportunity to respond to these memoranda.⁶⁶ The time allowed for the filing of additional memoranda and responses thereto is always very short.

⁶³ *Rule 22(2) of the Working Procedures.*

⁶⁴ *Rule 24 of the Working Procedures.*

⁶⁵ *Rule 28(1) of the Working Procedures.*

⁶⁶ *Rule 28(2) of the Working Procedures.*

4.3 Oral Hearing

4.3.1 Conduct of the Oral Hearing

Rule 27 WP

After the written submissions are received, and approximately 30-45 days after receipt of the notice of appeal, the Appellate Body division hearing the appeal conducts an oral hearing.⁶⁷ The oral hearing is not open to the public. This hearing consists of brief opening statements by the participants and the third participants, followed by questions to the participants and the third participants from the Appellate Body Division hearing the appeal. The hearing is usually concluded by brief closing statements by the participants and the third participants. Unlike what happens in the panel process, the participants cannot ask questions of each other. The oral hearing usually lasts a full day. Occasionally, hearings can last longer. A transcript of the oral hearing, which is for the use of the Appellate Body only, is produced by a team of professional court reporters.

4.3.2 Third Party Participation in the Oral Hearing

Before the amendment of Rules 24 and 27 of the *Working Procedures*, which provisionally took effect on 27 September 2002, only third parties that had submitted a third participant's submission could participate in the oral hearing. However, over the years a practice had developed under which the Appellate Body would allow third parties that had not filed a third participant's submission to attend the oral hearing as a "passive observer".⁶⁸

Rules 24 & 27 WP

Under the currently applicable provisional rules, the rights of third parties to participate in the oral hearing have been significantly extended. Rule 24 (2) and (4) of the *Working Procedures* provide:

- (2) *A third party not filing such written submission shall, within the same period of 25 days, notify the Secretariat in writing if it intends to appear at the oral hearing, and, if so, whether it intends to make an oral statement.*
- (4) *Any third party that has neither filed a written submission in accordance with paragraph (1), nor notified the Secretariat in accordance with paragraph (2), may, at the discretion of the division hearing the appeal, make an oral statement at the oral hearing, respond to questions posed by the division, and comment on responses given by others.*

Rule 27 of the *Working Procedures* provides:

Any third participant that has filed a submission pursuant to Rule 24(1) or has notified the Secretariat pursuant to Rule 24(2) that it intends to appear at the oral hearing may appear to make oral arguments or presentations at the oral hearing.

⁶⁷Rule 27(1) of the *Working Procedures*.

⁶⁸E.g., *Appellate Body Report, Argentina – Safeguard Measure on Imports of Footwear, WT/DS121/AB/R, adopted 12 January 2000, para. 7.*

These Rules will again be amended in February 2003.

4.3.3 Representation by Private Legal Counsel

In the appeal in EC – *Bananas III*, the question arose as to whether a WTO Member could be represented by private legal counsel, who were not government employees, at the oral hearing of the Appellate Body. The Appellate Body ruled that private legal counsel could participate in proceedings before the Appellate Body as part of the delegations of the participants or the third participants. The Appellate Body noted:

*... we can find nothing in the Marrakesh Agreement Establishing the World Trade Organization. . . , the DSU or the Working Procedures, nor in customary international law or the prevailing practice of international tribunals, which prevents a WTO Member from determining the composition of its delegation in Appellate Body proceedings. ...*⁶⁹

The Appellate Body furthermore noted that such representation may well be a matter of particular significance to many developing countries, who are often lacking in technical resources, to enable them to participate fully, and successfully, in Appellate Body proceedings.⁷⁰ In recent years it has become common for private legal counsel to be part of the delegation of a participant at the oral hearing of the Appellate Body and to speak for the participant at the hearing.

4.4 Deliberations and Decisions

4.4.1 Deliberations of the Division

Throughout the appellate review process, both before and after the oral hearing, the Appellate Body division hearing the appeal meets to discuss all the participants' written submissions, and to deliberate on the issues raised in an appeal. In its deliberations before the oral hearing, the division also prepares questions to put to the participants at the oral hearing. Only Members of the division, and selected staff of the Appellate Body Secretariat, attend the deliberations, which are confidential.

4.4.2 Ex Parte Communications

Article 18.1 DSU

Participants in an appeal are prohibited from having *ex parte* communications with the Appellate Body. Article 18.1 of the DSU states:

There shall be no ex parte communications with the panel or Appellate Body concerning matters under consideration by the panel or Appellate Body.

⁶⁹ Appellate Body Report, EC – *Bananas III*, para. 10.

⁷⁰ *Ibid.*, para. 12.

This prohibition encompasses meetings by a Member or Members of a division with one participant or third participant in the absence of other participants or third participants, discussions with participants or third participants by a Member of the Division in the absence of all Members of the Division, and any discussion of the subject matter of the appeal between an Appellate Body Member not assigned to a division and the participants or third participants to an appeal.

4.4.3 Exchange of Views

Rule 4 WP

After the oral hearing and before the drafting of the report, Members of the division exchange views on all issues raised in the appeal with their colleagues who are not on the Division.⁷¹ The exchange of views puts in practice the principle of collegiality set forth in the *Working Procedures*.⁷² Rule 4(3) of the *Working Procedures* states:

In accordance with the objectives set out in paragraph 1, the division responsible for deciding each appeal shall exchange views with the other Members before the division finalizes the appellate report for circulation to the WTO Members.

The Presiding Member of the division chairs the meeting, introduces the issues arising in the appeal and informs Members of the provisional views of the Members of the division. All Appellate Body Members are then given the opportunity to contribute to the discussion on these issues. Depending, among other things, on the complexity of the issues under discussion, this exchange of views usually takes place over two days. The fact that Members of the Appellate Body exchange views does not mean that decisions are taken by all seven members: the Appellate Body does not sit in plenum, there is no “full bench” that sits to hear appeals. The Members of the division hearing the appeal are the Members who make the final decisions on the issues of law and legal reasoning appealed. Rule 4(4) of the *Working Procedures* provide:

Nothing in these Rules shall be interpreted as interfering with a division’s full authority and freedom to hear and decide an appeal assigned to it in accordance with paragraph 1 of Article 17 of the DSU.

4.4.4 Drafting, Signing and Circulation of the Report

After the exchange of views the division completes its deliberations. The Presiding Member of the division coordinates the drafting of the Appellate Body report.⁷³ The report is drafted without the presence of the participants in the appeal.⁷⁴

⁷¹By the time of the exchange of views, all Members of the Appellate Body will have received and read copies of the documents filed in an appeal.

⁷²Rule 4 of the *Working Procedures*.

⁷³Rule 7(2) of the *Working Procedures*.

⁷⁴Article 17.10 of the DSU.

On the front cover of an Appellate Body report, the title of the dispute is identified, as is the reference number with the tag AB/R. An Appellate Report consists of two main sections, colloquially referred to as the “descriptive part” and the “findings section”. The descriptive part of the report identifies the participants and third participants, as well as the Members of the division. In this section, the Appellate Body will also provide a brief history of the dispute, including details of all the procedural steps taken in the appeal. There will also be a summary of all the main arguments made by the participants and third participants. In the findings section of the report, the Appellate Body makes its detailed and reasoned findings. In the final paragraphs of the report, the Appellate Body will uphold, modify or reverse the legal findings and conclusions of the Panel, and if necessary, will make a recommendation to the DSB.

Once finalized, the report is signed by the Members of the division, and then translated into French and Spanish, the other two official languages of the WTO. As explained above, Appellate Body reports must be circulated to WTO Members in all three official languages within 90 days of the notice of appeal. An Appellate Body report is made public at the same time that it is circulated to WTO Members. It is posted on the WTO website the same day. Additionally, Appellate Body reports are reproduced in the *Dispute Settlement Reports*, the DSR, published by Cambridge University Press.

4.4.5 Adoption of the Report

Article 17.14 DSU

The Appellate Body report, along with the panel report, is put on the DSB agenda at a meeting within 30 days after circulation of the Appellate Body report.⁷⁵ Unless there is a consensus against adoption, the DSB automatically adopts both reports. The panel report is adopted as upheld, modified or reversed by the Appellate Body: it is to be read in conjunction with the Appellate Body report. Article 17.14 of the DSU provides WTO Members the right “to express their views on an Appellate Body report.” Indeed, WTO Members, and not just the participants, often take full advantage of this opportunity to comment extensively on Appellate Body reports at DSB meetings, and especially on those portions of the report which they do not agree with.

4.5 Test Your Understanding

1. Briefly describe the various steps in the Appellate Body proceedings.
2. When may a notice of appeal be filed? What are the requirements for a notice of appeal? Does an “other appellant” within the meaning of Rule 23 of the *Working Procedures* have to file a notice of appeal? Can an appeal be withdrawn and if so, when?
3. What are the requirements for an appellant’s submission and for an appellee’s submission?

⁷⁵Article 17.14 of the DSU.

- 4. How is the oral hearing in an appeal conducted? How is the exchange of views conducted?**
- 5. Can private legal counsel and WTO Members that did not reserve their third party rights participate in the oral hearing of the Appellate Body?**
- 6. When is an Appellate Body report made available to WTO Members that are not involved in the dispute? When is the report made public?**

5. DEVELOPING COUNTRY MEMBERS

Objectives

On completion of this section, the reader will be able:

- **to appraise the use made by developing country Members of the appellate review process and,**
- **to discuss the special and differential treatment provisions relating to the appellate review process applicable to developing country Members.**

5.1 Use of the Appellate Review Process

In its first eight years, the Appellate Body has considered and decided over 50 appeals. The statistics on the use of the appellate review mechanism, and the dispute settlement system more generally, suggest that both developing and developed country Members have found that the WTO dispute settlement system achieves results, and have confidence in its functioning.

Among the developing country Members, India and Brazil have been the most frequent users of the appellate review process but other developing country Members have also made use of the process.

Moreover, an important way in which developing country Members have familiarized themselves with the appellate review process is by participating as third participants. Developing country Members which have been third parties are likely to have found that their knowledge of the functioning of the dispute settlement system has been considerably enhanced by such participation. As one former Appellate Body Member has advised, developing countries should not hesitate to take up this role in appropriate conditions, because their familiarity with the inner workings of the system will stand them in good stead.⁷⁶

5.2 Special Rules for Developing Country Members

Rule 16 WP

Various provisions in the DSU require special attention to be paid to the interests and needs of developing country Members at different stages in WTO dispute settlement proceedings.⁷⁷ None of these provisions specifically concerns the Appellate Body proceedings. However, above, Rule 16(1) of the Working Procedures allows any participant to request the division hearing the appeal to adopt, in the interests of fairness and orderly procedure in the conduct of an appeal, an appropriate procedure for the purposes of that appeal.⁷⁸

⁷⁶See Lacarte-Muro, JandGappah, P, "Developing Countries and the WTO Legal and Dispute Settlement System: A View From the Bench", *Journal of International Economic Law*, 2000, 395, 397.

⁷⁷See also Articles 3.12, 4.10, 8.10, 12.10 and 12.11 of the DSU. For a more detailed discussion on special rules applicable to developing country Members in WTO dispute settlement proceedings, we refer to Modules 3.1 and 3.2.

⁷⁸ See above, Section 3.1 of this Module.

Furthermore, any participant may, pursuant to Rule 16(2), request a division to modify a time period set out in the *Working Procedures* or the date for the oral hearing if that period or date would result in “manifest unfairness”.⁷⁹ Where a developing country Member participating in Appellate Body proceedings makes a specific representation and pleads special circumstances, the division hearing the appeal will consider such request and, where appropriate, adopt a suitable procedure or adjust a time period or date. However, the Appellate Body can only act on a specific request when it has received such a request.

Thus, in *EC – Bananas III*, for instance, Jamaica, a third participant in that appeal, asked the Appellate Body, under Rule 16(2) of the *Working Procedures*, to postpone the date of the oral hearing. The Appellate Body considered but declined this request, on the grounds that it was not persuaded that there were exceptional circumstances resulting in manifest unfairness to either Jamaica or any other participant. In the same appeal, the Appellate Body, at the request of Saint Lucia, ruled that private legal counsel who were not government employees could participate in proceedings before the Appellate Body as part of the delegations of the participants or the third participants.⁸⁰ The Appellate Body noted in this respect that representation by counsel of a government’s own choice may well be a matter of particular significance – *especially for developing country Members* – to enable them to participate fully in dispute settlement proceedings.

Effective legal assistance to developing country Members in dispute settlement proceedings in general, and Appellate Body proceedings in particular, is given by the newly established, Geneva-based Advisory Centre on WTO Law. In the summer of 2001, the Advisory Centre assisted for the first time a WTO developing country Member in a dispute settlement procedure when it assisted Pakistan in the Appellate Body proceedings in *United States – Cotton Yarn*. Module 3.1 provides more information on the Advisory Centre on WTO Law and the UNCTAD project *International Lawyers for Multilateral Trade Cooperation (“ILMTC”)*. Under this project law firms and independent legal practitioners have committed themselves to provide a certain amount of free legal advice to least-developed countries on issues relating to international economic dispute settlement, including WTO dispute settlement.

⁷⁹ See above, Section 3.2.2 of this Module.

⁸⁰ Appellate Body Report, *EC – Bananas III*, para 10.

6. CASE STUDIES

1. The Panel report in the dispute *Concordia – Measures Affecting Agricultural Products*, complaint by Victoria, has been circulated. Concordia, the respondent in the proceedings before the Panel, has filed a notice of appeal with the Appellate Body. Concordia imposed certain quarantine and testing requirements upon all imported fruit. These restrictions were imposed to ensure that no fruit entering Concordia contains the anitep fly, which is known to multiply rapidly and to destroy fruit trees. Based on the scientific evidence before it, the Panel found that the anitep fly has been extinct for more than 150 years. Concordia appeals this finding. Concordia also submits that “the Panel exhibited bias in its assessment of the evidence”. Concordia is of the view that the Panel erred in failing to consider certain evidence brought forward by Concordia. In fact, Concordia is of the view that “the Panel relied on the statement of one expert, and one expert only”, and ignored all the other evidence submitted by Concordia. Moreover, Concordia believes that the Panel erred in failing to consider some of the arguments advanced by Concordia. Finally, Concordia disputes the Panel finding under Article 5.1 of the SPS *Agreement* that the quarantine and testing requirements at issue are not based on a risk assessment. Concordia believes that the Panel erred in its application of the requirements of Article 5.1 to the facts before it. The Kingdom of Victoria, the complainant, is of the view that Concordia’s appeal “is completely baseless and should not be entertained by the Appellate Body”. You are a legal officer in the Appellate Body Secretariat, and have been asked to advise the Appellate Body with respect to the admissibility of Concordia’s appeal.
2. In the same dispute, an *amicus curiae* brief has been submitted by the Action Group for the Restitution of Respectable Values (AGRRV). The Kingdom of Victoria requests the division hearing the appeal to ignore the AGRRV brief. Concordia does not object to the brief, and insists on having a preliminary oral hearing at which it can present its arguments in support of the brief. The Kingdom of Victoria opposes a preliminary hearing, and insists that it has a right to make an additional written submission on this issue. You are the Presiding Member of the Appellate Body division hearing the appeal. How would you handle this issue?
3. Meanwhile the Republic of Micronesia, a third party in the dispute before the panel, files a notice of appeal with the Appellate Body Secretariat. Further, Indigo State, which has been a WTO Member for just under six months, and did not have the opportunity to participate in the panel proceedings, decides that it would like to participate in the appellate proceedings. How should the Appellate Body division in this appeal react?
4. The Kingdom of Victoria objects to your sitting on the division on the basis that you, the Presiding Member of the division, are a national of Concordia. Moreover, it has become known to Victoria that you have a daughter who is married to the owner of Concordia’s largest fruit company. Victoria objects to

your sitting on the division hearing the appeal on this basis as well. Can you sit on this division?

5. Concordia has filed its appellant's submission. The Kingdom of Victoria, which has a policy of publishing all its submissions on the internet, decides to publish Concordia's appellant's submission as well. Is this a problem?
6. In its request for the establishment of a panel, the Kingdom of Victoria had claimed that the quarantine and testing requirements at issue were inconsistent with Articles 5.1, 5.5 and 5.6 of the *SPS Agreement*. After having found that the SPS measures at issue were inconsistent with Article 5.1, the Panel exercised judicial economy and did not make findings on the consistency with Articles 5.5 and 5.6. In its appellee's submission, the Kingdom of Victoria invites the Appellate Body – in case it were to reverse the Panel's finding on Article 5.1 - to complete the legal analysis and examine whether the SPS measures at issue are consistent with Articles 5.5 and 5.6. Can the Appellate Body do so?
7. Nicolasia, which intends to submit a third participant's submission, is a developing country that has no experience in preparing submissions and in arguing cases before the Appellate Body. Dr. F. Tungamirai Tanganai, the First Secretary at the Permanent Mission of Nicolasia in Geneva, telephones the Chairman of the Appellate Body, who is not a Member of the Appellate Division hearing the appeal to seek assistance in arguing Micronesia's case.
How will the Chairman react? What options exist for a developing country such as Nicolasia to enable it to participate effectively in the Appellate Body proceedings?

7. FURTHER READING

7.1 Articles

- **Bronckers, M. and McNelis, N.**, “Fact and Law in Pleadings Before the WTO Appellate Body”, *International Trade Law and Regulation*, 1999, 118-123.
- **Lacarte-Muro, J. and Gappah, P.**, “Developing Countries and the WTO Legal and Dispute Settlement System: A View From the Bench”, *Journal of International Economic Law*, 2000, 395-402.
- **Lugard, M.**, “Scope of Appellate Review: Objective Assessment of the Facts and Issues of Law”, *Journal of International Economic Law*, 1998, 323-327.
- **McRae, D. M.**, “The Emerging Appellate Jurisdiction in International Trade Law”, in Cameron J. and Campbell K. (eds.), *Dispute Settlement in the WTO* (Cameron May, 1998), 98-110.
- **Rangaswami, V.**, “Operation of the Appellate Process and Functions, Including the Appellate Body”, *Law and Policy in International Business*, 2000, 701-704.
- **Shoyer, A W. and Solovy, E M.**, “The Process and Procedure of Litigating at the World Trade Organization : A Review of the Work of the Appellate Body”, *Law and Policy in International Business*, 2000, 677-696.
- **Van den Bossche P.**, “Appellate Review in WTO Dispute Settlement”, in Weiss, F. (ed.), *Improving WTO Dispute Settlement Procedures: Issues and Lessons from the Practice of Other International Courts and Tribunals* (Cameron May, 2000), 305-319.

7.2 Documents and Information

For information on WTO activities, see www.wto.org. Official WTO documents can be obtained by searching on the WTO’s online document database, available at: <http://docsonline.wto.org>. A very useful website on WTO dispute settlement is www.worldtradelaw.net.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.4 IMPLEMENTATION AND ENFORCEMENT



UNITED NATIONS
New York and Geneva, 2003

NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

One of the distinguishing features of the WTO dispute settlement mechanism when compared with other dispute settlement mechanisms administered by other international organizations is the relatively high rate of compliance by WTO Members with the recommendations and rulings of panels and the Appellate Body as adopted by the Dispute Settlement Body. This relatively high rate of compliance has increased confidence in the dispute settlement mechanism and encouraged its use by a significant number of WTO Members including developing countries.

This Module provides a detailed overview of the implementation process under the Dispute Settlement Understanding from the moment the DSB adopts a panel report and/or an Appellate Body report until the time the responding Member brings its measures into conformity with WTO law.

The first Section of this Module recalls that it is a fundamental obligation of WTO Members to implement promptly the recommendations and rulings of the DSB. However, where it is not possible for the concerned Member to implement promptly the recommendations and rulings of the DSB, it may be entitled to a reasonable period to do so. The first Section contains a detailed discussion of the procedure to be followed to determine the reasonable period of time for implementation and the factors taken into account in this determination.

The second Section of the Module deals with the procedure provided in Article 21.5 of the DSU to resolve disagreements on the existence or WTO consistency of measures taken to implement the recommendations and rulings of the DSB.

The third Section of the Module explains the circumstances under which the complaining Member could have recourse to the alternative remedies of compensation and suspension of concessions or other obligations towards the responding Member. It stresses that both compensation and suspension of concessions are temporary measures to promote full compliance. The third Section describes in detail the principles and procedures which have to be followed by a Member which wants to avail itself of the right to suspend concessions to the responding Member and reviews the emerging case law on this remedy.

1. THE IMPLEMENTATION OF RECOMMENDATIONS AND RULINGS

Objectives

On completion of this Section, the reader will be able:

- **to appreciate that prompt compliance with recommendations and rulings of the Dispute Settlement Body is required, but where it is impracticable to comply immediately, the Member concerned shall have a reasonable period in which to do so.**
- **to explain how the decision on this reasonable period of time for implementation is taken and which factors determine the length of that period for implementation.**

1.1 Prompt Compliance

Article 3.7 DSU

The credibility of the dispute settlement mechanism of the WTO depends to a large extent on the prompt implementation of the recommendations and rulings of the Dispute Settlement Body (“DSB”). In other words, for the proper functioning of the dispute settlement mechanism, it is necessary for Members whose measures have been found to be inconsistent with their obligations under the covered WTO Agreement to bring them into conformity. Article 3.7 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“the DSU”) provides that in the absence of a mutually satisfactory solution to a dispute, the preferred objective of the dispute settlement mechanism:

...is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements.

Article 21.1 DSU

Article 21.1 of the DSU provides that:

...[p]rompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.

The DSU makes it clear that the alternative remedy of compensation is temporary and should be resorted to only when it is not possible to withdraw the inconsistent measures.¹ It further provides that suspension of concessions or other obligations should be resorted to at the last instance.²

Article 21.3 DSU

To ensure prompt compliance with the recommendations and rulings of the DSB, the DSU provides that within thirty days after the adoption of the panel

¹ Article 3.7 of the DSU.

²Ibid.

and/or Appellate Body report by the DSB, the responding Member shall disclose at a meeting of the DSB how it intends to implement the recommendations and rulings of the DSB.³ It is at this meeting of the DSB that the Member concerned may outline the difficulties it may have in promptly implementing the recommendations and rulings and indicate that it may need a reasonable period of time to fulfil its obligations. Contemplating such situations, the DSU provides that where it is impracticable for the Member concerned to comply immediately, it shall have a reasonable period to do so. Article 21.3 of the DSU provides:

At a DSB meeting held within 30 days⁴ after the date of adoption of the panel or Appellate Body report, the Member concerned shall inform the DSB of its intentions in respect of implementation of the recommendations and rulings of the DSB. If it is impracticable to comply immediately with the recommendations and rulings [of the DSB], the Member concerned shall have a reasonable period in which to do so.

The scope of Article 21.3 of the DSU has been examined in a number of arbitration awards. Generally, the arbitrators have indicated that it is only in compelling cases that the Member concerned shall be excused from implementing promptly the recommendations and rulings of the DSB. In other words, Members do not have discretion to decide when they want to comply promptly with the recommendations and rulings of the DSB. In *Australia – Salmon*, the Arbitrator stated that the primary objective of the DSU is the immediate withdrawal of the measure which has been found to be inconsistent with a covered agreement. The Arbitrator held:

Taken together, these provisions clearly define the rights and obligations of the Member concerned with respect to the implementation of the recommendations and rulings of the DSB. In the absence of a mutually agreed solution, the first objective is usually the immediate withdrawal of the measure judged to be inconsistent with any of the covered agreements. Only if it is impracticable to do so, is the Member concerned entitled to a reasonable period of time for implementation.⁵

Similarly in *Canada – Pharmaceutical Patents*, the Arbitrator underlined that the fact that it is not always so that a responding Member would be given a reasonable period of time to implement the recommendations and rulings of

³ It should be noted that Article 4.12 of the Agreement on Subsidies and Countervailing Measures provides that “...except for time periods specifically prescribed in this Article, time-periods applicable under the DSU for the conduct of such disputes shall be half the time prescribed therein”. It is the view of some Members that in cases involving prohibited export subsidies, the responding Member has to inform the DSB within 15 days about how it intends to bring its measures into conformity with the recommendations and rulings of the DSB and the covered agreements. This view is not shared by some Members who argue that Article 4.12 is only applicable to the procedures before the implementation phase.

⁴ If a meeting of the DSB is not scheduled during this period, such a meeting of the DSB shall be held for this purpose.

⁵ Award of the Arbitrator, *Australia – Measures Affecting Importation of Salmon* (“Australia – Salmon”), WT/DS18/9, para. 30.

the DSB. Entitlement to a reasonable period of time would depend on the circumstances of each case. It was not an automatic right which could be invoked at will by responding Members. The Arbitrator in *Canada - Pharmaceutical Patents* stated:

Further, and significantly, a “reasonable period of time” is not available unconditionally. Article 21.3 makes it clear that a reasonable period of time is available for implementation only “[i]f it is impracticable to comply immediately with the recommendations and rulings” of the DSB. Implicit in the wording of Article 21.3 seems to me to be the assumption that, ordinarily, Members will comply with recommendations and rulings of the DSB “immediately”. The “reasonable period of time” to which Article 21.3 refers is, thus, a period of time in what is implicitly not the ordinary circumstance, but a circumstance in which “it is impracticable to comply immediately ... “⁶

1.2 Reasonable Period of Time for Implementation

Should the responding Member be able to establish that it cannot promptly implement the recommendations and rulings of the DSB, it may be entitled to a “reasonable period of time” to do so. To prevent inordinate delays, Article 21.3 of the DSU defines a “reasonable period of time” as follows:

The reasonable period of time shall be:

- (a) the period of time proposed by the Member concerned, provided that such period is approved by the DSB; or in the absence of such approval,*
- (b) a period of time mutually agreed by the parties to the dispute within 45 days after the date of adoption of the recommendations and rulings; or in the absence of such agreement,*
- (c) a period of time determined through binding arbitration within 90 days after the date of adoption of the recommendations and rulings.⁷ In such arbitration, a guideline for the arbitrator⁸ should be that the reasonable period of time to implement panel or Appellate Body recommendations should not exceed 15 months from the date of adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances.*

1.2.1 Approved by the DSB

Article 21.3(a) DSU

No Member has yet had recourse to the first option. This is probably because it is necessary to obtain the consent of the prevailing Member given the fact that the DSB decides by consensus.⁹ If the consent of the prevailing Member

⁶ *Award of the Arbitrator, Canada – Patent Protection of Pharmaceutical Products (“Canada – Pharmaceutical Patents”), WT/DS114/13, para. 45.*

⁷ *If the parties cannot agree on an arbitrator within ten days after referring the matter to arbitration, the arbitrator shall be appointed by the Director-General within ten days, after consulting the parties.*

⁸ *The expression “arbitrator” shall be interpreted as referring either to an individual or a group.*

⁹ *Article 2.4 of the DSU. Footnote 1 of the DSU provides that “[t]he DSB shall be deemed to have decided by consensus on a matter submitted for its consideration, if no Member, present at the meeting of the DSB when the decision is taken, formally objects to the proposed decision.”*

is not obtained beforehand, it is likely that it would not join the consensus to approve the reasonable period of time requested by the responding Member, unless the time-period requested is indeed very “reasonable”. In a few cases, however, the responding Member’s proposal for an *extension* of the reasonable period of time decided through arbitration was accepted by the DSB.¹⁰ It needs to be qualified, however, that in all these cases, the responding Member had outlined very persuasive reasons why it was impracticable for it to bring its measures into conformity with the covered agreements within the original time-frame envisaged, and had also indicated in its request that it had obtained the tacit approval of the prevailing Members.

1.2.2 Mutual Agreement Between the Parties

Article 21.3(b) DSU

The second option, which has been resorted to more frequently than the other options, is likely to be pursued by parties in relatively straightforward cases where compliance may be effected without necessarily going through a complicated legislative procedure. An agreement between the parties has to be reached within 45 days from the date of the adoption of the panel and /or Appellate Body report, although they can choose to extend the time and continue with their efforts to reach agreement. Where the parties fail to reach agreement, they can have recourse to the third option.

1.2.3 Arbitration

Article 21.3(c) DSU

The third option i.e., recourse to arbitration, has usually been resorted to in cases, where there are sharp differences between the parties on what steps are needed to be taken by the responding Member to comply with the recommendations and rulings of the DSB. The parties are usually likely to have recourse to arbitration when they fail to reach a mutual agreement under Article 21.3(b) of the DSU. As a general rule, the arbitrator should determine the reasonable period of time for the implementation of the recommendations and rulings of the DSB within 90 days from the date of adoption of the panel and/or Appellate Body by the DSB. Where the parties are in agreement, they can extend the deadline or request the arbitrator to suspend his/her work so as to afford them the opportunity to reach a mutually satisfactory agreement on a date for the implementation of the recommendations and rulings of the DSB.¹¹

1.2.4 Appointment of an Arbitrator

Apart from indicating that an arbitrator can be an individual or a group of individuals, the DSU does not indicate who can serve as an arbitrator for the purposes of determining the reasonable period of time under Article 21.3(c). Since the DSU entered into force in 1995, the arbitrator has always been a

¹⁰ See, e.g., United States - Tax Treatment for “Foreign Sales Corporations” (“US – FSC”), *WT/DS108/11*, dated 2 October 2000; United States – Section 110(5) of the US Copyright Act (“US – Section 110(5) Copyright Act”), *WT/DS160/14*, dated 18 July 2001; and United States – Anti-Dumping Act of 1916 (“US – 1916 Act”), *WT/DS136/13*, dated 18 July 2001.

¹¹ See, e.g., United States – Definitive Safeguard Measures on Imports of Circular Welded Quality Line Pipe from Korea (“US – Line Pipe”), *WT/DS202/17*.

member of the Appellate Body. If the parties to the dispute cannot agree on an arbitrator within ten days after referring the matter to arbitration, the arbitrator shall be appointed by the Director-General of the WTO within ten days after consulting with the parties.¹²

1.2.5 Mandate of the Arbitrator

The issue has arisen as to the scope of the mandate of the arbitrator under Article 21.3 (c) of the DSU. Basically, the issue has revolved around whether it is within the mandate of the arbitrator to suggest ways and means through which the responding Member could bring its measures into conformity with the covered agreement. A number of arbitrators have indicated that they do not regard this issue as falling within their mandate, and that the only issue for them to determine is what will be the reasonable period of time for the Member concerned to bring its measures into conformity with a covered agreement taking into account all the relevant facts and the surrounding circumstances. *In EC – Hormones*, the Arbitrator made it clear that it was not the duty of arbitrators to suggest ways and means through which the responding Member could bring its measures into conformity with WTO law. Their task under Article 21.3(c) of the DSU was to determine what would be a reasonable period of time for the responding Member to bring its measures into conformity with WTO law taking into account the relevant facts and the surrounding circumstances. The Arbitrator stated:

It is not within my mandate under Article 21.3(c) of the DSU, to suggest ways or means to the European Communities to implement the recommendations and rulings of the Appellate Body Report and Panel Reports. My task is to determine the reasonable period of time within which implementation must be completed. Article 3.7 of the DSU provides, in relevant part, that “the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements”. Although withdrawal of an inconsistent measure is the preferred means of complying with the recommendations and rulings of the DSB in a violation case, it is not necessarily the only means of implementation consistent with the covered agreements. An implementing Member, therefore, has a measure of discretion in choosing the means of implementation, as long as the means chosen are consistent with the recommendations and rulings of the DSB and with the covered agreements.¹³

Similarly in *US – Hot Rolled Steel*, the Arbitrator stated that while the complexity of a proposed legislation may be relevant in the determination of the reasonable period of time to be granted to the responding Member, it was not the duty of the arbitrator to make a determination as to the proper scope and content of the proposed implementing legislation. The Arbitrator in this case held:

¹² Footnote 12 of the DSU.

¹³ Award of the Arbitrator; EC - Measures Concerning Meat and Meat Products (“EC – Hormones”), WT/DS26/15, para. 38.

I do not believe that an arbitrator acting under Article 21.3(c) of the DSU is vested with jurisdiction to make any determination of the proper scope and content of implementing legislation, and hence do not propose to deal with it. The degree of complexity bears upon the length of time that may be relevant for the arbitrator, to the extent that such complexity bears upon the length of time that may reasonably be allocated to the enactment of such legislation. But the proper scope and content of anticipated legislation are, in principle, left to the implementing Member to determine.¹⁴

The possible reason why arbitrators have steadfastly refused to be drawn into making determinations about the adequacy of measures to be implemented by the responding Member to bring its measures into conformity is because of the procedure under Article 21.5 of the DSU, under which the adequacy of measures could be challenged.¹⁵ As was pointed out by the Arbitrator in *Canada – Pharmaceutical Patents*, Article 21.5 of the DSU would become superfluous if arbitrators were to make determinations regarding the consistency of the proposed implementing measures with the covered agreements. The Arbitrator held:

As an arbitrator under Article 21.3(c), certainly my responsibility includes examining closely the relevance and duration of each of the necessary steps leading to implementation to determine when a “reasonable period of time” for implementation will end. My responsibility does not, however, include in any respect a determination of the consistency of the proposed implementing measure with the recommendations and rulings of the DSB. The proper concern of an arbitrator under Article 21.3(c) is with when, not what. What a Member must do to comply with the recommendations and rulings of the DSB in any particular case is addressed elsewhere in the DSU...If there is any question about whether what a Member chooses as a means of implementation is sufficient to comply with the recommendations and rulings of the DSB, as opposed to when that Member proposes to do it, then Article 21.5 applies, not Article 21.3. (italics in original)¹⁶

In non-violation complaints, however, Article 26.1(c) provides that an arbitrator under Article 21.3(c) may:

[u]pon the request of either party, ...include a determination of the level of benefits which have been nullified or impaired, and may also suggest ways and means of reaching a mutually satisfactory adjustment. ...

There is the further provision that “such suggestions shall not be binding upon the parties to the dispute”.¹⁷

¹⁴ *Award of the Arbitrator*; United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan (“US – Hot-Rolled Steel”), WT/DS184/13, para. 30.

¹⁵ See below, Section 2.2.

¹⁶ *Award of the Arbitrator*, Canada – Pharmaceutical Patents, paras 41 and 42.

¹⁷ Article 26.1(c) of the DSU.

While arbitrators have not considered it their duty to suggest ways and means through which the responding Member could bring its measures into conformity with a covered agreement, the Arbitrator in *Argentina – Hides and Leather* indicated in general terms the sort of measures that a responding Member may need to take to bring the non-conforming measure into conformity with WTO law:

[T]he non-conforming measure is to be brought into a state of conformity with specified treaty provisions either by withdrawing such measure completely, or by modifying it by excising or correcting the offending portion of the measure involved. Where the non-conforming measure is a statute, a repealing or amendatory statute is commonly needed. Where the measure involved is an administrative regulation, a new statute may or may not be necessary, but a repealing or amendatory regulation is commonly required. It thus appears that the concept of compliance or implementation prescribed in the DSU is a technical concept with a specific content: the withdrawal or modification of a measure, or part of a measure, the establishment or application of which by a Member of the WTO constituted the violation of a provision of a covered agreement.¹⁸

1.2.6 Burden of Proof

In *Canada – Pharmaceutical Patents*, the Arbitrator pointed out that the fundamental obligation of Members under the DSU was immediate compliance with the recommendations and rulings of the DSB, and that a Member wishing to have a reasonable period of time to do so must provide reasons. The Arbitrator stated:

...[A]s immediate compliance is clearly the preferred option under Article 21.3, it is, in my view, for the implementing Member to bear the burden of proof in showing – “[i]f it is impracticable to comply immediately” – that the duration of any proposed period of implementation, including its supposed component steps, constitutes a “reasonable period of time”. And the longer the proposed period of implementation, the greater this burden will be.¹⁹

Earlier, the Arbitration in *EC – Hormones* had ruled:

In my view, the party seeking to prove that there are “particular circumstances” justifying a shorter or a longer time has the burden of proof under Article 21.3(c). In this arbitration, therefore, the onus is on the European Communities to demonstrate that there are particular circumstances which call for a reasonable period of time of 39 months, and it is likewise up to the United States and Canada to demonstrate that there are particular circumstances which lead to the conclusion that 10 months is reasonable.²⁰

¹⁸ Award of the Arbitrator; *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather* (“Argentina – Hides and Leather”), WT/DS155/10, paras. 40 and 41.

¹⁹ Award of the Arbitrator; *Canada – Pharmaceutical Patents*, para. 47.

²⁰ Award of the Arbitrator; *EC – Hormones*, para. 27.

In *Canada – Pharmaceutical Patents*, the Arbitrator rejected the argument of Canada, the responding Member in that case, that since it had undertaken to achieve compliance in significantly less time than is contemplated by the Article 21.3(c) guideline, the onus was “clearly” on the European Communities, as complaining Member, to establish that there were “particular circumstances” to justify an even shorter period”.

1.3 Factors Determining the Reasonable Period of Time

1.3.1 Shortest Period Possible Within a Member’s Legal System

It is well established under the jurisprudence that the responding Member would only be entitled to the shortest period possible within its legal system to implement the recommendations and rulings of the DSB. In other words, in deciding the reasonable period of time to be given to a Member to comply with the recommendations and rulings of the DSB, account will be taken of the legislative and administrative procedures which have to be fulfilled to bring the measures into conformity with the covered agreements. Thus, where a lengthy procedure has to be followed to amend the measure which has been found to be in conflict with WTO rules, the responding Member would be entitled to an extended period of time. On the other hand, if the recommendations and rulings of the DSB can be implemented within a specific time-frame consistently with the Member’s domestic laws and regulations, then that fact would be taken into account in deciding on the reasonable period of time. In *EC – Hormones*, the Arbitrator in refusing the request by the European Communities that it be given 39 months to implement the recommendations and rulings of the DSB stated that a Member would only be entitled to the shortest period possible within its legal system. The Arbitrator ruled:

Article 21.3(c) also should be interpreted in its context and in light of the object and purpose of the DSU. Relevant considerations in this respect include other provisions of the DSU, including, in particular, Articles 21.1 and 3.3. ... Read in context, it is clear that the reasonable period of time, as determined under Article 21.3(c), should be the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB. In the usual case, this should not be greater than 15 months, but could also be less.²¹

While a Member is obliged to implement the recommendations and rulings of the DSB within the shortest possible time permissible under its legal system, it is not required to resort to extraordinary legislative procedures to bring its measures into conformity with the WTO law. Put in another way, the responding Member has to follow the normal procedures for amending its legislation to bring it into conformity with a covered agreement. In *Korea –*

²¹ *Award of the Arbitrator; EC - Hormones, para. 26.*

Alcoholic Beverages, the United States and the European Communities argued that Korea could bring its measures into conformity within a shorter period of time, if it submitted the tax bill to an extraordinary session of the National Assembly. In rejecting this argument of the United States and the European Communities, the Arbitrator noted that it was not necessary for Korea to resort to an extraordinary legislative procedure to bring its measures into conformity with WTO law. The Arbitrator stated:

Although the reasonable period of time should be the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB, this does not require a Member, in my view, to utilize an extraordinary legislative procedure, rather than the normal legislative procedure, in every case. Taking into account all of the circumstances of the present case, I believe that it is reasonable to allow Korea to follow its normal legislative procedure for the consideration and adoption of a tax bill with budgetary implications.²²

1.3.2 Legal versus Other Factors

In deciding on whether there are particular circumstances justifying a period shorter or longer than the guideline of 15 months within the meaning of Article 21.3(c) of the DSU, a number of arbitrators have indicated that only relevant legal considerations would be taken into account. In other words, extraneous matters such as the likely impact of the proposed new legislation on an industry or political considerations will be ignored. In *Canada – Pharmaceutical Patents*, Canada argued that it would need 11 months to bring its measures into conformity with WTO law. It justified its request *inter alia* on the basis it would have to revoke the “Manufacturing and Storage of Patented Medicines Regulations”, which was “a very sensitive political matter in Canada” and required extensive consultations with stakeholders, interest groups and the general public. In rejecting Canada’s request and fixing the reasonable period of time at six months from the date of adoption of the Panel Report by the DSB, the Arbitrator underlined that only relevant legal considerations would be taken into account in deciding the length of the reasonable period of time. The Arbitrator in *Canada – Pharmaceutical Patents* found:

There may well be other “particular circumstances” that may be relevant to a particular case. However, in my view, the “particular circumstances” mentioned in Article 21.3 do not include factors unrelated to an assessment of the shortest period possible for implementation within the legal system of a Member. Any such unrelated factors are irrelevant to determining the “reasonable period of time” for implementation. For example, as others have ruled in previous Article 21.3 arbitrations, any proposed period intended to allow for the “structural adjustment” of an affected domestic industry will not be relevant to an assessment of the legal process. The determination of a

²² Award of the Arbitrator, Korea – Taxes on Alcoholic Beverages (“Korea – Alcoholic Beverages”), WT/DS75/16, para. 42.

“reasonable period of time” must be a legal judgement based on an examination of relevant legal requirements

...

I see nothing in Article 21.3 to indicate that the supposed domestic “contentiousness” of a measure taken to comply with a WTO ruling should in any way be a factor to be considered in determining a “reasonable period of time” for implementation. All WTO disputes are “contentious” domestically at least to some extent; if they were not, there would be no need for recourse by WTO Members to dispute settlement.²³

Similarly, in the *US – 1916 Act*, the Arbitrator dismissed the argument of the United States that recent political changes in Washington were relevant in determining the reasonable period of time within which it should bring its measures into conformity with the recommendations and rulings of the DSB. The Arbitrator noted:

In view of the fundamental obligations assumed by the Members of the WTO, factors such as the volume of legislation proposed, and the high percentage of bills that never become law, cannot be considered to extend the period of time for implementation. As for the argument that legislation passed by the United States Congress is usually passed at the end of the legislative session, this again may be the usual practice in the United States Congress, but it is not the outcome of a legal requirement

...

The United States also urges me to take account of the “additional special circumstances” involved in this case, that is, the need for a period of transition to a new President, a new Administration, and a new Congress, and the accompanying shifts in the balance of power between the two principal political parties in the United States. Even allowing for these unusual circumstances, I note that what is significant for the case at hand is that the first session of the 107th United States Congress has been in progress since 3 January 2001. It is, therefore, possible for the United States to introduce a legislative proposal and have it passed by the Congress as speedily as possible, using, as I have stated earlier, all the flexibility available within its normal legislative procedures.²⁴

1.3.3 Complexity of Implementing Measures and Process

In *Canada – Pharmaceutical Patents*, the Arbitrator indicated that one of the factors which may be taken into account in determining the reasonable period of time is the complexity of the proposed implementing measures. If extensive regulations have to be introduced which would affect many sectors of activity, then a compelling case could be made for granting a longer time-period. On the other hand, if the recommendations and rulings of the DSB can be effected through a simple change in the law, then a shorter period may be apposite. The Arbitrator in the above dispute stated:

²³ *Award of the Arbitrator; Canada – Pharmaceutical Patents, paras. 52 and 60.*

²⁴ *Award of the Arbitrator; United States – Anti-Dumping Act of 1916 (US – 1916 Act), WT/DS136/11, paras. 38-40.*

Likewise, the complexity of the proposed implementation can be a relevant factor. If implementation is accomplished through extensive new regulations affecting many sectors of activity, then adequate time will be required to draft the changes, consult affected parties, and make any consequent modifications as needed. On the other hand, if the proposed implementation is the simple repeal of a single provision of perhaps a sentence or two, then, obviously, less time will be needed for drafting, consulting, and finalizing the procedure. To be sure, complexity is not merely a matter of the number of pages in a proposed regulation; yet it seems reasonable to assume that, in most cases, the shorter a proposed regulation, the less its likely complexity.²⁵

In *EC – Bananas III*, the Arbitrator dismissed the argument of the complaining parties that a shorter time-period was required by the European Communities to bring their measures into conformity with WTO rules. He stated that he was satisfied that the complexity of the implementation process in the European Communities justified a longer time-period than the 15 month guideline provided under Article 21.3(c) of the DSU. The Arbitrator held:

The Complaining Parties have not persuaded me that there are “particular circumstances” in this case to justify a shorter period of time than stipulated by the guideline in Article 21.3(c) of the DSU. At the same time, the complexity of the implementation process, demonstrated by the European Communities, would suggest adherence to the guideline, with a slight modification, so that the “reasonable period” of time for implementation would expire by 1 January 1999.²⁶

1.3.4 Means of Implementation

One of the factors which would be taken into account in deciding on the reasonable period of time is the means of implementation of the recommendations and rulings of the DSB. If they could be implemented through an administrative decision, then the reasonable period of time could be considerably shorter than the 15 month guideline. By contrast, if they could be implemented only through a cumbersome legislative procedure, then the reasonable period of time could be longer. The Arbitrator in *Canada – Pharmaceutical Patents* ruled:

[I]f implementation is by administrative means, such as through a regulation, then the “reasonable period of time” will normally be shorter than for implementation through legislative means. It seems reasonable to assume, unless proven otherwise due to unusual circumstances in a given case, that regulations can be changed more quickly than statutes. To be sure, the administrative process can sometimes be long; but the legislative process can oftentimes be longer

²⁵ *Award of the Arbitrator, Canada – Pharmaceutical Patents, para. 50.*

²⁶ *Award of the Arbitrator, European Communities – Regime for the Importation, Sale and Distribution of Bananas (“EC – Bananas III”), WT/DS27/15, para. 19.*

...
*In addition, the legally binding, as opposed to the discretionary, nature of the component steps leading to implementation should be taken into account. If the law of a Member dictates a mandatory period of time for a mandatory part of the process needed to make a regulatory change, then that portion of a proposed period will, unless proven otherwise due to unusual circumstances in a given case, be reasonable. On the other hand, if there is no such mandate, then a Member asserting the need for a certain period of time must bear a much more imposing burden of proof.*²⁷

1.3.5 Flexibility in the Legislative Process

If the legislative procedures in the responding Member are quite flexible in the sense that it can influence the time the implementing legislation could be passed so as to bring its measures into conformity with the covered agreements, it would be expected to do so considering that the primary responsibility of Members under the DSU is prompt compliance. In *Canada – Patent Term*, the arbitrator stated that flexibility in the legislative process is a factor which would be taken into account in deciding the reasonable period of time to be given to a responding Member to bring its measures into conformity. He declined in the instant case to accede to Canada's request of 14 months and two days and required it to bring its measures into conformity within 10 months from the date of the adoption of the Panel and Appellate Body reports by the DSB. The Arbitrator reasoned as follows:

*The different steps in this [legislative] process and their sequence are clearly structured and defined. With respect to timing and scheduling, however, the process is flexible, as Canada acknowledged at the oral hearing. Use of this flexibility does not require recourse to extraordinary procedures. Following earlier arbitration awards, I consider this flexibility to be an important element in establishing the “reasonable period of time”. Ultimately, the “reasonable period of time” appears to be a function of the priority which Canada attributes to the amendment of its Patent Act in order to bring it into conformity with its obligations under Article 33 of the TRIPS Agreement. ...[I]t seems to me that this is [a]... matter for which the Canadian Parliament should try to comply with the international obligations of Canada as soon as possible, taking advantage of the flexibility that it has in its normal legislative procedures.*²⁸

1.3.6 Steps Taken to Comply with Rulings of the DSB

A number of arbitrators have indicated that one of the factors that would be taken into account in deciding the reasonable period of time to be granted to a responding Member is the steps taken by it after the adoption of a panel and/

²⁷ *Award of the Arbitrator, Canada – Pharmaceutical Patents, paras. 49 and 51.*

²⁸ *Award of the Arbitrator, Canada – Term of Patent Protection (“Canada – Patent Term”), WT/DS170/10, paras. 63 and 64. See further, Award of the Arbitrator, United States – Section 110 (5) Copyright Act, and Award of the Arbitrator, Canada – Certain Measures Affecting the Automotive Industry (“Canada – Autos”), WT/DS139/12.*

or Appellate Body report and before arbitration is resorted to, to ensure prompt compliance. In *US – Section 110(5) Copyright Act*, the Arbitrator cautioned Members that the steps adopted by them in the aftermath of the adoption by the DSB of a panel and/or Appellate would be carefully scrutinized by arbitrators for the purpose of determining the reasonable period of time to be granted them. The Arbitrator in this case held:

*...Article 21.1 establishes that “prompt compliance” is essential in order to ensure effective resolution of disputes to the benefit of all Members. Clearly, timeliness is of the essence. Thus, an implementing Member must use the time after adoption of a panel and/or Appellate Body report to begin to implement the recommendations and rulings of the DSB. Arbitrators will scrutinize very carefully the actions an implementing Member takes in respect of implementation during the period after adoption of a panel and/or Appellate Body report and prior to any arbitration proceeding. If it is perceived by an arbitrator that an implementing Member has not adequately begun implementation after adoption so as to effect “prompt compliance”, it is to be expected that the arbitrator will take this into account in determining the “reasonable period of time”.*²⁹

1.3.7 Developing Countries

If implementation is to be effected by a developing country, its particular circumstances may be taken into account in accordance with the provisions of Article 21.2 of the DSU. If the country is, for example, facing economic crisis and there is evidence that prompt implementation of the recommendations and rulings of the DSB could exacerbate the crisis, it could be given an extended period of time to comply. This was the reasoning of the Arbitrator in *Indonesia – Autos*, where he took account of the deteriorating economic conditions in Indonesia and granted it an additional six months to bring its measures into conformity with the covered agreements. The Arbitrator stated:

*Indonesia is not only a developing country; it is a developing country that is currently in a dire economic and financial situation. Indonesia itself states that its economy is “near collapse”. In these very particular circumstances, I consider it appropriate to give full weight to matters affecting the interests of Indonesia as a developing country pursuant to the provisions of Article 21.2 of the DSU. I, therefore, conclude that an additional period of six months over and above the six-month period required for the completion of Indonesia’s domestic rule-making process constitutes a reasonable period of time for implementation of the recommendations and rulings of the DSB in this case.*³⁰

Where the matter was raised by a developing country Member, the DSU provides that the “DSB shall consider what further action it might take which

²⁹ *Award of the Arbitrator*; *US – Section 110(5) Copyright Act*, *WT/DS160/12*, para. 46. See further, *Award of the Arbitrator*; *Canada – Patent Term*, para. 62.

³⁰ *Award of the Arbitrator*; *Indonesia – Certain Measures Affecting the Automobile Industry (“Indonesia – Autos”)*, *WT/DS54/15*, para. 24.

would be appropriate to the circumstances.”³¹ It shall consider in this context “not only the trade coverage of measures complained of, but also their impact on the economy of developing country Members concerned.”³²

1.4 Test Your Understanding

- 1. Are recommendations and rulings adopted by the DSB to be complied with immediately or within a reasonable period of time?**
- 2. Who decides what the reasonable period of time for implementation in a particular dispute is?**
- 3. Is it within the mandate of an arbitrator under Article 21.3 (c) of the DSU to determine whether the intended implementation of the recommendations and rulings is WTO-consistent?**
- 4. Is the complexity of the implementing measure and of the amendment or withdrawal process relevant in the determination of the reasonable period of time for implementation? If so, how**
- 5. Is political unrest or economic hardship that may result from the implementation of recommendations and rulings relevant in the determination of the reasonable period of time for implementation? Does it in this respect matter whether the responding Member is a developing country Member?**

³¹ Article 21.7 of the DSU.

³² Article 21.8 of the DSU.

2. RESOLVING DISPUTES REGARDING IMPLEMENTATION

Objectives

On completion of this Section, the reader will be able to discuss the procedure provided in Article 21.5 of the DSU to resolve disputes between parties regarding the existence of the WTO-consistency of implementing measures.

2.1 Status Reports

Article 21.6 DSU

To ensure that the responding Member complies with the recommendations and rulings of the DSB within the reasonable period established pursuant to the provisions of article 21.3(c), the DSU provides that [t]he DSB shall keep under surveillance the implementation of adopted recommendations or rulings. It further provides that any Member can raise the issue of implementation of recommendations or rulings at anytime following their adoption by the DSB. The mechanism for monitoring whether the responding Member is committed to implementing the recommendations or rulings of the DSB is established in Article 21.6 of the DSU. This Article provides:

Unless the DSB decides otherwise, the issue of implementation of the recommendations or rulings shall be placed on the agenda of the DSB meeting after six months following the date of establishment of the reasonable period of time pursuant to paragraph 3 and shall remain on the DSB's agenda until the issue is resolved. At least 10 days prior to each such DSB meeting, the Member concerned shall provide the DSB with a status report in writing of its progress in the implementation of the recommendations or rulings.

From a Member's status report, it should be possible to determine whether it would be able to comply with the recommendations and rulings of the DSB within the reasonable period of time. However, those that have been submitted by responding Members tend to be very bland and not very informative. Under normal circumstances, if the reports are lacking in detail and are imprecise as to the steps being taken to comply with the recommendations or rulings, the complaining Member or any other Member could make an observation in the DSB that the responding Member is not taking adequate steps to comply and that the DSB should request it to fulfil its obligations within the time foreseen. In practice, however, Members reserve their comments until after the lapse of the reasonable period of time, as it is possible for measures to be implemented on the last day of the reasonable period.

2.2 Recourse to Article 21.5 of the DSU

Article 21.5 DSU

If the responding Member adopts measures which are intended to implement the recommendations or rulings of the DSB within the reasonable period of

time, and there is a dispute concerning their consistency with a covered agreement, the complaining Member can request the establishment of a panel to determine whether the implementing measures are in conformity with WTO law. Also when there is disagreement concerning the existence of implementing measures, the complaining Member can request the establishment of a panel to settle this disagreement. Where such a request is made, the matter will be referred to the original panel if possible, which shall circulate its report within 90 days of the date of the referral of the matter to it. Where the panel cannot provide its report within the time-frame, it is expected to inform the DSB in writing of the reasons for the delay and indicate when it will be able to submit its report. Article 21.5 of the DSU provides:

Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time-frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report.

2.3 Scope of Proceedings under Article 21.5 of the DSU

2.3.1 Consistency with WTO Law

The issue has arisen whether the focus of an Article 21.5 panel is limited only to examining if the measures implemented by the responding Member comply with the recommendations and rulings of the DSB in that particular case, or whether it extends to examining the conformity of the implementing measures with the relevant provisions of the covered agreement(s). In *Canada – Aircraft (Article 21.5 - Brazil)*, the Appellate Body, in reversing the ruling of the Panel in the Article 21.5 proceedings, held that the proceedings under this article are not only meant to establish whether the adopted measures are consistent with the DSB recommendations and rulings, but also whether they are consistent with the relevant provisions of the covered agreement(s).³³ Under normal circumstances, if the measures adopted by a Member are consistent with the recommendations and rulings of the DSB, they will usually also be consistent with the provisions of the covered agreements. The Appellate Body in *Canada – Aircraft (Article 21.5 - Brazil)* ruled:

We have already noted that these proceedings, under Article 21.5 of the DSU, concern the “consistency” of the revised TPC programme with Article 3.1(a) of the SCM Agreement. Therefore, we disagree with the Article 21.5 Panel that the scope of these Article 21.5 dispute settlement proceedings is limited

³³Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU* (“Canada – Aircraft (Article 21.5 – Brazil)”), WT/DS70/AB/RW, adopted 4 August 2000.

to “the issue of whether or not Canada has implemented the DSB recommendation”. ... It follows then that the task of the Article 21.5 Panel in this case is, in fact, to determine whether the new measure – the revised TPC programme – is consistent with Article 3.1(a) of the SCM Agreement.³⁴

2.3.2 Measures

Where a measure has been the subject of dispute settlement and found to be inconsistent with the provisions of a covered agreement, it follows that the measure which has been taken in compliance with the recommendations and rulings with the DSB has to be necessarily different, otherwise there is a strong probability that the adopted measure may also be inconsistent with WTO Law. In *Canada – Aircraft (Article 21.5 - Brazil)*, the Appellate Body stressed with regard to the measure at issue in proceedings under Article 21.5 of the DSU:

Proceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those “measures taken to comply with the recommendations and rulings” of the DSB. In our view, the phrase “measures taken to comply” refers to measures which have been, or which should be, adopted by a Member to bring about compliance with the recommendations and rulings of the DSB. In principle, a measure which has been “taken to comply with the recommendations and rulings” of the DSB will not be the same measure as the measure which was the subject of the original dispute, so that, in principle, there would be two separate and distinct measures: the original measure which gave rise to the recommendations and rulings of the DSB, and the “measures taken to comply” which are – or should be – adopted to implement those recommendations and rulings. In these Article 21.5 proceedings, the measure at issue is a new measure, the revised TPC programme, which became effective on 18 November 1999 and which Canada presents as a “measure taken to comply with the recommendations and rulings” of the DSB.³⁵

2.4 Repeated Recourse to Article 21.5 of the DSU

Although not explicitly provided in the DSU, some Members have had repeated recourse to Article 21.5 of the DSU to challenge the consistency with a covered agreement of measures that have been implemented by a responding Member following an Article 21.5 panel report, which had reached the conclusion that the measures implemented by that Member did not comply with the panel/Appellate Body report as adopted by the DSB. In the dispute between Brazil and Canada over export subsidies for the regional aircraft industry, for example, the parties availed themselves of Article 21.5 procedures on several occasions. While recourse to Article 21.5 of the DSU serves the useful purpose of further clarifying Members’ obligations under the *WTO Agreement* and settling definitively disputes between the parties, the view has been expressed in the

³⁴*Appellate Body Report, Canada – Aircraft (Article 21.5 – Brazil), paras. 40 -41.*

³⁵*Ibid., para. 36.*

DSB that there is the risk that it could be abused by some Members who, instead of bringing their measures into full conformity with the recommendations and rulings of the DSB, may implement legislation which did not cure all the defects in their earlier legislation found to be inconsistent with their obligations under a covered agreement.

It seems that there is the general acceptance among WTO Members that insofar as a responding Member has adopted implementing legislation in response to an Article 21.5 report and, there is disagreement as to the consistency of the implemented measures with the recommendations and rulings of the DSB, it is always possible for recourse to Article 21.5 be made regardless of the previous number of times recourse had been made to this provision. In *Canada – Dairy*, New Zealand and the United States requested an Article 21.5 panel for the second time, as they thought that the Appellate Body had failed to settle definitively the dispute between them and Canada.³⁶ In a statement to the DSB, the representative of New Zealand noted that:

New Zealand continued to consider that Canada had failed to comply with the original DSB's recommendations and rulings. As highlighted previously – on more than one occasion – in substitution for the dairy export measures that had been ruled in contravention of Canada's WTO commitments, Canada had put in place "new measures" for the export of dairy products... The Appellate Body's Report in relation to the earlier Article 21.5 proceedings had reversed some of the Article 21.5 Panel's findings, but the Appellate Body had declined to rule on the consistency of the measure in question. Instead the Appellate Body had concluded that, in light of the factual findings made by the Panel and the uncontested facts in the Panel record, it was unable to complete the analysis of the claims made by New Zealand under Articles 9.1(c) and 10.1 of the Agreement on Agriculture. In its Report, the Appellate Body made it clear that its ruling "does not amount to a finding that the measure at issue is WTO-consistent, but simply that the Panel's findings were vitiated by error of law" (paragraph 104 of the AB Report). Accordingly, there continued to be "a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB" between Canada and New Zealand, within the terms of Article 21.5 of the DSU. New Zealand therefore requested, pursuant to Article 21.5 of the DSU, that the matter be referred to the original Panel.³⁷

In response, the representative of Canada expressed disappointment with the decision by New Zealand and the United States to have second recourse to Article 21.5 of the DSU.³⁸

³⁶ *Appellate Body Report, Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21.5 of the DSU by New Zealand and the United States* ("Canada – Dairy (Article 21.5 – New Zealand and US)", *WT/DS103/AB/RW, WT/DS113/AB/RW*, adopted 18 December 2001).

³⁷ *WT/DSB/M/116, 31 January 2002, paras. 52-53.*

³⁸ *Ibid.*, para. 56.

2.5 Consultations Under Article 21.5 Proceedings

The DSU does not indicate whether consultations should be held by the parties before the request of an article 21.5 panel is made. Some Members of the WTO are of the view that consultations are *sine qua non* to the establishment of a panel, and that any request for an article 21.5 panel should be denied, unless the parties had held consultations which had failed to settle the dispute between them. Proponents of this view Point out that Article 21.5 provides that disputes on implementation “shall be decided through recourse to *these* dispute settlement procedures”. *These* dispute settlement procedures are the procedures set out in the DSU. Under these procedures, and in particular, under Article 6.2 of the DSU, consultations are mandatory and should precede the panel request. Proponents of the view that consultations are mandatory in the context of Article 21.5 proceedings buttress their argument with the fact that the implemented measures at issue may not exactly be the same as the measures which were considered by the original panel and, as such, it is necessary for the parties to have an exchange of views on these measures before a request for the establishment of a panel is made.

This view is not shared by some Members who believe that Article 21.5 proceedings are different, and that if the parties are required to hold consultations before making a request for the establishment of an Article 21.5 panel, it would unnecessarily delay the dispute settlement process, especially considering that the parties would have held consultations before the initial request for the establishment of a panel and, would as such, be apprised of all the relevant facts of the case. In other words, the responding Member would not be prejudiced if consultations are not held since it would be aware of the legal basis of the complaint. In the absence of any definitive guidelines in the DSU, parties to Article 21.5 disputes have been agreeing on procedures to expedite such proceedings. In *US - FSC*, the parties agreed on, *inter alia*, holding consultations within 12 days of a request being made, and in the event of a deadlock in the consultations, agreeing to the establishment of an Article 21.5 panel immediately thereafter thus shortening the time periods under the relevant provisions of the DSU.³⁹

2.6 Appellate Review in Article 21.5 Proceedings

Article 21.5 of the DSU does not explicitly provide for the possibility to appeal Article 21.5 panel reports. However, the jurisdiction of the Appellate Body in Article 21.5 proceedings could be based on Article 17.1 of the DSU, which provides that the “[t]he Appellate Body shall hear appeals from panel cases”, and on Article 17.6 which provides that “[a]n appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel.” In some disputes, Members have concluded bilateral agreements to confer on each other the right to appeal an Article 21.5 panel report to the Appellate Body.

³⁹United States – Tax Treatment for “Foreign Sales Corporations”, *complaint by the European Communities* (“US – FSC”), *WT/DS108/12*.

2.7 Relationship Between Articles 21.5 and 22.2 of the DSU

The issue has arisen as to the relationship between Article 21.5 and Article 22.2 of the DSU. Under the former, if there is disagreement as to the existence of the WTO consistency of measures taken by the respondent Member to comply with the recommendations and rulings of the DSB, the complaining Member can request the establishment of an Article 21.5 panel to evaluate those measures. Under Article 22.2 of the DSU, if the responding Member fails to bring the non-conforming measure into compliance within the reasonable period of time and the parties to the dispute are unable to agree on compensation within 20 days after the date of the expiry of the reasonable period, the complaining Member can request authorization from the DSB to suspend the application to the responding Member of concessions or other obligations under the covered agreements. The issue is whether the complaining Member can request authorization from the DSB to suspend concessions towards the responding Member before it has been established through an Article 21.5 proceeding that there has either been no implementation at all or no WTO-consistent implementation of the recommendations and ruling of the DSB. The issue arises because under Article 22.6, the DSB has to grant authorization to suspend concessions within thirty days of the expiry of the reasonable period of time, unless it decides by consensus to reject the request for authorization. In the meantime, if recourse had been made to Article 21.5, the proceedings would not have been completed by then to establish whether the proposed implementing measures correctly implement the recommendations and rulings of the DSB. A request for authorization at this stage would imply that the complaining Member had come to the conclusion that the proposed implementing measures are not WTO-consistent. However, pursuant to Article 23 of the DSU, WTO Members must have recourse to the rules and procedures of the DSU to determine whether a measure is WTO-inconsistent; Members may not decide unilaterally whether a measure is WTO-inconsistent.

In *EC – Bananas III*, the United States asserted that it had the right to request authorization from the DSB to suspend concessions and other obligations towards the EC, notwithstanding the European Communities new banana regime, adopted in response to the recommendations and rulings of the DSB. The European Communities strongly opposed the request by the United States on the ground that if the request was permitted, it would amount to sanctioning a unilateral determination by the United States that its new banana regime was not consistent with the recommendations and rulings of the DSB. The European Communities argued that the proper procedure was for the United States to request an Article 21.5 panel to determine whether its new banana regime was consistent with the recommendations and rulings of the DSB. According to the European Communities, it was only after the ruling by the Article 21.5 panel that the United States could have recourse to Article 22.2 of the DSU. The representative of the European Communities said in the DSB that:

...Members were at a critical juncture in this dispute and warned that the situation could become more critical. Either the DSB would decide to place this matter back on the correct multilateral track under the Article 21.5 procedure or it would face a highly political dispute in January 1999 if, and when, one of the parties sought authorization from the DSB to suspend concessions. It was the first time that recourse to Article 21 or 22 procedures was being considered by the DSB. In other cases, implementation of recommendations had not been challenged. In the context of this case, the DSU provisions and their interpretations were being carefully examined. This process had revealed that the DSU contained a number of ambiguities which had to be clarified. However, it was necessary to decide now on how to proceed in this case.⁴⁰

The European Communities and the United States eventually managed to reach agreement which allowed both requests under Articles 21.5 and 22.2 to proceed simultaneously.

After this case, it became customary for parties to a dispute to reach agreement on the sequencing of procedures under Articles 21 and 22. In some cases, the parties agreed to initiate the procedures under Articles 21.5 and 22 simultaneously and later suspend the retaliation procedures under Article 22 until after the completion of the Article 21.5 process, on the understanding that if the compliance panel confirmed that implementation of the recommendations and rulings of the DSB had not taken place, the complaining Member may re-activate the retaliation process under Article 22 of the DSU.⁴¹ In other cases, the parties agreed to initiate the procedures under Article 21.5 before resorting to the retaliation procedures under Article 22, on condition that the responding Member would not object to a request for retaliation under Article 22, on the ground that the 30 day-period specified in Article 22.6 had elapsed. In the context of the DSU negotiations, a number of Members have stated that they attach priority to this issue and that the bilateral agreements that have been concluded between parties should be formalized, in the interest of certainty and predictability.⁴²

2.8 Test Your Understanding

- 1. When and why would a party have recourse to Article 21.5?**
- 2. Does an Article 21.5 panel determine whether the responding Member has adopted an implementing measure that is consistent with the recommendations and rulings adopted by the DSB?**

⁴⁰ WT/DSB/M/51/Add.1, 26 February 1999, p 4. See also the request by the European Communities for arbitration under Article 22.6 of the DSU, WT/DS27/46; 3 February 1999.

⁴¹ See, for example, Canada – Dairy, WT/DS103/14; and US - FSC, WT/DS108/12.

⁴² See the following proposals: TN/DS/W/1 by the European Communities; TN/DS/W/8 by Australia; TN/DS/W/9 by Ecuador; TN/DS/W/11 by The Republic of Korea; and concept paper by Bolivia, Canada, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Japan, Republic of Korea, New Zealand, Norway, Peru, Switzerland, Uruguay and Venezuela on "Remedying the Dispute Settlement Understanding's Articles 21.5/22 'Sequencing Issue'"; Job(02)/45, dated 27 May 2002.

- 3. Does referral to an Article 21.5 panel have to be preceded by consultations? Can parties appeal an Article 21.5 panel report?**
- 4. Do you consider it necessary for an Article 21.5 panel to determine that the responding Member has not implemented the recommendations and rulings of the DSB in a WTO-consistent manner, *before* the complaining Member can request the DSB authorization to suspend concessions or other obligations under Article 22 of the DSU? Is your position consistent with Articles 21.5 and 22 as currently drafted?**

3. COMPENSATION AND SUSPENSION OF CONCESSIONS

3.1 Lack of Compliance

Articles 3.7 and 22.1 DSU

If the responding party does not bring its measures into conformity with a covered agreement within the reasonable period of time established pursuant to Article 21.3 of the DSU, the prevailing Member can either seek compensation or get authorization from the DSB to suspend equivalent concessions or other obligations to the responding Member.⁴³ The DSU stresses that neither compensation nor suspension of concessions is to be preferred to the full implementation of the recommendations and rulings of the DSB. It accordingly provides that they are temporary measures to be resorted to in the event of the impossibility to implement the recommendations and rulings of the DSB within the reasonable period of time decided pursuant to Article 21.3 of the DSU.

3.2 Compensation

Article 22.2 DSU

Under Article 22.2 of the DSU, the responding Member is obliged to enter into negotiations with the complaining Member if the latter requests compensation following the lack of implementation of the recommendations and rulings within the reasonable period of time. While the request for compensation is expected to be made by the complaining Member, the responding Member could, on its own volition, offer compensation as a means of temporarily resolving the dispute, provided that it is acceptable to the complaining Member.

Non-Discrimination

If the parties are able to reach agreement on compensation, the agreed concessions must be consistent with the covered agreements. This means, *inter alia*, that they must be extended on an MFN basis to other Members of the WTO. In other words, compensation should not be discriminatory in the sense of benefiting only the complaining Member. The requirement that compensation has to be accorded on an MFN basis was recognized in a different context by the Appellate Body in *European Communities – Poultry*, where it noted that:

*We see nothing in Article XXVIII to suggest that compensation negotiated within its framework may be exempt from compliance with the non-discrimination principle inscribed in Articles I and XIII of the GATT 1994.*⁴⁴

⁴³ Article 22.9 of the DSU provides that where it is not possible for a regional or local government of a responding Member to comply promptly with the recommendations and rulings of the DSB, the Member may negotiate compensation with the complaining Member if requested, or alternatively the complaining Member may suspend concessions or other obligations towards that Member.

⁴⁴ Appellate Body Report *European Communities – Measures Affecting Importation of Certain Poultry Products* (“EC – Poultry”), WT/DS69/ABR, adopted 23 July 1998, para. 100.

Concerns have been expressed in the DSB that compensation arrangements being entered into by some Members may be in breach of the non-discrimination principle. At the DSB meeting of 18 January 2002, the representative of Australia expressed concern about the proposed compensatory arrangement between the United States and the European Communities. He noted that it was imperative that any compensation agreed between the parties be consistent with the relevant rules of the WTO including the non-discrimination principle. The representative of Australia stated:

Australia wished to register its strong concerns about the compensation arrangements that it understood had been agreed between the United States and the EC. [It was its understanding] that those compensation arrangements might infringe WTO obligations on non-discrimination. They also appeared to anticipate a delay in the United States' implementation by up to three years. Australia was particularly concerned by the apparent discriminatory nature of the proposed compensation arrangements. In this regard, Australia noted that no compensation had been offered to other Members whose interests were being nullified and impaired by continued violation by the United States of its WTO obligations.⁴⁵

3.3 Suspension of Concessions

Articles 22.2 and 22.6 DSU

Where the parties are unable to agree on compensation within 20 days after the date of expiry of the reasonable period of time, the complaining Member may request authorization from the DSB to suspend the application to the responding Member of concessions or other obligations under the covered agreements.⁴⁶ Where such a request is made, 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.⁴⁷ In effect, if the parties are unable to agree on compensation within twenty days after the expiry of the reasonable period of time, authorization could be given within 10 days after that date by the DSB to the complaining Member to suspend concessions or other obligations on a discriminatory basis towards the responding Member. The suspension of concessions or other obligations is commonly also referred to as “retaliation”.

Article 3.7 DSU

With respect to the suspension of concessions, Article 3.7 of the DSU provides:

The last resort which this Understanding provides to the Member invoking the dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures. (Emphasis added)

⁴⁵ WT/DSB/M/117. 15 February 2002, para. 32.

⁴⁶ Article 22.2 of the DSU.

⁴⁷ Article 22.6 of the DSU.

A party would be considered to be in breach of its obligations under the DSU if it were to proceed unilaterally to suspend concessions or other obligations towards the responding Member without the authorization of the DSB. In *US – Certain EC Products*, the Appellate Body affirmed the necessity of Members to seek the prior approval of the DSB before suspending concessions or other obligations. The Appellate Body held in that case:

*The obligation of WTO Members not to suspend concessions or other obligations without prior DSB authorization is explicitly set out in Articles 22.6 and 23.2(c), not in Article 3.7 of the DSU. ... We consider, however, that if a Member has acted in breach of Articles 22.6 and 23.2(c) of the DSU, that Member has also, in view of the nature and content of Article 3.7, last sentence, necessarily acted contrary to the latter provision.*⁴⁸

3.4 Principles and Procedures Governing Suspension

WTO Members wishing to avail themselves of this remedy have to observe a number of elaborate conditions. The whole purpose seems to prevent Members from abusing this remedy to erect barriers to trade which may ordinarily be prohibited under the covered agreements.

3.4.1 Suspension in the Same Sector Under the Same Agreement

Article 22.3(a) DSU

As a general rule, the complaining party is required first to seek suspension of concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment. According to the Article 22.3(f) of the DSU, “sector” means:

- (i) with respect to goods, all goods;*
- (ii) with respect to services, a principal sector as identified in the current “Services Sectoral Classification List” which identifies such sectors;*
- (iii) with respect to trade-related intellectual property rights, each of the categories of intellectual property rights covered in Section 1, or Section 2, or Section 3, or Section 4, or Section 5, or Section 6, or Section 7 of Part II, or the obligations under Part III, or Part IV of the Agreement on TRIPS.*

Thus if the dispute relates to discriminatory treatment in respect of market access for a particular agricultural product, the complaining party may seek to suspend concessions or other obligations with respect to another agricultural product. In *EC– Bananas III*, the Arbitrators noted that if a panel or Appellate Body report contains findings of WTO-inconsistencies in only one and the same sector within the meaning of Article 22.3(f) of the DSU, proposed

⁴⁸ *Appellate Body Report, United States – Import Measures on Certain Products from the European Communities (“US – Certain EC Products”), WT/DS165/ABR., adopted 10 January 2001, para. 120.*

suspension of equivalent concessions by the complaining Member in that sector was less likely to be controversial than if under different sectors and agreements. The Arbitrators ruled:

If a panel or Appellate Body report contains findings of WTO-inconsistencies only with respect to one and the same sector in the meaning of Article 22.3(f) of the DSU, there is little need for a multilateral review of the choice with respect to goods or services or intellectual property rights, as the case may be, which a Member has selected for the suspension of concessions subject to the DSB's authorization. However, if a Member decides to seek authorization to suspend concessions under another sector, or under another agreement, outside the scope of the sectors or agreements to which a panel's findings relate, paragraphs (b)-(d) of Article 22.3 of the DSU provide for a certain degree of discipline such as the requirement to state reasons why that Member considered the suspension of concessions within the same sector(s) as that where violations of WTO law were found as not practicable or effective.⁴⁹

The Arbitrators in the same case, however, underlined that the fact that a request to suspend concessions in the same sector as that in which a violation has been found, is made under Article 22.3(a), is no reason why arbitrators should not carry out an examination to determine if the relevant principles established in the Article have been complied with. The Arbitrators reasoned that if they were prevented from carrying out this exercise, it would be relatively easy for Members to circumvent their obligations, a result not intended by the drafters of the DSU. The Arbitrators held:

In our view, if Article 22.3 of the DSU is to be given full effect, the authority of Arbitrators to review upon request whether the principles and procedures of subparagraphs (b) or (c) of that Article have been followed must imply the Arbitrators' competence to examine whether a request made under subparagraph (a) should have been made – in full or in part – under subparagraphs (b) or (c). If the Arbitrators were deprived of such an implied authority, the principles and procedures of Article 22.3 of the DSU could easily be circumvented. If there were no review whatsoever with respect to requests for authorization to suspend concessions made under subparagraph (a), Members might be tempted to always invoke that subparagraph in order to escape multilateral surveillance of cross-sectoral suspension of concessions or other obligations, and the disciplines of the other subparagraphs of Article 22.3 of the DSU might fall into disuse altogether.⁵⁰

3.4.2 Suspension in Another Sector Under the Same Agreement

Article 22.3(b) DSU

If the complaining party considers that it is not practical or effective to suspend

⁴⁹ *Decision by the Arbitrators, European Communities – Regime for the Importation, Sale and Distribution of Bananas, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT7DS27/ARB, para. 3.6.*

⁵⁰ *Ibid., para. 3.7.*

concessions in respect of another financial service, for example, it can seek to suspend concessions or other obligations in other sectors under the same agreement. According to the article 22.3(g) of the DSU, “agreement” means:

- (i) *with respect to goods, the agreements listed in Annex 1A of the WTO Agreement, taken as a whole as well as the Plurilateral Trade Agreements in so far as the relevant parties to the dispute are parties to these agreements;*
- (ii) *with respect to services, the GATS;*
- (iii) *with respect to intellectual property rights, the Agreement on TRIPS.*

Thus, where the complaining Member believes that it is not practical or effective for it to suspend concessions or other obligations with respect to another financial service, it may seek to suspend concessions on transport service.

3.4.3 Suspension Under Another WTO Agreement

Article 22.3(c) DSU

If the complaining party considers that it is not practical or effective for it to suspend concessions or other obligations in a different sector under the same agreement, it may seek to suspend concessions or other obligations under a different agreement. Thus, if the dispute concerns goods, it may seek to suspend concessions or other obligations under the GATS or TRIPS.

3.5 General Conditions to Be Fulfilled

Article 22.3(d) DSU

Since suspension of concessions is generally considered to be an extraordinary step, the DSU further provides in Article 22.3(d) that the Member seeking to have recourse to this remedy must take into account the following:

- (i) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that Member;
- (ii) the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations.

If the party is seeking authorization to suspend concessions and other obligations in a different sector under the same agreement or under another WTO agreement as specified in Articles 22.3 (b) and (c), respectively, it is obliged to provide reasons for its request to the DSB. The reasoned request shall at the same time be forwarded to the relevant WTO Council or sectoral body for its consideration, as the case may be.⁵¹

⁵¹ Article 22.3(e) of the DSU.

3.5.1 Scope of Article 22.3(a) of the DSU

In *EC – Bananas III*, the issue arose as to the proper scope of Article 22.3(a) of the DSU. The European Communities had argued that the United States was not entitled to request authorization to suspend concessions in trade in goods, as it did not have any interest in this sector. According to the European Communities the United States, according to it, should have requested authorization to suspend concessions in the distribution service sector or any other service sector given the finding of GATS violation by the panel and the Appellate Body, assuming that such violations would still continue under its revised banana regime. The Arbitrators rejected the EC’s argument and stated that it was a misreading of the relevant provisions of the DSU:

We recall that subparagraph (a) of Article 22.3 of the DSU refers to the suspension of “concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment.” We note that the words “same sector(s)” include both the singular and the plural. The concept of “sector(s)” is defined in subparagraph (f)(i) with respect to goods as all goods, and in subparagraph (f)(ii) with respect to services as a principal sector identified in the “Services Sectoral Classification List”. We, therefore, conclude that the United States has the right to request the suspension of concessions in either of these two sectors, or in both, up to the overall level of nullification or impairment suffered, if the inconsistencies with the EC’s obligations under the GATT and the GATS found in the original dispute have not been removed fully in the EC’s revision of its regime. In this case the “same sector(s)” would be “all goods” and the sector of “distribution services”, respectively. Our conclusion, based on the ordinary meaning of Article 22.3(a), is also consistent with the fact that the findings of violations under the GATT and the GATS in the original dispute were closely related and all concerned a single Import regime in respect of one product, i.e. bananas.⁵²

3.5.2 Scope of Discretion of the Complaining Member

The issue has also arisen as to whether it is the sole prerogative of the complaining Member under Articles 22.3(b) and (c) to decide whether it is not practicable or effective for it to suspend concessions in the same sector or in different sectors under the same agreement. In *EC – Bananas III*, Ecuador argued that the language in these articles was permissive and that it was the prerogative of the complaining Member to decide whether or not it was practicable or effective for it to suspend concessions in the same sector or in different sectors under the same agreement. It therefore contested the argument by the European Communities that it had not followed the principles and procedures set forth in Article 22.3. and that it should be denied authorization to suspend concessions under a different agreement. The Arbitrators accepted the argument of Ecuador that the language in Articles 22.3(b) and (c) conferred

⁵² *Decision by the Arbitrators, EC – Bananas III., Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT7DS27/ARB, para. 3.10.*

some discretion on the complaining Member, but went on to hold that when read in its entirety, Article 22 envisaged review by arbitrators to establish whether the relevant principles and procedures had been complied with by the Member seeking suspension of concessions or other obligations under a different sector under the same agreement or under a different agreement. The Arbitrators in *EC – Bananas III* held:

It follows from the choice of the words “if that party considers” in subparagraphs (b) and (c) that these subparagraphs leave a certain margin of appreciation to the complaining party concerned in arriving at its conclusions in respect of an evaluation of certain factual elements, i.e. of the practicability and effectiveness of suspension within the same sector or under the same agreement and of the seriousness of circumstances. However, it equally follows from the choice of the words “in considering what concessions or other obligations to suspend, the complaining party shall apply the following principles and procedures” in the chapeau of Article 22.3 that such margin of appreciation by the complaining party concerned is subject to review by the Arbitrators. In our view, the margin of review by the Arbitrators implies the authority to broadly judge whether the complaining party in question has considered the necessary facts objectively and whether, on the basis of these facts, it could plausibly arrive at the conclusion that it was not practicable or effective to seek suspension within the same sector under the same agreements, or only under another agreement provided that the circumstances were serious enough. The choice of the words “that party shall take into account” in subparagraph (d) makes clear that the Arbitrators have the authority to fully review whether the factors listed in subparagraphs (i)-(ii) of Article 22.3(d) have been taken into account by the complaining party in applying all the principles and procedures set forth in subparagraphs (a)-(c). By the same token, the choice of the words “it shall state the reasons therefore” in subparagraph (e) implies that the Arbitrators are to review the reasons stated therefore by a complaining party in making a request under subparagraphs (b) or (c).⁵³

3.5.3 Objective Assessment Under Article 22.3 (b) and (c)

In *EC – Bananas III*, the European Communities disputed the right of Ecuador to request authorization to suspend concessions and other obligations under the TRIPS Agreement, as no finding of inconsistency of its banana regime with this Agreement had been made by the Panel and the Appellate Body. Ecuador argued that its request was justified by Article 22.3 (c) of the DSU, as it was not practicable or effective for it to suspend concessions or other obligations in the areas where violations had been found by the Panel and the Appellate Body. The Arbitrators started their analyses by examining the ordinary meaning of the terms “practicable” and “effective” and went on to consider the substantive merits of the arguments of the parties. The Arbitrators held:

⁵³ Decision by the Arbitrators, *EC – Bananas III, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT7DS27/ARB/ECU*, paras. 52-53.

[W]e note that the ordinary meaning of “practicable” is “available or useful in practice; able to be used” or “inclined or suited to action as opposed to speculation etc.”.⁵⁴ In other words, an examination of the “practicability” of an alternative suspension concerns the question whether such an alternative is available for application in practice as well as suited for being used in a particular case. In contrast, the term “effective” connotes “powerful in effect”, “making a strong impression”, “having an effect or result”. Therefore, the thrust of this criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB rulings within a reasonable period of time. One may ask whether this objective may ever be achieved in a situation where a great imbalance in terms of trade volume and economic power exists between the complaining party seeking suspension and the other party which has failed to bring WTO-inconsistent measures into compliance with WTO law. In such a case, and in situations where the complaining party is highly dependent on imports from the other party, it may happen that the suspension of certain concessions or certain other obligations entails more harmful effects for the party seeking suspension than for the other party.⁵⁵ In these circumstances, a consideration by the complaining party in which sector or under which agreement suspension may be expected to be least harmful to itself would seem sufficient for us to find a consideration by the complaining party of the effectiveness criterion to be consistent with the requirement to follow the principles and procedures set forth in Article 22.3.⁵⁶ (italics added)

In further rejecting the argument of the European Communities that Ecuador had not followed the principles and procedures set forth in Article 22.3 of the DSU, the Arbitrators noted that contrary to the claim of the European Communities, Articles 22.3(b) and (c) do not require the complaining Member to establish that suspension of concessions or other obligations would be effective or practicable in the same sector and/or the same agreement. In other words, the Arbitrators pointed out that Articles 22.3(b) and (c) set out the relevant criteria in the negative. The Arbitrators in *EC – Bananas III* noted:

We emphasize that Article 22.3(b) and (c) does not require Ecuador, nor us, to establish that suspension of concessions or other obligations is practicable and/or effective under another agreement (i.e. the TRIPS Agreement) than those under which violations have been found (i.e. the GATT and the GATS). The burden is on the European Communities to establish that suspension within the same sector(s) and/or the same agreement(s) is effective and practicable. However, according to subparagraph (c) of Article 22.3, it is our task to review Ecuador’s consideration that the “circumstances are serious enough” to warrant suspension across agreements.⁵⁷

⁵⁴ *The New Shorter Oxford English Dictionary* (“Oxford English Dictionary”), Oxford (1993), p. 2317.

⁵⁵ Of course, suspension of concessions or other obligations is always likely to be harmful to a certain, limited extent also for the complaining party requesting authorization by the DSB.

⁵⁶ *Decision by the Arbitrators, EC - Bananas III, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT7DS27/ARB/ECU, paras. 52-53.*

⁵⁷ *Ibid.*, para. 78.

3.6 Scope of Article 22.3(d) of the DSU

Article 22.3(d) DSU

The Arbitrators in *EC – Bananas III* also examined the scope of Article 22.3(d). They were of the view that the Article cannot be read in isolation and due consideration should be given to other provisions of Article 22. In relation to sub-paragraph (i) of the Article 22.3(d), which provides that “in applying the above principles, ...[the complaining Member] shall take into account...the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party”, the European Communities had argued that the phrase “the importance of...trade” should be interpreted to mean trade in the relevant sector(s) and/or agreement(s) in their entirety. Ecuador disagreed and argued that it could only mean trade in goods and services in the bananas sector. The Arbitrators agreed with Ecuador on this point. They ruled:

We believe that the criteria of “such trade” and the “importance of such trade” to the complaining party relate primarily to trade nullified or impaired by the WTO-inconsistent measure at issue. In the light of this interpretation, we attribute particular significance to the factors listed in subparagraph (i) in the case before us, where the party seeking suspension is a developing country Member; where trade in bananas and wholesale service supply with respect to bananas are much more important for that developing country Member than for the Member with respect to which the requested suspension would apply⁵⁸

Distinction Article 22.3(d) (i) and (ii)

The Panel highlighted the different considerations that have to be taken into account under Article 22.3(d)(i) and (ii). It pointed out that whereas subparagraph (i) related primarily to the Member which had suffered nullification and impairment and was seeking suspension, subparagraph (ii) could relate to both parties, as suspension of concessions and other obligations could affect both the Member being “retaliated” against and the Member taking the action. The Arbitrators in *EC – Bananas III* stated in this respect:

[S]ubparagraph (ii) of Article 22.3(d) requires the complaining party to take into account in addition “broader economic elements” related to the nullification or impairment as well as “broader economic consequences” of the suspension of concessions or other obligations. The fact that the former criterion [subparagraph (i)] relates to “nullification or impairment” indicates in our view that this factor primarily concerns “broader economic elements” relating to the Member suffering such nullification or impairment, i.e. in this case Ecuador. We believe, however, that the fact that the latter criterion relates to the suspension of concessions or other obligations is not necessarily an indication that “broader economic consequences” relate exclusively to the party which was found not to be in compliance with WTO law, i.e. in this case the European Communities. As noted above, the suspension of

⁵⁸ *Ibid.*, para. 84.

concessions may not only affect the party retaliated against, it may also entail, at least to some extent, adverse effects for the complaining party seeking suspension, especially where a great imbalance in terms of trade volumes and economic power exists between the two parties such as in this case where the differences between Ecuador and the European Communities in regard to the size of their economies and the level of socio-economic development are substantial.⁵⁹

3.7 Equivalency

Article 22.4 DSU

To ensure that Members do not abuse this right to impose restrictions on the trade of the responding Member, Article 22.4 of the DSU provides that:

[t]he level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification and impairment.

In *EC – Bananas III*, the Arbitrators stated that equivalence can only be established after comparing the monetary value of the proposed suspension of concessions with the level of nullification and impairment suffered by the complaining Member. The Arbitrators reasoned:

Obviously...[equivalence] connotes a correspondence, identity or balance between two related levels, i.e. between the level of the concessions to be suspended, on the one hand, and the level of the nullification or impairment, on the other. The former level, i.e. the proposed suspension of concessions, is clearly discernible in respect of the overall amount (US\$520 million) suggested by the United States as well as in terms of the product coverage envisaged.⁶⁰ However, the same degree of clarity is lacking with respect to the latter, i.e. the level of nullification or impairment suffered. It is impossible to ensure correspondence or identity between two levels if one of the two is not clearly defined. Therefore, as a prerequisite for ensuring equivalence between the two levels at issue we have to determine the level of nullification or impairment.⁶¹

The Arbitrators went on to hold that before they could establish the level of nullification or impairment suffered by the United States, it was imperative for them to examine whether the European Communities' new regime for bananas was consistent with covered agreements. The Arbitrators held:

[W]e cannot fulfil our task to assess equivalence between the two levels before we have reached a view on whether the revised EC regime is, in light of our and Appellate Body's findings in the original dispute, fully WTO-consistent.

⁵⁹ *Ibid.*, paras 85-86.

⁶⁰ *WT/DS27/43*.

⁶¹ *Decision by the Arbitrators, EC - Bananas III, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT/DS27/ARB, paras 4.1 and 4.2.*

It would be the WTO-inconsistency of the revised EC regime that would be the root cause of any nullification or impairment suffered by the United States. Since the level of the proposed suspension of concessions is to be equivalent to the nullification or impairment, logic dictates that our examination as Arbitrators focuses on that latter level before we will be in a position to ascertain its equivalence to the level of the suspension of concessions proposed by the United States.⁶²

3.7.1 Disputes under the SCM

In *Brazil – Aircraft*, the issue arose as to whether the principle of equivalence has any relevance in disputes under the *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”). Brazil and Canada disagreed in this case whether countermeasures in the form of suspension of concessions or other obligations should be equivalent to the level of nullification or impairment suffered by the complaining Member. The Arbitrators decided against Brazil on this point noting that the concept of equivalence was not embedded in the *SCM Agreement*. The Arbitrators held:

[W]e recall that the concept of nullification or impairment is absent from Articles 3 and 4 of the SCM Agreement. In that framework, there is no legal obligation that countermeasures in the form of suspension of concessions or other obligations be equivalent to the level of nullification or impairment. [R]equiring that countermeasures in the form of suspension of concessions or other obligations be equivalent to the level of nullification or impairment would be contrary to the principle of effectiveness by significantly limiting the efficacy of countermeasures in the case of prohibited subsidies. Indeed, as shown in the present case, other countermeasures than suspension of concessions or obligations may not always be feasible because of their potential effects on other Members. This would be the case of a counter-subsidy granted in a sector where other Members than the parties compete with the products of the parties. In such a case, the Member taking the countermeasure may not be in a position to induce compliance. We are mindful that our interpretation may, at a first glance, seem to cause some risk of disproportionality in case of multiple complaints. However, in such a case, the arbitrator could allocate the amount of appropriate countermeasures among the complainants in proportion to their trade in the product concerned. The “inducing” effect would most probably be very similar ... [W]hen dealing with a prohibited export subsidy, an amount of countermeasures which corresponds to the total amount of the subsidy is “appropriate”.⁶³

Similarly in *US – FSC*, the Arbitrators rejected the argument of the United States that Article 4.10 of the *SCM Agreement* required countermeasures adopted not to be disproportionate to the trade impact of the violating measures on the complaining Member. The Arbitrators reasoned:

⁶² *Ibid.*, para. 4.8.

⁶³ *Decision by the Arbitrators, Brazil – Export Financing Programme for Aircraft, Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, WT/DS46/ARB, paras. 3.57-3.60.*

[A]s we interpret Article 4.10 of the SCM Agreement, a Member is entitled to act with countermeasures that properly take into account the gravity of the breach and the nature of the upset in the balance of rights and obligations in question. This cannot be reduced to a requirement that constrains countermeasures to trade effects ... At the same time, Article 4.10 of the SCM Agreement does not amount to a blank cheque. There is nothing in the text or in its context which suggests an entitlement to manifestly punitive measures. On the contrary, footnote 9 specifically guards us against such an unbounded interpretation by clarifying that the expression “appropriate” cannot be understood to allow “disproportionate” countermeasures. However, to read this indication as effectively reintroducing into that provision a quantitative limit equivalent to that found in other provisions of the SCM Agreement or Article 22.4 of the DSU would effectively read the specific language of Article 4.10 of the SCM Agreement out of the text. Countermeasures under Article 4.10 of the SCM Agreement are not even, strictly speaking, obliged to be “proportionate” but not to be “disproportionate”. Not only is a Member entitled to take countermeasures that are tailored to offset the original wrongful act and the upset of the balancing of rights and obligations which that wrongful act entails, but in assessing the “appropriateness” of such countermeasures – in light of the gravity of the breach –, a margin of appreciation is to be granted, due to the severity of that breach.⁶⁴

3.7.2 Calculation of Nullification and Impairment

In *EC – Hormones*, the Arbitrators were of the view that the relevant date to be taken into consideration when calculating nullification and impairment of benefits is the date on which the reasonable period of time expired. The Arbitrators ruled:

Upon careful consideration of the claims and arguments set forth by the parties, we consider that our starting-point is as follows: what would annual prospective US exports of hormone-treated beef and beef products to the EC be if the EC had withdrawn the ban on 13 May 1999? 13 May 1999 is the date of expiration of the reasonable period of time granted to the EC to implement the panel and Appellate Body reports. In accordance with DSU provisions, it was by 13 May 1999 that the EC had to bring its beef import regime into conformity with the SPS Agreement. We cannot assume that the EC from 1989 onwards, i.e. from the time it imposed the ban, was under a legal obligation to withdraw the ban. We note, in this respect, that the violations found were violations of the SPS Agreement, an agreement only in existence from 1 January 1995 onwards.⁶⁵ (Emphasis in original)

⁶⁴ Decision of the Arbitrator, *US – FSC, Recourse to Arbitration by the United States under Article 22.6 of the DSU, WT/DS108/ARB*, paras 5.60 – 5.62.

⁶⁵ Decision by the Arbitrators, *EC - Hormones, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, para. 38. See also Decision of the Arbitrator, *US – FSC*, para. 2.15, where the Arbitrator held that the relevant date for assessing the proposed suspension of concessions was the time when the United States should have withdrawn its prohibited subsidy: In *Brazil – Export Financing Programme for Aircraft, Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, the Arbitrators based their calculations on the number of deliveries and sales that took place between the end of the period of implementation and the latest period for which figures were available (18 November 1999 – 30 June 2000).

In *United States – Section 110(5) Copyright Act*, the Arbitrators, however, chose a different benchmark owing to the particular circumstances of the case. They were of the view that it was not possible to rely on the date the reasonable period of time expired and that it was appropriate to rely on the date on which the matter was referred to them. The Arbitrators ruled:

In the present case, the reasonable period of time was supposed to lapse on 27 July 2001. However, on 24 July 2001, the DSB agreed to an extension until 31 December 2001 or the date on which the current session of the US Congress adjourns, whichever is earlier. In those circumstances, ...[we] believe that using the date of the end of the reasonable period of time as cut-off date is not feasible, lest they will add uncertainty to ...[our] estimate by making additional assumptions as to the situation at the end of a period which, itself, is not known for sure.

...

[We] deem it appropriate to calculate the level of EC benefits nullified or impaired by the continuing operation of Section 110(5) (B) on a date as close as possible to the date on which the matter was referred to them. In this case, because of the statistical information available, [our] estimate will be based on the situation on 30 June 2001.⁶⁶

3.7.3 Burden of Proof

It is well established in WTO jurisprudence that a Member which claims that another Member has acted inconsistently with the WTO rules has the burden of proof. Thus, in the context of arbitration proceedings under Article 22 of the DSU, if the responding Member claims that the proposed suspension of concessions and other obligations is not equivalent to the level of nullification or impairment, then it would have the burden of proof. In *EC – Hormones*, the Arbitrators stated that WTO Members as sovereign states would be presumed to have complied with their obligations and that it was up to a Member who alleges otherwise to adduce evidence to that effect. The moment it satisfies this condition, it would be up to the other party to submit arguments and evidence sufficient to rebut that presumption. The Arbitrators in *EC – Hormones* reasoned as follows:

WTO Members, as sovereign entities, can be presumed to act in conformity with their WTO obligations. A party claiming that a Member has acted inconsistently with WTO rules bears the burden of proving that inconsistency... The act at issue here is the US proposal to suspend concessions. The WTO rule in question is Article 22.4 prescribing that the level of suspension be equivalent to the level of nullification and impairment. The EC challenges the conformity of the US proposal with the said WTO rule. It is thus for the EC to prove that the US proposal is inconsistent with Article 22.4. Following well-established jurisprudence, this means that it is for the EC to submit arguments and evidence sufficient to establish a prima facie case or

⁶⁶ *United States – Section 110(5) of the US Copyright Act, Recourse to Arbitration under Article 25 of the DSU, WT/DS160/ARB25/1, paras. 4.20 and 4.25.*

presumption that the level of suspension proposed by the US is not equivalent to the level of nullification or impairment caused by the EC hormone ban. Once the EC has done so, however, it is for the US to submit arguments and evidence sufficient to rebut that presumption. Should all arguments and evidence remain in equipoise, the EC, as the party bearing the original burden of proof, would lose. The same rules apply where the existence of a specific fact is alleged; in this case, for example, where a party relies on a decrease of beef consumption in the EC or the use of edible beef offal as pet food. It is for the party alleging the fact to prove its existence. The duty that rests on all parties to produce evidence to the arbitrators – an issue to be distinguished from the question of who bears the burden of proof – is crucial in Article 22 arbitration proceedings. The EC is required to submit evidence showing that the proposal is not equivalent. However, at the same time and as soon as it can, the US is required to come forward with evidence explaining how it arrived at its proposal and showing why its proposal is equivalent to the trade impairment it has suffered. Some of the evidence – such as data on trade with third countries, export capabilities and affected exporters – may, indeed, be in the sole possession of the US, being the party that suffered the trade impairment. This explains why we requested the US to submit a so-called methodology paper.⁶⁷

In *US – FSC*, the Arbitrators affirmed the decision of the Appellate Body in *US – Wool Shirts and Blouses* and said that as the Member challenging the consistency of the proposed amount of suspension of concessions, the United States had the burden of proof⁶⁸:

We recall that the general principles applicable to burden of proof, as stated by the Appellate Body, require that a party claiming a violation of a provision of the WTO Agreement by another Member must assert and prove its claim. We find these principles to be also of relevance to arbitration proceedings under Article 22.6 of the DSU and Article 4.10 of the SCM Agreement. In this procedure, we thus agree that it is for the United States, which has challenged the consistency of the European Communities proposed amount of suspension of concessions under Articles 4.10 of the SCM Agreement and 22.4 of the DSU, to bear the burden of proving that the proposed amount is not consistent with these provisions. We also note, however, that it is generally for each party asserting a fact, whether complainant or respondent, to provide proof thereof. In this respect, therefore, it is also for the European Communities to provide evidence for the facts which it asserts. In addition, we consider that both parties generally have a duty to cooperate in the proceedings in order to assist us in fulfilling our mandate, through the provision of relevant information.

⁶⁷Decision by the Arbitrators, *EC - Hormones, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, paras 9-11.

⁶⁸Decision of the Arbitrator, *US – FSC, Recourse to Arbitration by the United States under Article 22.6 of the DSU*, paras. 2.10-2.11.

3.7.4 *Suspension Consistent With the Covered Agreements*

The complaining Member cannot suspend concessions or other obligations if a covered agreement prohibits such suspension. In other words, the fact that the responding party has adopted an inconsistent measure does not authorize the complaining Member to adopt the same measure. In their request for suspension of concessions in *US – 1916 Act*, the European Communities and Japan proposed to adopt “mirror” legislation to the United States’ Anti-dumping Act of 1916 which had been found by both the Panel and the Appellate Body to be inconsistent with the WTO Agreement on Anti-Dumping. A number of Members expressed concern about the request of the European Communities and Japan. Brazil noted that:

...[I]n addressing the remedies available in the dispute settlement mechanism, the DSU drafters had not intended to allow open-ended solutions that would enable a Member to go as far as enacting “mirror” legislation, which had been declared to be WTO-inconsistent. Therefore the question was, if the 1916 Act was WTO inconsistent because it contained specific actions against dumping not provided for in the Agreement, how could the WTO endorse a solution for non-compliance which was not compatible with the same Agreement. This mirror solution would have deleterious effect on the system and would distort the fundamental principles of good faith and the abidance by the rules.⁶⁹

3.8 Arbitration

Article 22.6 DSU

According to Article 22.6 of the DSU, where there is a dispute between the parties as to the level of suspension proposed, or where there are claims that the party seeking suspension has not followed the principles and procedures established in Article 22.3(b) and (c), the matter can be referred to arbitration. The arbitration proceedings must be completed within 60 days after the date of the expiry of the reasonable period of time.⁷⁰ Concessions or other obligations can only be suspended after the arbitration proceedings have been completed. In other words, concessions or other obligations cannot be suspended in the course of the arbitration proceedings.⁷¹

3.8.1 *Arbitration Request*

Like a panel request under Article 6.2 of the DSU, a request for arbitration under Article 22 of the DSU has to meet certain minimum requirements. As has been stated by a number of panels and the Appellate Body in the context of Article 6.2 of the DSU, these requirements have been imposed as a result of considerations relating to the due process of law. A long line of cases has established in that context that the responding Member should be apprised of

⁶⁹ *WT/DSB/M/117*; 15 February 2002, para. 21 t p5.

⁷⁰ Article 22.6 of the DSU.

⁷¹ *Ibid.*

all the relevant facts at the appropriate time to enable it to defend itself against the charges levelled by the complaining Member. Timeliness is essential as surprise should not be sprung upon responding Members. In *EC – Bananas III*, the Arbitrators stated that the requirements under Article 6.2 of the DSU applied *mutatis mutandis* to requests under Articles 22.2 and 22.6 of the DSU:

The DSU does not explicitly provide that the specificity requirements, which are stipulated in Article 6.2 for panel requests, apply mutatis mutandis to arbitration proceedings under Article 22. However, we believe that requests for suspension under Article 22.2, as well as requests for a referral to arbitration under Article 22.6, serve similar due process objectives as requests under Article 6.2. First, they give notice to the other party and enable it to respond to the request for suspension or the request for arbitration, respectively. Second, a request under Article 22.2 by a complaining party defines the jurisdiction of the DSB in authorizing suspension by the complaining party. Likewise, a request for arbitration under Article 22.6 defines the terms of reference of the Arbitrators. Accordingly, we consider that the specificity standards, which are well-established in WTO jurisprudence under Article 6.2, are relevant for requests for authorization of suspension under Article 22.2, and for requests for referral of such matter to arbitration under Article 22.6, as the case may be. They do, however, not apply to the document submitted during an arbitration proceeding, setting out the methodology used for the calculation of the level of nullification or impairment.⁷²

In the same case, the Arbitrators endorsed the statement made by the Arbitrators in *EC – Hormones*, that a request under Article 22 has to satisfy at least two basic requirements:

(1) the request must set out a specific level of suspension, i.e. a level equivalent to the nullification and impairment caused by the WTO-inconsistent measure, pursuant to Article 22.4; and (2) the request must specify the agreement and sector(s) under which concessions or other obligations would be suspended, pursuant to Article 22.3.⁷³

3.8.2 Appointment of Arbitrators

The DSU provides that the arbitration between the parties shall be carried out by the original panel, if the members are available, or by an arbitrator appointed by the Director-General of the WTO. Where a member of the original panel is

⁷² *Decision by the Arbitrators, EC – Bananas III, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT/DS26/ARB/ECU, para. 20.*

⁷³ *Decision by the Arbitrators, E - Hormones, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT/DS26/ARB, para. 16. The Arbitrators noted that “[t]he more precise a request for suspension is in terms of product coverage, type and degree of suspension, etc..., the better. Such precision can only be encouraged in pursuit of the DSU objectives of ‘providing security and predictability to the multilateral trading system’ (Article 3.2) and seeking prompt and positive solutions to disputes (Articles 3.3 and 3.7). It would also be welcome in light of the statement in Article 3.10 that ‘all Members will engage in DSU procedures in good faith and in an effort to resolve the dispute’.*

not available, another person can be appointed as a replacement. It should be noted that the term arbitrator is used to refer to both the original panel and an individual who may be appointed by the Director-General of the WTO for the purposes of Article 22.6 of the DSU.

3.8.3 *Functions of the Arbitrator*

Article 22.6 and 22.7 DSU

The issue has arisen as to the scope of the mandate of Arbitrators under Articles 22.6 and 22.7 of the DSU. In *EC – Bananas III*, the Arbitrators were of the view that their mandate under Article 22.7 was broader than that conferred on them under Article 22.6:

Article 22.7 of the DSU empowers the Arbitrators to examine claims concerning the principles and procedures set forth in Article 22.3 of the DSU in its entirety, whereas Article 22.6 of the DSU seems to limit the competence of Arbitrators in such examinations to cases where a request for authorization to suspend concessions is made under subparagraphs (b) and (c) of Article 22.3 of the DSU. However, we believe that there is no contradiction between paragraphs 6 and 7 of Article 22 of the DSU, and that these provisions can be read together in a harmonious way.⁷⁴

It is not the function of the arbitrator to examine the nature of the concessions or other obligations proposed to be suspended by the prevailing Member, but rather to determine whether the level of suspension is equivalent to the level of nullification or impairment.⁷⁵ In *EC – Hormones*, the Arbitrators refused to accede to the request by the *European Communities* to request the United States “to submit a list of proposed suspension of concession equivalent to the level of nullification or impairment, once this level has been determined by the arbitrator.” After noting that there was no textual basis for this request, the Arbitrators stated that:

Arbitrators are explicitly prohibited from “examin[ing] the nature of the concessions or other obligations to be suspended” (other than under Articles 22.3 and 22.5). On these grounds, we cannot require that the US further specify the nature of the proposed suspension. As agreed by all parties involved in this dispute, in a case a proposal for suspension were to target, for example, only biscuits with a 100 per cent ad valorem, it would not be for the arbitrators to decide that, for example, cheese and not biscuits should be targeted; that a 150 per cent tariff should be imposed instead of a 100 per cent tariff; or that tariff increases should be levied on a product weight basis, not ad valorem. All of these are qualitative aspects of the proposed suspension touching upon the “nature” of concessions to be withdrawn. They fall outside the arbitrators’ jurisdiction. What we do have to determine, however, is whether the overall proposed level of suspension is equivalent to the level of nullification and impairment. This involves a quantitative not a qualitative – assessment of the proposed suspension.⁷⁶

⁷⁴ Decision by the Arbitrators, *EC – Bananas III*, ...

⁷⁵ Article 22.7 of the DSU.

⁷⁶ Decision by the Arbitrators, *EC – Hormones*, ...

Thus, if the prevailing Member has proposed to suspend concessions totalling \$1 billion, the arbitrator, at the request of the responding Member, can determine whether its inability to implement the recommendations and rulings of the DSB has impaired or nullified the complaining Member's benefit to the level of the proposed amount. It is not the duty of the arbitrator to determine which concessions have to be suspended by the prevailing Member. The arbitrator may also determine whether the proposed suspension is allowed under a covered agreement. When there is a claim that the principles and procedures set forth in Article 22.3 have not been followed, the arbitrator would be entitled to examine it, and in the event of reaching the conclusion that they have indeed not been followed, the complaining Member would be required to apply them consistently with the provisions of the paragraph.

3.8.4 *Decision of the Arbitrator*

Parties to arbitration under Article 22.6 of the DSU are obliged to accept the decision of the arbitrator as final in the sense that they cannot appeal it to the Appellate Body or seek a second arbitration. The decision of the arbitrator is expected to be communicated promptly to the DSB which shall, at the request of the prevailing party, grant authorization to suspend concessions or other obligations where the request is consistent with the decision of the arbitrator. The DSB may decide, however, by consensus to reject the request of the prevailing Member.

3.9 *Surveillance and Termination*

Article 22.8 DSU

Article 22.8 of the DSU underscores the fact that the primary remedy of the WTO dispute settlement mechanism is implementation of the recommendations and rulings of the DSB as promptly as possible. It provides that suspension of concessions or other obligations is temporary and should be resorted to only when it is not possible to implement the recommendations and rulings of the DSB. To facilitate the implementation of adopted recommendations and rulings, it further provides that the DSB shall keep under surveillance such recommendations and rulings until such time that the measure which has been found to be inconsistent with a covered agreement is removed, or when the parties negotiate a mutually satisfactory solution to the problem. Article 22.8 of the DSU provides that:

The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached. In accordance with paragraph 6 of Article 21, the DSB shall continue to keep under surveillance the implementation of adopted recommendations or rulings, including those cases where compensation has been provided or concessions or other obligations have been suspended but the recommendations to bring



a measure into conformity with the covered agreements have not been implemented.

3.10 Test Your Understanding

- 1. Can mutually agreed compensation within the meaning of Article 22.2 of the DSU constitute a definitive settlement of a dispute**
- 2. Can suspension of concessions or other obligations authorized by the DSB under Article 22.6 of the DSU constitute a definitive settlement of a dispute?**
- 3. If a panel or Appellate Body report only contains findings of inconsistency with respect to trade in textiles, can the complaining Member then request the suspension of concessions with respect to trade in agricultural products? In which circumstances may the complaining Member seek compensation under the GATS or TRIPS Agreement?**
- 4. How is the appropriate level of suspension of concessions or other obligations to be determined? By whom is the appropriate level to be determined in case of disagreement between the parties? Will the complaining Member have to show that the proposed level of suspension is appropriate?**

4. CASE STUDIES

1. At its meeting of last month, the DSB adopted the Appellate Body Report and the Panel Report as upheld by the Appellate Body Report in *Farland – Anti-Dumping Duties Imposed on Handheld Computers*, complaint by Richland. The Appellate Body and the Panel ruled that the anti-dumping duties imposed by Farland on handheld computers from Richland were inconsistent with the *Anti-Dumping Agreement*. Furthermore, they ruled also that also Farland's anti-dumping legislation itself, the *Trade Defence Act of 1994*, was inconsistent with the *Anti-Dumping Agreement*. The Appellate Body recommended that the DSB request that Farland bring its measures found in its Report, and upheld in the Panel Report, to be inconsistent with its obligations under the *Anti-Dumping Agreement*.

Farland, a developing country with a struggling infant computer industry, is very disappointed with this outcome. At the DSB meeting of last week, Farland announced that it would comply with the recommendations and rulings adopted by the DSB but argued that it did not need to comply immediately. In its opinion, it was entitled to a reasonable period of time to withdraw the anti-dumping measures imposed on handheld computers and to amend its anti-dumping legislation. Farland argued that for the withdrawal of the anti-dumping measures it would need six months in order to allow its computer manufacturers to adapt to the new situation. For the amendment of the anti-dumping legislation, Farland claims that it will need at least 20 months. i.e., until after the next elections, because there is currently no majority in Parliament to change the anti-dumping legislation. According to Farland, it is entitled to a long reasonable period of time for implementation because it is a developing country in economic crisis. Farland and Richland are unable to reach an agreement on the reasonable period of time for implementation and Farland objects to the appointment of an arbitrator.

What can Richland do? Which factors can and/or must be taken into account in determining the reasonable period of time for implementation?

2. The Panel in *Lowland – Measures Concerning the Safety of Bicycles*, complaint by Sealand, had found that the *Bicycle Safety Act* of Lowland was inconsistent with the *TBT Agreement*, and, in particular, Article 2.4 thereof. Some of the technical regulations set out in the *Bicycle Safety Act* were not based on the relevant international safety standard for bicycle seats. Lowland did not appeal the panel report and agreed with Sealand on a reasonable period of time for implementation of 15 months. A few days before the expiry of this reasonable period of time, Lowland modified the *Bicycle Safety Act* to comply with the recommendations and rulings of the DSB. Sealand, however, considered that Lowland's legislation as modified was still inconsistent with the *TBT Agreement* and it demanded that Lowland pay compensation for the continued WTO-inconsistency of the *Bicycle Safety Act*. Lowland refused to enter into negotiations on compensation because it is of the opinion that the amended

Bicycle Safety Act is no longer inconsistent with the *TBT Agreement*. On day 21 after the expiry of the reasonable period of time for implementation, Sealand requests authorization from the DSB to suspend the application to Lowland of concessions or other obligations for an amount of US\$30 million per year. Sealand seeks to suspend concessions or other obligations relating to trade in agricultural products and financial services. Lowland objects to this suspension of concessions or other obligations not only because it considers that the *Bicycle Safety Act* is now WTO consistent, but also because the level of suspension proposed is excessive and the relevant rules on suspension have not been followed.

How should either Sealand or Lowland proceed?

5. FURTHER READING

5.1 Books and Articles

- **Anderson, K.**, “Peculiarities of Retaliation in WTO Dispute Settlement, Centre for International Economic Studies Discussion Paper No. 0207 (Adelaide University, 2002).
- **Charnovitz, S.**, “Rethinking WTO Trade Sanctions”, *American Journal of International Law*, 2001, 792-832.
- **Hufbauer, G., Schott, J. and Elliott, K.**, *Economic Sanctions Reconsidered*, 2nd edition (Institute for International Economics, Washington, 1990).
- **Jackson, J.**, “Designing and Implementing Effective Dispute Settlement Procedures: WTO Dispute Settlement, Appraisal and Prospects”, in Krueger, A. (ed.), *The WTO as an International Organization* (University of Chicago Press, 1998).
- **Komura, N.**, “The EC Banana Regime and Judicial Control”, *Journal of World Trade*, 2000, 1-87.
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- **Monnier, P.**, “The Time to Comply with an Adverse WTO Ruling: promptness within Reason”, *Journal of World Trade*, 2001, 825-845.
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- **Salas, M. and Jackson, J.**, “Procedural Overview of the WTO EC-Banana Dispute”, *Journal of International Economic Law*, 2000, 145-66.
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5.2 Documents and Information

For information on WTO activities, see www.wto.org. Official WTO documents can be obtained by searching on the WTO’s online document database, available at: <http://docsonline.wto.org>. A very useful website on WTO dispute settlement is www.worldtradelaw.net.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.6 ANTI DUMPING MEASURES



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

The official title of this WTO agreement reads *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*. However, it is consistently referred to as the *Anti-Dumping Agreement (ADA)*.

The ADA sets out the conditions under which WTO Members may apply anti-dumping measures as a remedy against injurious dumping in their markets. It provides detailed rules on the concepts of *dumping* and *material injury* and contains many procedural provisions that WTO Members, wishing to take anti-dumping action, must comply with.

This Module gives an overview of the provisions of the *Anti-Dumping Agreement*, and how these provisions have been interpreted by Panels and the Appellate Body over the last seven years. It covers both substantive and procedural rules. Since the entry into force of the ADA in 1995, ten WTO Panel reports have been issued interpreting ADA provisions, of which seven were appealed. These Panel and Appellate Body reports offer crucial interpretations of key provisions of the Agreement. Panel and Appellate Body findings form an important element of this Module are covered in tandem with the relevant provisions. This Module takes into account reports issued until 31 August 2001.

The first Section gives a general overview of the ADA.

The second Section, entitled “the determination of dumping”, explains in some detail the three forms of dumping, considered actionable under the ADA. The third Section on the “determination of injury” examines the material injury requirement, as well as related concepts such as the determination of the like product and the domestic industry and the causal link between the dumped imports and the injury suffered by the domestic industry.

The fourth Section, entitled “the national procedures”, highlights the various stages of an anti-dumping investigation and discusses the rights of interested parties.

Section 5 discusses WTO dispute settlement procedures particular to the ADA. Section 6 analyses the position of developing countries under the ADA.

This Module describes how to conduct a simple anti-dumping calculation and the formal stages of anti-dumping procedures. It also identifies the areas in which the case law of the Panel and the Appellate Body has had a significant impact on the application of the ADA provisions.

1. INTRODUCTION

This section gives an overview of the history of international regulation of dumping, anti-dumping measures and forms of dumping and injury. It also provides a summary overview of the Anti-Dumping Agreement [ADA] and explains certain key terms in the ADA.

1.1 History

Dumping occurs if a company sells at a lower price in an export market than in its domestic market. If such dumping injures the domestic producers in the importing country, under certain circumstances the importing country authorities may impose anti-dumping duties to offset the effects of the dumping.

National anti-dumping legislation dates back to the beginning of the 20th century. The GATT 1947 contained a special article on dumping and anti-dumping action. Article VI of the GATT *condemns* dumping that causes injury, but it does not prohibit it.

Article VI:1 GATT 1994

The contracting parties recognize that dumping, by which products of one country are introduced into the commerce of another country at less than the normal value of the products, is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry.

Rather, Article VI authorizes the *importing Member* to take measures to offset injurious dumping. This approach follows logically from the definition of dumping as price discrimination practised by private companies. The GATT addresses *governmental* behaviour and therefore cannot possibly prohibit dumping by private enterprises. Moreover, importing countries may not find it in their interest to act against dumping, for example because their user industries benefit from the low prices.

Thus, GATT (and now the WTO) approaches the problem from the other side, *i.e.* from the position of the importing Member. However, recognizing the potential for trade-restrictive application, GATT (like WTO) law prescribes in some detail the circumstances under which anti-dumping measures may be imposed.

Since 1947, anti-dumping has received elaborate attention in the GATT/WTO on several occasions. Following a 1958 GATT Secretariat study of national anti-dumping laws, a Group of Experts was established that in 1960 agreed on certain common interpretations of ambiguous terms of Article VI.

An Anti-Dumping Code was negotiated during the 1967 Kennedy Round and signed by 17 parties. The Code was revised during the Tokyo Round. The Tokyo Round Code had 25 signatories, counting the EC as one. Although the 1979 Code was not explicitly mentioned in the Ministerial Declaration on the Uruguay Round, fairly early in the negotiations a number of GATT Contracting Parties, including the EC, Hong Kong, Japan, Korea and the United States proposed changes to the 1979 Code.

1.2 Current Situation

Article VI was carried forward into GATT 1994. A new agreement, the Agreement on Implementation of Article VI [ADA], was concluded in 1994 as a result of the Uruguay Round. Article VI and the ADA apply together.

Article 1 ADA

An anti-dumping measure shall be applied only under the circumstances provided for in Article VI of GATT 1994 and pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement.

1.3 Outline of ADA

The ADA is divided into three parts and two important annexes. Part I, covering Articles 1 to 15, is the heart of the Agreement and contains the definitions of dumping (Article 2) and injury (Article 3) as well as all procedural provisions that must be complied with by importing Member authorities wishing to take anti-dumping measures. Articles 16 and 17 in Part II establish respectively the WTO Committee on Anti-Dumping Practices [ADP] and special rules for WTO dispute settlement relating to anti-dumping matters. Article 18 in Part III contains the final provisions. Annex I provides procedures for conducting on-the-spot investigations while Annex II imposes constraints on the use of best information available in cases where interested parties insufficiently cooperate in the investigation.

1.4 Actionable Forms of Dumping

GATT 1947 applied only to goods which implied that dumping of services was not covered. Indeed, the General Agreement on Trade in Services, negotiated during the Uruguay Round, does not contain provisions with respect to dumping or anti-dumping measures.

It has furthermore long been accepted that neither Article VI (nor the ADA) cover exchange rate dumping, social dumping, environmental dumping or freight dumping.

On the other hand, the reasons why companies dump are considered irrelevant as long as the technical definitions are met: Dumping may therefore equally cover predatory dumping,¹ cyclical dumping,² market expansion dumping,³ state-trading dumping⁴ and strategic dumping.⁵

Conceptually, the calculation of dumping is a comparison between the export price and a benchmark price, the normal value of the like product. Depending on the circumstances in the domestic market, this normal value can be calculated in various manners as shown in Section 2 below.

1.5 Like Product

Article 2.6 ADA

The term like product ('produit similaire') is defined in Article 2.6 ADA as a product, which is identical, *i.e.* alike in all respects, to the product under consideration, or in the absence of such a product, another product, which has characteristics closely resembling those of the product under consideration. This definition is strict and may be contrasted, for example, with the broader term 'like or directly competitive products' in the Safeguards Agreement. In the context of the ADA, the term is relevant for both the dumping and injury determination.

Typical like product might be, for example, polyester staple fibres, stainless steel plates, or colour televisions [CTVs]. Such products can often⁶ be classified within a Harmonized System⁷ heading. Thus, polyester staple fibres fall under HS heading 55.03, stainless steel plates fall under HS heading 72.19 and CTVs under HS heading 85.28.

However, within the like product, there will invariably be many types or models. To give a simple example, in the case of CTVs, CTVs with different screen sizes (14", 20", 24") will constitute different models. Similarly, in the case of stainless steel plates, plates of different thickness would be different types. While many variations are possible, the underlying principle is that the comparison must be as precise as possible. Consequently, a variation that has an appreciable impact on the price or the cost of a product would normally be treated as a different model or type. For calculation purposes, authorities will then normally compare identical or very similar models or types.

1.6 Forms of Injury

In order to impose anti-dumping measures, an authority must determine not only that dumping is occurring, but also that such dumping is causing material injury to the domestic industry producing the like product. Material injury in this context comprises present material injury, future injury (threat of material injury) and material retardation of the establishment of a domestic industry. These concepts are explained in Section 3.

¹ *Dumping in order to drive competitors out of business and establish a monopoly.*

² *Selling at low prices because of over-capacity due to a downturn in demand.*

³ *Selling at a lower price for export than domestically in order to gain market share.*

⁴ *Selling at low prices in order to earn hard currency.*

⁵ *Dumping by benefiting from an overall strategy which includes both low export pricing and maintaining a closed home market in order to reap monopoly or oligopoly profits.*

⁶ *Depending on the product definition, however, the product under investigation may sometimes cover several HS headings while at other times it may need to be defined further because the HS heading is too broad.*

⁷ *Harmonized Commodity Description and Coding System, developed by the World Customs Organization in Brussels.*

1.7 Investigation Periods

In order to calculate dumping and injury margins, the importing Member authorities will select an investigation period [IP]. This is often the one-year period, preceding the month or quarter in which the case has been initiated. Some jurisdictions, however, use shorter investigation periods, for example, six months. Extremely detailed cost and pricing data will need to be provided for this investigation period. On top of that, an injury investigation period [IIP], detailed in Section 3 below, will be selected, in order to determine whether the dumping has caused injury.

1.8 Test Your Understanding

1. **Under the WTO, are companies allowed to dump their products in export markets?**
2. **A domestic industry of a WTO Member alleges that the currency depreciation of another WTO Member allows the exporters of that Member to sell at dumped prices. Assuming that the other conditions have been satisfied, can the WTO Member initiate an anti-dumping investigation?**
3. **A company argues that it dumped because of a downturn in the business cycle. In other words, it did not intend to cause injury to the domestic industry in the importing country. Will this defence be accepted?**
4. **A domestic industry argues that while its financial situation is all right for the moment, it fears that dumped imports may cause it injury in the future. Is the importing country Government allowed to start an anti-dumping case on this basis?**
5. **Can coffee producers in a WTO Member bring an anti dumping complaint against dumping by tea producers from another WTO Member?**

2. THE DETERMINATION OF DUMPING

This section reviews the dumping determination in detail. It analyses concepts such as export price and normal value. It also addresses the need for a fair comparison as well as comparison methods between the two. The section concludes with several calculation examples designed to show how dumping margins are computed.

2.1 Overview of Article 2

Article 2 of the ADA covers the determination of dumping. While Article 2 is lengthy, it sets out basic principles and leaves discretion to WTO Members with respect to implementation.

“normal value”

Article 2.1 provides that a product is to be considered as being dumped, *i.e.* introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country. This is the standard situation.

Article 2.2 sets out alternatives for calculating normal value in cases when there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, because of the particular market situation or the low volume of the sales in the domestic market of the exporting country, such sales do not permit a proper comparison.

“export price”

Article 2.3 covers the construction of the export price.

Article 2.4 contains detailed rules for making a fair comparison between export price and normal value.

Article 2.5 deals with transshipments.

Article 2.6 defines the like product.

Last, Article 2.7 confirms the applicability of the second supplementary provision to paragraph 1 of Article VI in Annex I to GATT 1994, the so-called non-market economy provision.

Panel Report, Thailand-H-Beams

Article 2 contains multiple obligations relating to the various components that enter into the complex process of determining the existence of dumping and calculating the dumping margin.⁸

⁸Panel Report, *Thailand – Anti-Dumping Duties on Angles, Shapes and sections of Iron or Non-Alloy Steel and H-Beams from Poland, (Thailand - H-Beams)*, WT/DS122/R para. 7.35.

2.2 The Export Price

According to Article 2.1 ADA, the export price is the price at which the product is exported from one country to another. In other words, it is the transaction price at which the product is sold by a producer/exporter in the exporting country to an importer in the importing country. This price is normally indicated in export documentation, such as the commercial invoice, the bill of lading and the letter of credit. It is this price that is allegedly dumped and for which an appropriate normal value must be found in order to determine whether dumping in fact is taking place.

In some cases, the export price may not be reliable. Thus, where the exporter and the importer are related, the price between them may be unreliable because of transfer pricing reasons.

“constructed export price”

Article 2.3 ADA provides that the export price then may be constructed on the basis of the price at which the imported products are first resold to an independent buyer. In such cases, allowances for costs, duties and taxes, incurred between importation and resale, and for profits accruing, should be made in accordance with Article 2.4 ADA. Such allowances decrease the export price, increasing the likelihood of a dumping finding.

This was an important reason for a WTO Panel to interpret the relevant part of Article 2.4 restrictively.

Panel Report, US- Stainless Steel

The term “should” in its ordinary meaning generally is non-mandatory, i.e., its use in this sentence indicates that a Member is not required to make allowance for costs and profits when constructing an export price. We believe that, because the failure to make allowance for costs and profits could only result in a higher export price – and thus a lower dumping margin – the ADAgreement merely permits, but does not require, that such allowances be made.

...we view this sentence as providing an authorization to make certain specific allowances. We therefore consider that allowances not within the scope of that authorization cannot be made.⁹

2.3 Normal Value

2.3.1 Standard Situation: Domestic Price

Article 2.1 provides that a product is dumped if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country. This is the standard situation: the normal value is the

⁹Panel Report, United States – Anti-Dumping Measures on Stainless Steel Plate in Coils and Stainless Steel Sheet and Strip from Korea (US – Stainless Steel), WT/DS179/R, paras. 6.93-6.94 footnotes omitted.

price of the like product, in the ordinary course of trade, in the home market of the exporting Member.

This definition presupposes that there are in fact domestic sales of the like product and that such sales are made in the ordinary course of trade. In this context, it is important to remember that, in the first stage, comparisons are made between identical or closely resembling models and that only later one weighted average dumping margin is calculated per producer/exporter. Thus, in the first stage, each exported model is matched to a domestic model, where possible, in order to determine whether a domestic price in the ordinary course of trade exists.

If this is found to be the case and if, for example, the domestic price of a model is 100 and its export price is 80, the *dumping amount* is 20 and the *dumping margin* is $20/80 \times 100 = 25\%$.¹⁰

2.3.2 Alternatives: Third Country Exports or Constructed Normal Value

Article 2.2 ADA

Article 2.2 provides that when there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, because of the particular market situation or the low volume of sales in the domestic market of the exporting country, such sales do not permit a proper comparison, the dumping margin shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country, provided that the price is representative, or with the cost of production in the country of origin plus a reasonable amount of administrative, selling and general costs and for profits.

In other words, Article 2.2 envisages three special situations and provides two alternative methods for calculating normal value in such cases (often called: third country exports and constructed normal value). Some of these are further explained below.

Situation 1: No domestic sales in the ordinary course of trade.

It may occur that different models are sold in the domestic and the export markets. In the case of CTVs, for example, some countries have the PAL/SECAM system while other countries use the NTSC system. Authorities may then decide that CTVs with different systems cannot be compared.

It is also possible that there are no domestic sales *in the ordinary course of trade*, notably because domestic sales (either of the like product or of certain types) are sold at a loss.

Situation 2: Unrepresentative volume of domestic sales; five per cent rule

¹⁰ In order to calculate the dumping margin, most countries divide the dumping amount by the CIF export price because any anti-dumping duties imposed will be levied at the CIF level.

It may also happen that a producer does not sell the like product on the domestic market in representative quantities.

Footnote 2 ADA

Sales of the like product destined for consumption in the domestic market of the exporting country shall normally be considered a sufficient quantity for the determination of the normal value if such sales constitute 5 per cent or more of the sales of the product under consideration to the importing Member; provided that a lower ratio should be acceptable where the evidence demonstrates that domestic sales at such lower ratio are nonetheless of sufficient magnitude to provide for a proper comparison.

“home market viability test”

Thus, authorities will generally have to decide whether domestic sales of both the like product and individual models represent five per cent or more of the export sales to the importing Member (at this stage sales below cost are included). This is sometimes called the home market viability test. If this is not the case, an alternative normal value must be found, either for the like product or for specific models.

2.3.3 Second Alternative Method: Constructed Normal Value

In dumping investigations, importing Member authorities routinely request both price and cost information in order to check whether domestic sales are made below cost. A WTO Panel has upheld this practice.

Panel Report, Guatemala-Cement II

...Nothing in those provisions prevents an investigating authority from requesting cost information, even if the applicant does not allege sales below cost.¹¹

Most companies produce several products. Furthermore, costs must be calculated on a type-by-type basis. Cost calculations therefore invariably include cost *allocations*. Suppose, for example, that the product under investigation is polyester staple fibres [PSF]. The main raw materials used in the production of PSF are PTA (purified terephthalic acid) and MEG (mono ethylene glycol), which may be manufactured by the same producers. Producers of PSF may also produce other items such as partially oriented yarn and polyester textured yarn. These are all different products, but they may be produced in the same factory. PSF itself in turn can be broken down in various types, for example, on the basis of quality, denier, decitex, lustre, and silicon treatment. Each combination of these would constitute a separate type.

Allocation of costs is not only complex, but also may involve corporate choices, with which the investigating authority may not necessarily agree. In principle, however, the records of the producer under investigation prevail.

¹¹Panel Report, *Guatemala - Anti-Dumping Measures on Grey Portland Cement from Mexico (Guatemala-Cement II)*, WT/DS156/R, para. 8.183.

Article 2.2.1.1 ADA

...costs shall normally be calculated on the basis of records kept by the exporter or producer under investigation, provided that such records are in accordance with the generally accepted accounting principles of the exporting country and reasonably reflect the costs associated with the production and sale of the product under consideration. Authorities shall consider all available evidence on the proper allocation of costs, including that which is made available by the exporter or producer in the course of the investigation provided that such allocations have been historically utilized by the exporter or producer, in particular in relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditures and other development costs.

Article 2.2 distinguishes three elements of constructed normal value:

- cost of production;
- reasonable amount for administrative, selling and general costs (often called SGA);
- reasonable amount for profits.

With respect to the calculation of the latter two cost elements, Article 2.2.2 sets out various possibilities.

Article 2.2.2. ADA

For the purpose of paragraph 2, the amounts for administrative, selling and general costs and for profits shall be based on actual data pertaining to production and sales in the ordinary course of trade of the like product by the exporter or producer under investigation. When such amounts cannot be determined on this basis, the amounts may be determined on the basis of:

- (i) the actual amounts incurred and realized by the exporter or producer in question in respect of production and sales in the domestic market of the country of origin of the same general category of products;*
- (ii) the weighted average of the actual amounts incurred and realized by other exporters or producers subject to investigation in respect of production and sales of the like product in the domestic market of the country of origin;*
- (iii) any other reasonable method, provided that the amount for profit so established shall not exceed the profit normally realized by other exporters or producers on sales of products of the same general category in the domestic market of the country of origin.*

“ordinary course of trade”

It is important to note that the qualifier ‘ordinary course of trade’ in the chapeau of Article 2.2.2 is not repeated in sub-paragraphs (i) to (iii). The Appellate Body has held in *EC-Bed Linen* that, as a result, it cannot be read into sub-paragraph (ii). In the same case, the Appellate Body further ruled that Article 2.2.2(ii) cannot be invoked in situations where there is only one producer/exporter with domestic sales.

**Appellate Body
Report, EC- Bed Linen**

...Reading into the text of Article 2.2.2(ii) a requirement provided for in the chapeau of Article 2.2.2 is not justified either by the text or by the context of Article 2.2.2(ii)....

Therefore, we reverse the finding of the Panel in paragraph 6.87 of the Panel Report that, in calculating the amount for profits under Article 2.2.2(ii) of the Anti-Dumping Agreement, a Member may exclude sales by other exporters or producers that are not made in the ordinary course of trade.¹²

**Appellate Body
Report, EC- Bed Linen**

...To us, the use of the phrase “weighted average” in Article 2.2.2(ii) makes it impossible to read “other exporters or producers” as “one exporter or producer”. First of all, and obviously, an “average” of amounts for SG&A and profits cannot be calculated on the basis of data on SG&A and profits relating to only one exporter or producer. Moreover, the textual directive to “weight” the average further supports this view because the “average” which results from combining the data from different exporters or producers must reflect the relative importance of these different exporters or producers in the overall mean. In short, it is simply not possible to calculate the “weighted average” relating to only one exporter or producer. Indeed, we note that, at the oral hearing in this appeal, the European Communities conceded that the phrase “weighted average” envisages a situation where there is more than one exporter or producer.¹³

2.3.4 Special Situations

“sales below cost”

Where domestic sales of the like product and comparable models are representative, it often happens that *some* domestic sales are sold below cost of production. Article 2.2.1 provides that such sales below cost may be treated as not being ‘in the ordinary course of trade’ and may be disregarded, *i.e.* excluded from the normal value calculation, only where the investigating authorities determine that such sales are made within an extended period of time in substantial quantities at prices which do not provide for the recovery of all costs within a reasonable period of time. In practice, sales below cost are often excluded where the weighted average selling prices is below the weighted average per unit costs or where they represent more than 20 per cent of the quantity of total domestic sales of the models concerned. Exclusion of sales below cost will increase the normal value and thereby makes a finding of dumping more likely, as the example below shows. In this example the full cost of production is 50:

Date	Quantity	Normal value	Export price
1/8	10	40	50
10/8	10	100	100
15/8	10	150	150
20/8	10	200	200

¹² Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India (EC-Bed Linen)*, WT/DS141/AB/R, paras. 83-84.

¹³ Appellate Body Report, *EC-Bed Linen*, para. 74, footnote omitted.

In this example, involving four sales transactions of 10 units each, the domestic sales transaction made on 1 August at a price of 40 is lower than the cost of 50. As it represents 25 per cent of domestic sales (> 20 per cent), it may be excluded. As a result, the average normal value becomes $(100+150+200/3=)$ 150. The average export price is $(50+100+150+200/4=)$ 125. Therefore, the dumping amount is 25 and the dumping margin is 20 per cent. If, on the other hand, the domestic sale of 40 would have been included, the average normal value would have been 122.5 and no dumping would have been found.

2.3.5 Related Party Sales on the Domestic Market

“related party”

It may happen that domestic producers and distributors are related. Some WTO Members will then ignore the prices charged by the producer to the distributor on the ground that they are not arms’ length transactions. Instead, they base normal value on the sales made by the distributor to the first independent customer. This price will be higher and is therefore more likely to lead to a finding of dumping.

In *US – Hot-Rolled Steel*, the Appellate Body considered the practice a permissible interpretation and reversed the Panel finding that it could find no legal basis for this practice in the ADA. However, the Appellate Body cautioned that in such cases special care must be taken to effect a fair comparison.

Appellate Body Report, US – Hot-Rolled Steel

The use of downstream sales prices to calculate normal value may affect the comparability of normal value and export price because, for instance, the downstream sales may have been made at a different level of trade from the export sales. Other factors may also affect the comparability of prices, such as the payment of additional sales taxes on downstream sales, and the costs and profits of the reseller. Thus, we believe that when investigating authorities decide to use downstream sales to independent buyers to calculate normal value, they come under a particular duty to ensure the fairness of the comparison because it is more than likely that downstream sales will contain additional price components which could distort the comparison.¹⁴

“transhipments”

In the typical situation, a product is exported from country A to country B. However, it is possible that more than two countries are involved in the product flow. Article 2.5 ADA deals with this situation. The basic rule is that where products are not imported directly from the *country of origin* but are exported from an intermediate country, the export price shall normally be compared with the comparable price in the *country of export* (country of transhipment).

By way of exception, Article 2.5 nevertheless allows a comparison with the price in the *country of origin*, if, for example, the products are merely transhipped through the country of export, such products are not produced in the country of export, or there is no comparable price for them in the country of export.

¹⁴ Appellate Body Report, *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan (US – Hot-Rolled Steel)*, WT/DS184/AB/R, para. 168.

2.4 Non-market Economy Dumping/Surrogate Country

GATT 1994, which was originally negotiated in 1947, contains a footnote to Article VI.

**Second
Supplementary
Provision to paragraph
1.2 of Article VI GATT
1947**

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

This provision has formed the basis for some GATT/WTO Members not to accept prices or costs in non-market economies as an appropriate basis for the calculation of normal value on the ground that such prices and costs are controlled by the Government and therefore not subject to market forces. The investigating authority will then resort to prices or costs in a third - market economy - country as the basis for normal value. This means that export prices from the non-market economy to the importing Member will be compared with prices or costs in this *surrogate/analogue country*.

**“surrogate/ analogue
country”**

It may be noted that for several systemic reasons the surrogate country concept tends to lead to findings of high dumping. To give an example: producers in the surrogate country will be competing in the market place with the non-market economy exporters and it is therefore not in their interest to minimize a possible finding of dumping for their non-market economy competitors.

2.5 Fair Comparison and Allowances

Article 2.4 ADA

Article 2.4 lays down as key principle that a fair comparison shall be made between export price and the normal value. This comparison shall be made at the same level of trade, normally the ex-factory level, and in respect of sales made at as nearly as possible the same time. The ex-factory price is the price of a product at the moment that it leaves the factory. Thus, Article 2.4 envisages that costs incurred after that be deducted to the extent that they are included in the price.

If, for example, an export sale is made on a CIF basis, this means that the seller pays for the inland freight in the exporting country, ocean freight and insurance. Thus, these costs are included in the export price and must therefore be deducted to return to the ex factory level. If, on the other hand, the terms of the sale are ex-factory, no deduction will need to be made because the price is already at an ex-factory level.

Article 2.4 goes on to require that due allowance shall be made in each case, on its merits, for differences which affect price comparability, including

differences in conditions and terms of sale, taxation, levels of trade, quantities, physical characteristics, and any other differences which are also demonstrated to affect price comparability.

It must be emphasized that the wording of Article 2.4 is open-ended and requires allowance for *any* difference demonstrated to affect price comparability.

“net back”

The calculation examples provided at the end of this section explain in more detail how importing Member authorities may *net back* a market price to an ex-factory price.

2.6 Comparison Methods

Where multiple domestic and export transactions exist, as will normally be the case, the question arises how these transactions must be compared with each other. This issue is addressed by Article 2.4.2 ADA. Article 2.4.2 contemplates two basic rules and one exception.

2.6.1 Main Rules

In principle, prices in the two markets should be compared on a weighted average to weighted average basis or on a transaction-to-transaction basis. A calculation example may be helpful. Assume the following:

Date	Normal value	Export price
1 January	50	50
8 January	100	100
15 January	150	150
21 January	200	200

Under the weighted average method, the weighted average normal value ($500/4=125$) is compared with the weighted average export price (*idem*), as a result of which the dumping amount is zero.

Under the transaction-to-transaction method, domestic and export transactions which took place on or near the same date will be compared with each other. In the perfectly symmetrical example above, the transactions on 1 January will be compared with each other and so on. Again, the dumping amount will be zero.

2.6.2 Exception

Exceptionally, weighted average normal value may be compared to prices of individual export transactions if the authorities find a pattern of export prices which differ significantly among different purchasers, regions or time periods,

and if an explanation is provided as to why such differences cannot be taken into account appropriately by the use of one of the two principal methods.

If we apply the exceptional method to the example above, the result will be quite different:

Date	Normal value WA basis	Export price T-by-T	Dumping amount
1 January	125	50	75
8 January	125	100	25
15 January	125	150	-25
21 January	125	200	-75

“zeroing”

Thus, there is a positive dumping amount of 100 (75 and 25 on the first two transactions) and a negative dumping amount of 100 (-25 and -75 on the last two transactions). The negative dumping occurs because the export price is actually higher than the normal value. If the negative dumping can be used to offset the positive dumping amount, no dumping will be found to exist. However, it has been the practice of some WTO Members not to allow such offset and to attribute a zero value to negatively dumped transactions. This is known as the practice of *zeroing*. As a result of application of this method, in the example above the dumping amount will be 100 and the dumping margin: $100/500 \times 100 = 20\%$.

Article 2.4.2 ADA

Use of this method implies that if just one transaction is dumped, dumping will be found.¹⁵ The method therefore facilitates dumping findings. Prior to the conclusion of the Uruguay Round, it was standard practice of some WTO Members to apply this method.¹⁶ Because of pressure exerted by other WTO Members, Article 2.4.2 was adopted and WTO Members generally resorted to use of the weighted average method (the first of the two main rules).

However, within the weighted average method, some WTO Members applied a new type of zeroing: *inter-model zeroing*. If, for example, model A was dumped while model B was not dumped, the Members would not allow the negative dumping of model B to offset the positive dumping of model A. In *EC-Bed Linen*, the Appellate Body upheld the Panel finding that this practice was inconsistent with Article 2.4.2:

Appellate Body Report, EC – Bed Linen

Under this method, the investigating authorities are required to compare the weighted average normal value with the weighted average of prices of all comparable export transactions. Here, we emphasize that Article 2.4.2 speaks of “all” comparable export transactions. ...By “zeroing” the “negative

¹⁵ If, on the other hand, all transactions are dumped, the weighted average method and the weighted average to transaction-to-transaction method will yield the same result. This, however, is relatively rare.

¹⁶ The EC practice was challenged unsuccessfully in the GATT by Japan in EC-ATCs, Panel Report, EC – Anti-Dumping Duties on Audio Tapes in Cassettes Originating in Japan, ADP/136 issued 28 April 1955, *unadopted*.

dumping margins”, the European Communities, therefore, did not take fully into account the entirety of the prices of some export transactions, namely, those export transactions involving models of cotton-type bed linen where “negative dumping margins” were found. Instead, the European Communities treated those export prices as if they were less than what they were. This, in turn, inflated the result from the calculation of the margin of dumping. Thus, the European Communities did not establish “the existence of margins of dumping” for cotton-type bed linen on the basis of a comparison of the weighted average normal value with the weighted average of prices of all comparable export transactions – that is, for all transactions involving all models or types of the product under investigation. Furthermore, we are also of the view that a comparison between export price and normal value that does not take fully into account the prices of all comparable export transactions – such as the practice of “zeroing” at issue in this dispute – is not a “fair comparison” between export price and normal value, as required by Article 2.4 and by Article 2.4.2.¹⁷

In *US-Stainless Steel*¹⁸, the Panel ruled that the United States’ use of multiple averaging periods in the *Plate* and *Sheet* investigations was inconsistent with the requirement of Article 2.4.2 to compare a weighted average normal value with a weighted average of all comparable export transactions. The United States had divided the investigation period for the purpose of calculating the overall margin of dumping into two averaging periods to take into account the Republic of Korea’s won devaluation in the period November-December 1997, corresponding to the pre- and post-devaluation periods. The United States had calculated a margin of dumping for each sub-period. When combining the margins of dumping calculated for the sub-periods to determine an overall margin of dumping for the entire investigation period, the DOC¹⁹ had treated the period November-December, where the average export price was higher than the average normal value, as a sub-period of zero dumping—where in fact there was *negative dumping* in that sub-period. The Panel concluded that this was not allowed under Article 2.4.2—although the Article did not prohibit multiple averaging as such; multiple averaging could be appropriate in cases where it would be necessary to insure that comparability is not affected by differences in the timing of sales within the averaging periods in the home and export markets.

2.7 Simplified Calculation Examples

The operation of these complicated rules is illustrated by the following simple calculation examples.

¹⁷ Appellate Body Report, EC-Bed Linen, para. 55.

¹⁸ Panel Report, US-Stainless Steel, paras. 6.105-6.125

¹⁹ Throughout the Panel Report DOC is used to refer to the “United States Department of Commerce”.

Example 1: Direct sale to unrelated customers

Normal value	Export price
Producer X → unrelated customer	Producer X → unrelated importer
Sales price: 100	CIF sales price: 100
- duty drawback: 5	- physical difference: 5
- discounts: 2	- discounts: 2
- packing: 1	- packing: 1
- inland freight: 1	- inland freight: 1
	- ocean freight/insurance: 6
- credit: 5	- credit: 2
- guarantees: 2	- guarantees: 2
- commissions: 2	- commissions: 2
= ex-factory normal value: 82	= ex-factory export price: 79

The dumping margin is: $(82-79/100 \times 100) = 3\%$. This example illustrates that while the domestic and export *sales prices* are the same, there is nevertheless a dumping margin because the *ex factory* export price is lower than the *ex factory* normal value.

Example 2: Direct sale to unrelated customers

Normal value	Export price
Producer X → unrelated customer	Producer X → unrelated importer
Sales price: 100	CIF sales price: 100
- duty drawback: 5	- physical difference: 5
- discounts: 5	- discounts: 2
- packing: 1	- packing: 1
- inland freight: 1	- inland freight: 1
	- ocean freight/insurance: 6
- credit: 6	- credit: 1
- guarantees: 2	- guarantees: 2
- commissions: 2	- commissions: 2
= ex-factory normal value: 78	= ex-factory export price: 80

The dumping margin on this transaction is: $(78-80/100 \times 100) = -2$. Invoking the exception of Article 2.4.2, last sentence, some countries may not give credit for the *negative* dumping in the computation of the weighted average dumping margin, and attribute a zero value to it (zeroing). However, the CIF price will be taken into account in the denominator of the calculation of the weighted average dumping margin.

Example 3: Construction of export price

Normal value	Export price
X → unrelated customer 140	X → related importer → unrelated retailer 100 140
- duty drawback: 5	- discounts subs.: 5
- discounts subs.: 5	- inland freight subs.: 0.5
- inland freight subs.: 0.5	- credit by subs.: 2
- packing: 1	- guarantees by subs.: 2
- credit.: 4	- net SGA subs.: 17 (12.14%)
- guarantees: 2	- reasonable profit subs. (5%): 7
- level of trade: 24 (17.14%)	- customs duties paid by subs.: 8.2
	- constructed EP: <u>98.3</u>
	- ocean freight/insurance: 6
	- inland freight: 1
	- packing: 1
	- physical difference: 5
= ex-factory normal value: 98.5	= ex-factory export price: 85.3

The dumping margin on this transaction is: $(98.5-85.3=13.2/100 \times 100) = 13.2\%$.

In this calculation example, we have made an adjustment on the normal value side for a difference in the level of trade equal to 17.14 per cent or 24. Such a difference in levels of trade exists because the producer sells in both his domestic market and his export market to retailers. In the export market, his importer acts as a distributor. In the domestic market, however, the producer performs the distributor function in-house. An adjustment must be made for his indirect costs and profits relating to this function because, on the export side, the same costs and profits are deducted in the process of constructing the export price. The example assumes that, as the functions are the same in

both markets, the costs and profits will be the same too (12.14 per cent and five per cent). In reality, the situation is often more complex and the level of trade adjustments may give rise to heated arguments with claims sometimes being rejected on evidentiary grounds.

In *US-Hot-Rolled Steel*, the Appellate Body emphasized in a comparable case involving domestic sales through an affiliate distributor that allowances must be made with extra care in order to effectively calculate the normal value at the ex-factory level and ensure fair comparison.

**Article 2.4, in fine,
ADA**

If...price comparability has been affected, the authorities shall establish the normal value at a level of trade equivalent to the level of trade of the constructed export price, or shall make due allowance as warranted under this paragraph. The authorities shall indicate to the parties in question what information is necessary to ensure a fair comparison and shall not impose an unreasonable burden of proof on those parties.

Last, it is noted that the ADA does not provide guidelines for calculating the ‘reasonable profit’ of the related importer.

2.8 Test Your Understanding.

- 1. A WTO Member initiates an anti-dumping investigation in which it only analyses price dumping. In other words, it does not examine cost dumping. Is this allowed?**
- 2. A WTO Member decides to treat a non-market economy country as a market economy for purposes of its anti-dumping law and practice. Can it do so under the WTO?**
- 3. In order to avoid taxation in the importing Member a multinational company sells to its related party in the importing country at an artificially high price. How can an investigating authority solve this problem?**
- 4. An export-oriented company has only minimal sales in its home market. Can such sales be used as the basis for normal value? Are there alternative manners in which normal value may be established?**
- 5. A company sells in its domestic market to a related distributor for a price of 100. The related distributor sells to a related retailer for a price of 140. The retailer sells to an (unrelated) end-user for a price of 190. Which price should an investigating authority use? Which allowances, if any, should be made?**

3. THE DETERMINATION OF INJURY

The determination of injury consists of a determination that the dumped imports have caused material injury to the domestic industry producing the like product.

3.1 Overview of Article 3

Article 3.1 is an introductory paragraph providing that the injury determination shall be based on positive evidence and involve an objective examination of both (a) the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.

Article 3.2 provides more details on the analysis of the volume factor and the price factor.

Article 3.3 establishes the conditions for cumulation.

Article 3.4 provides the list of injury factors that must be evaluated by the investigating authority.

Article 3.5 lays down the framework for the causation analysis, including a listing of possible ‘other known factors.’

Article 3.6 contains the product line exception.

Articles 3.7 and 3.8 provide special rules for a determination of threat of material injury.

3.2 The Notion of ‘Dumped Imports’

Throughout Article 3, the notion of ‘dumped imports’ is used. However, many cases involve a mixture of dumped and non-dumped transactions. Furthermore, dumping determinations are normally made on a producer-by-producer basis and it is therefore possible that certain producers are found not to have dumped. A conceptual issue therefore is whether such non-dumped imports may be treated as dumped in the injury analysis. In the *EC-Bed Linen* case, India argued that non-dumped transactions ought to be excluded from the injury analysis.

The Panel did not agree that the ADA required such specificity, but in an important *obiter dictum* opined that imports from producers found not to have dumped, should not be included in the injury analysis.

**Panel Report, EC-Bed
Linen**

*...It is possible that a calculation conducted consistently with the AD Agreement would lead to the conclusion that one or another Indian producer should be attributed a zero or de minimis margin of dumping. In such a case, it is our view that the imports attributable to such a producer/exporter may not be considered as “dumped” for purposes of injury analysis. However, we lack legal competence to make a proper calculation and consequent determination of dumping for any of the Indian producers – its task is to review the determination of the EC authorities, not to replace that determination, where found to be inconsistent with the AD Agreement, with our own determination. In any event, we lack the necessary data to undertake such a calculation. Thus, while the treatment of imports attributable to producers or exporters found to **not** be dumping is an interesting question, it is not an issue before us and we reach no conclusions in this regard.²⁰*

3.3 The Like Product/Product Line Exception

Section 1 explains that the definition of the like product plays a role in both the dumping and the injury determination because it is with respect to this product that dumping and injury must be established.

Article 3.6 ADA

As an exception to the principle that it must be established that the domestic industry producing the *like product* must suffer injury by reason of the dumped imports, Article 3.6 provides that when available data do not permit the separate identification of the domestic production of the like product on the basis of such criteria as the production process, producers’ sales and profits, the effects of the dumped imports shall be assessed by the examination of the production of the narrowest group or range of products, which includes the like product, for which the necessary information can be provided. This is sometimes called the *product line* exception.

Suppose, for example, that the domestic industry brings an anti-dumping complaint against fresh cut red roses. It is possible that in such a case the domestic industry does not maintain specific data with regard to production processes, sales and profits of this product, but only with respect to the broader category of all fresh cut roses. In such a case, Article 3.6 would permit the investigating authority to assess the effects of the dumped imports with respect to all fresh cut roses.

3.4 The Domestic Industry

Article 4 ADA

Article 4 ADA defines the domestic industry as the domestic producers as a whole of the like products or those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products. The ADA does not define the term ‘a major proportion.’

²⁰ Panel Report, EC-Bed Linen, WT/DS141/R, para. 6.138.

There are two exceptions to this principle.

First, where domestic producers are related to exporters or importers or themselves import the dumped products, they *may* be excluded from the definition of the domestic industry under Article 4.1(i). Such producers may benefit from the dumping and therefore may distort the injury analysis. Exclusion is a discretionary decision of the importing Member authorities for which the ADA does not provide further guidance.

If for example, an investigation is initiated against PSF and that one of the targeted foreign producers has also established a factory in the importing Member, thereby qualifying as a domestic producer. This domestic producer might be opposed to imposition of anti-dumping measures on its related company and could therefore, for example, take the position that it is not injured by the dumped exports. Article 4.1(i) allows the investigating authority to exclude this producer from the injury analysis.

Second, a regional industry comprising only producers in a certain market of a Member's territory may be found to exist under Article 4.1(ii) if these producers sell all or almost all of their production in that market and the demand within that market is not to any substantial degree supplied by producers of the product located elsewhere in the territory. Injury may then be found even where a major portion of the total domestic industry is not injured, provided that there is a concentration of dumped imports into the isolated market and the dumped imports are causing injury to the producers of all or almost all of the production in that market. If the regional industry exception is used, anti-dumping duties shall be levied only on imports consigned for final consumption to that area. Where this is not allowed under the constitutional law of the importing Member, exporters should be given the opportunity to cease exporting to the area concerned or to give undertakings. Findings of the existence of a regional industry are relatively rare and tend to be confined to industries where transportation is a major cost item, such as, for example, cement.

Last, it is noted that the definition of the domestic industry is closely linked to the standing determination which importing Member authorities must make prior to initiation.

3.5 Material Injury

The determination of material injury must be based on *positive* evidence and involve an *objective* examination of the volume of the dumped imports, their effect on the domestic prices in the importing Member market and their consequent impact on the domestic industry. The Appellate Body has held that this determination may be based on the confidential case file and overruled a panel finding that it follows from the words 'positive' and 'objective' that the injury determination should be based on reasoning or facts disclosed to, or discernible by, the interested parties.

**Appellate Body
Report, Thailand-H-
Beams**

...An anti-dumping investigation involves the commercial behaviour of firms, and, under the provisions of the Anti-Dumping Agreement, involves the collection and assessment of both confidential and non-confidential information. An injury determination conducted pursuant to the provisions of Article 3 of the Anti-Dumping Agreement must be based on the totality of that evidence. We see nothing in Article 3.1 which limits an investigating authority to base an injury determination only upon non-confidential information... We consider, therefore, that the requirement in Article 3.1 that an injury determination be based on "positive" evidence and involve an "objective" examination of the required elements of injury does not imply that the determination must be based only on reasoning or facts that were disclosed to, or discernible by, the parties to an anti-dumping investigation. Article 3.1, on the contrary, permits an investigating authority making an injury determination to base its determination on all relevant reasoning and facts before it.²¹

However, the Appellate Body emphasized due process rights of interesting parties, emanating from Articles 6 and 12 ADA, against which the injury determination must be scrutinized. These will be discussed in Section 4 below.

3.5.1 Injury Investigation Period

A recommendation of the WTO Committee on Anti-Dumping Practices provides that injury should preferably be analysed over a period of at least three years.²² This period is often called the injury investigation period [IIP]. Such a relatively long period is needed particularly because of the causation requirement.

While the industry must be suffering material injury during the regular investigation period and detailed injury margin calculations in the case of application of a lesser duty rule will be based on the data existing during the regular investigation period, the analysis of injury and causation needs a longer period in order to examine trend factors, such as those mentioned in Articles 3.4 and 3.5 ADA.

3.5.2 Volume and Prices

Article 3.2 ADA

Article 3.2 provides more details on the volume and price analysis. It emphasizes the relevance of a significant increase in dumped imports, either absolute or relative to production or consumption in the importing Member. With regard to the effect of the dumped imports on prices, the investigating authority must consider whether there has been a significant price undercutting by the dumped imports, or whether the effect of the imports has been to significantly depress prices or prevent price increases, which otherwise would have occurred.

²¹ Appellate Body Report, Thailand-H-Beams, WT/DS122/AB/R, paras. 107 and 111.

²² WTO Committee on Anti-Dumping Practices - Recommendation Concerning the Periods of Data Collection for Anti-Dumping Investigations - Adopted by the Committee on 5 May 2000, G/ADP/6

The wording is understandably broad because injury can occur in many forms. Thus, for example, in the typical situation, there will be an absolute increase in the volume of imports over the IIP coupled to a decreasing trend in prices of the imports. Indeed, the simultaneous occurrence of these two trends will be a strong indicator not only of injury but also of causation because it indicates that producers are gaining market share through aggressive pricing.

In many other cases, however, the situation will not be so clear-cut. It is possible, for example, that domestic producers cut back production, while foreign producers continue to export at steady levels. This would mean that the imports increase relative to production (but not in absolute terms). Similarly, with regard to prices, it is possible that, faced with increased costs for raw materials, domestic producers are precluded from increasing prices to pass on the price increase to their customers through the presence in the market of low-priced imports which are sold at the same price as before.

3.5.3 *Cumulation of Dumped Imports from Various Countries*

Article 3.3 ADA

The principle of cumulation, contained in Article 3.3, means that where imports from several countries are simultaneously subject to anti-dumping investigations, their effects may be assessed cumulatively for injury purposes as long as they do not qualify for the *de minimis* or *negligibility* thresholds and a cumulative assessment is appropriate in light of the conditions of competition among the imports and between imports and the like domestic product. Many WTO Members apply cumulation almost as a matter of course as long as the thresholds are not met.

3.5.4 *Examination of the Impact of the Dumped Imports on the Domestic Industry*

Article 3.4 ADA

Article 3.4 requires that the examination of the impact of the dumped imports on the domestic industry shall include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry producing the like product in the importing country and then mentions 15 specific factors. Article 3.4 concludes that this list is not exhaustive and that no single or several of these factors can necessarily give decisive guidance.

The 15 injury factors

Article 3.4 ADA

...actual and potential decline in sales, profits, output, market share, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments.

The scope of this obligation has been examined in four panel proceedings thus far.²³ All four Panels, strongly supported by the Appellate Body in *Thailand-H-beams*, held that the evaluation of the 15 factors is mandatory in each case and must be clear from the published documents.

**Appellate Body
Report, Thailand-H-
Beams**

...The Panel concluded its comprehensive analysis by stating that “each of the fifteen individual factors listed in the mandatory list of factors in Article 3.4 must be evaluated by the investigating authorities...” We agree with the Panel’s analysis in its entirety, and with the Panel’s interpretation of the mandatory nature of the factors mentioned in Article 3.4 of the Anti-Dumping Agreement.²⁴

**Panel Report, EC-Bed
Linen**

It appears from this listing that data was not even collected for all the factors listed in Article 3.4, let alone evaluated by the EC investigating authorities. Surely a factor cannot be evaluated without the collection of relevant data.²⁵

3.5.5 Threat of Injury

It may occur that a domestic industry alleges that it is not yet suffering material injury, but is threatened with material injury, which will develop into material injury unless anti-dumping measures are taken.

Article 3.7 ADA

However, because such statements are easy to make and any investigation based on threat of material injury will necessarily be speculative because it involves analysis of events that have not yet happened, Article 3.7 offers special provisions for a threat case. Thus, a determination of threat must be based on facts and not merely on allegation, conjecture or remote possibility. The change in circumstances which would create a situation in which the dumping would cause injury, must be clearly foreseen and imminent.

In making a threat determination, the importing Member authorities *should* consider, *inter alia*, four special factors.

**Special threat factors
Article 3.7, ADA**

- (i) a significant rate of increase of dumped imports into the domestic market indicating the likelihood of substantially increased importation;*
- (ii) sufficiently freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased dumped exports to the importing Member’s market, taking into account the availability of other export markets to absorb any additional exports;*
- (iii) whether imports are entering at prices that will have a significant depressing or suppressing effect on domestic prices, and would likely increase demand for further imports; and*
- (iv) inventories of the product being investigated.*

²³ Panel Report, Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States (Mexico – Corn Syrup) WT/DS132/R; Panel Report, Thailand-H-Beams; Panel Report, EC-Bed Linen; Panel Report, Guatemala-Cement II.

²⁴ Appellate Body Report, Thailand-H-Beams, para. 125, footnote omitted.

²⁵ Panel Report, EC-Bed Linen, para. 6.167.

No single factor will necessarily be decisive, but the totality of the factors considered must lead to the conclusion that further dumped exports are imminent and that, unless protective action is taken, material injury would occur. The *Mexico – Corn Syrup*²⁶ Panel concluded that a threat analysis must also include evaluation of the Article 3.4 factors.

3.6 Causation/Other Known Factors

The evaluation of import volumes and prices and their impact on the domestic industry is relevant not only for determining whether the domestic industry has in fact suffered material injury, but often will also be indicative of whether the injury has been caused by the dumped imports or by other factors. Thus Article 3.5 ADA, first sentence, refers back to Articles 3.2 and 3.4 ADA.

Article 3.5 ADA

Furthermore, the demonstration of the causal link must be based on an examination of all relevant evidence before the authorities, which must also examine any known factors other than the dumped imports which are also injuring the domestic industry, and the injury as a result of such other known factors must not be attributed to the dumped imports. Article 3.5 then provides a non-exhaustive list of other factors which may be relevant depending on the facts of the case.

The other known factors, Article 3.5 ADA

...the volume and prices of imports not sold at dumping prices, contraction in demand or changes in the patterns of consumption, trade-restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.

In *Mexico – Corn Syrup*, for example, the Panel addressed the Mexican authorities' analysis of an alleged restraint agreement between Mexican sugar refiners and soft drink bottlers.

Panel Report, Mexico – Corn Syrup

...the question for purposes of an anti-dumping investigation is not whether an alleged restraint agreement in violation of Mexican law existed, an issue which might well be beyond the jurisdiction of an anti-dumping authority to resolve, but whether there was evidence of and arguments concerning the effect of the alleged restraint agreement, which, if it existed, would be relevant to the analysis of the likelihood of increased dumped imports in the near future. If the latter is the case, in our view, the investigating authority is obliged to consider the effects of such an alleged agreement, assuming it exists.²⁷

A WTO Panel has held that, contrary to the Article 3.4 factors, the Article 3.5 factors need not be examined as a matter of course in each administrative determination. Rather, such examination will depend on the arguments made

²⁶ Panel Report, Mexico – Corn Syrup, para.7.127.

²⁷ Panel Report, Mexico – Corn Syrup, para. 7.174. footnote omitted.

by interested parties in the course of the administrative investigation.

**Panel Report,
Thailand-H-Beams**

The text of Article 3.5 refers to “known” factors other than the dumped imports which at the same time are injuring the domestic industry but does not make clear how factors are “known” or are to become “known” to the investigating authorities. We consider that other “known” factors would include those causal factors that are clearly raised before the investigating authorities by interested parties in the course of an AD investigation. We are of the view that there is no express requirement in Article 3.5 that investigating authorities seek out and examine in each case on their own initiative the effects of all possible factors other than imports that may be causing injury to the domestic industry under investigation.²⁸

**Panel Report, Mexico
– Corn Syrup**

While an examination of the Article 3.7 factors is required in a threat of injury case, that analysis alone is not a sufficient basis for a determination of threat of injury, because the Article 3.7 factors do not relate to the consideration of the impact of the dumped imports on the domestic industry....In our view, consideration of the Article 3.4 factors in examining the consequent impact of imports is required in a case involving threat of injury in order to make a determination consistent with the requirements of Articles 3.1 and 3.7.²⁹

3.7 Injury Margins

The determination whether dumping has caused material injury to the domestic industry producing the like product is generally made with respect to the country or countries under investigation. By nature, this is either an affirmative or a negative determination. If the determination is affirmative, WTO Members, which apply a lesser duty rule in accordance with Articles 8.1 and 9.1, will then calculate injury margins.

The ADA does not give any guidance on such calculation and arguably leaves its Members substantial discretion. Injury margins are normally producer-specific, as are dumping margins, and that they will compare the prices of imported and domestically produced like products, focusing on whether the former are undercutting or underselling the latter.

Example 1: Calculation injury margin, based on price undercutting

	Domestic producer X	Foreign exporter Y	Foreign exporter Z
Price	100	80	110
Injury margin		$(100-80=20)/80 \times 100=25\%$	$100-110=-10=0$

²⁸ Panel Report, Thailand - H-Beams, para. 7.273 footnote omitted.

²⁹ Panel Report, Mexico – Corn Syrup, paras. 7.126-7.127.

Example 2: Calculation injury margin, based on price underselling

	Domestic producer X	Foreign exporter Y	Foreign exporter Z
Price	100	80	110
Target price	121		
Injury margin		$(121-80=41)/80 \times 100 = 51.25\%$	$(121-110=11)/110 \times 100 = 10\%$

In the second example, it is assumed that the unit cost of domestic producer X actually is 110. Faced with the low-priced imports, however, he has been forced to sell below cost. A target price may be calculated for producer X, comprised of his costs plus a reasonable profit, for example 10 per cent. In the example, the target price will therefore become: $110 + (110 \times 10\% = 11) = 121$.

3.8 Test Your Understanding

1. An administering authority investigating injury allegedly caused by dumped tomato imports determines that inventories are not a relevant injury factor for such a highly perishable product and therefore does not evaluate it in the definitive measure. Is this legal?
2. A domestic industry wishes to bring an anti-dumping case against the producers of the like product in another country. However, one of the producers is related to an exporter and opposes the case. Can the investigating authority initiate the case?
3. The investigating authority finds that the volume of dumped imports has consistently decreased during the past three years. Can it nevertheless find that injury has been caused by dumped imports?
4. The investigating authority finds that imports were in fact higher-priced than the products sold by the domestic industry. Can such higher-priced imports cause injury to the domestic industry?
5. In an anti-dumping case involving five exporters, the investigating authority finds that four of them did not dump. The fifth exporter dumped some 50 per cent of its exports while the other 50 per cent was not dumped. In analysing the volume of the dumped imports, which data should the investigating authority use?

4. THE NATIONAL PROCEDURES

By far the largest portion of the ADA is dedicated to various procedural obligations that authorities wishing to investigate injurious dumping must comply with. This section provides an overview of these procedural obligations that national authorities must comply with throughout the course of an anti-dumping investigation. It also provides a flowchart of the various steps in an anti-dumping investigation. This section discusses due process rights, such as notification, public notices, confidentiality, disclosure of findings and hearings, as well as restrictions on use of facts available. It further analyses the remedies of anti-dumping duties and undertakings and summarizes duty assessment systems.

4.1 Introduction

The following Articles of the ADA contain important procedural provisions:

- Article 5* Initiation and subsequent investigation, including the standing determination
- Article 6* Evidence, including due process rights of interested parties
- Article 7* Provisional measures
- Article 8* Price undertakings
- Article 9* Imposition and collection of anti-dumping duties
- Article 10* Retroactivity
- Article 11* Duration and review of anti-dumping duties and price undertakings, including
- Article 12* Public notice and explanation of determinations, pertaining to initiation, imposition of preliminary and final measures
- Article 13* Judicial review

It falls outside the scope of this volume to discuss these procedural provisions in detail. However, the general tendency of Panels and the Appellate Body has been to interpret these provisions strictly.

The relevant Panel findings in *Guatemala - Cement II* may serve as an example of this because they cover many of the procedural requirements.³⁰

³⁰ *The Appellate Body Report in US - Hot-Rolled Steel and the Panel Report in Argentina – Definitive Measures on Imports of Ceramic Floor Tiles from Italy (Argentina – Ceramic Tiles), WT/DS189/R, offer interesting material on use of facts available.*

**Panel Report,
Guatemala-Cement II**

- (a) Guatemala's determination that there was sufficient evidence of dumping and threat of injury to initiate an investigation, is inconsistent with Article 5.3 of the AD Agreement
- (b) Guatemala's determination that there was sufficient evidence of dumping and threat of injury to initiate an investigation and consequent failure to reject the application for anti-dumping duties by Cementos Progreso is inconsistent with Article 5.8 of the AD Agreement .
- (c) Guatemala's failure to timely notify Mexico under Article 5.5 of the AD Agreement is inconsistent with that provision.
- (d) Guatemala's failure to meet the requirements for a public notice of the initiation of an investigation is inconsistent with Article 12.1.1 of the AD Agreement .
- (e) Guatemala's failure to timely provide the full text of the application to Mexico and Cruz Azul is inconsistent with Article 6.1.3 of the AD Agreement.
- (f) Guatemala's failure to grant Mexico access to the file of the investigation is inconsistent with Articles 6.1.2 and 6.4 of the AD Agreement .
- (g) Guatemala's failure to timely make Cementos Progreso's 19 December 1996 submission available to Cruz Azul until 8 January 1997 is inconsistent with Article 6.1.2 of the AD Agreement .
- (h) Guatemala's failure to provide two copies of the file of the investigation as requested by Cruz Azul is inconsistent with Article 6.1.2 of the AD Agreement.
- (i) Guatemala's extension of the period of investigation requested by Cementos Progreso without providing Cruz Azul with a full opportunity for the defence of its interest is inconsistent with Article 6.2 of the AD Agreement .
- (j) Guatemala's failure to inform Mexico of the inclusion of non-governmental experts in the verification team is inconsistent with paragraph 2 of Annex I of the AD Agreement .
- (k) Guatemala's failure to require Cementos Progreso's to provide a statement of the reasons why summarization of the information submitted during verification was not possible is inconsistent with Article 6.5.1 of the AD Agreement .
- (l) Guatemala's decision to grant Cementos Progreso's 19 December submission confidential treatment on its own initiative is inconsistent with Article 6.5 of the AD Agreement .
- (m) Guatemala's failure to "inform all interested parties of the essential facts under consideration which form the basis for the decision whether to apply definitive measures" is inconsistent with Article 6.9 of the AD Agreement.
- (n) Guatemala's recourse to "best information available" for the purpose of making its final dumping determination is inconsistent with Article 6.8 of the AD Agreement ...³¹

³¹Panel Report, Guatemala-Cement II, para. 9.1.

4.2 Application

Article 5.2 ADA

An anti-dumping case normally starts with the official submission of a written complaint by the domestic industry to the importing Member authorities that injurious dumping is taking place. This complaint is called the application in the ADA. Article 5.2 contains the requirements for the contents of this application. It must include *evidence* on dumping, injury and the causal link between the two; simple assertion is not sufficient. More specifically, to the extent *reasonably available* to the applicant, the application must contain the following information:

Article 5.2(i)-(iv), ADA

- (i) *the identity of the applicant and a description of the volume and value of the domestic production of the like product by the applicant. Where a written application is made on behalf of the domestic industry, the application shall identify the industry on behalf of which the application is made by a list of all known domestic producers of the like product (or associations of domestic producers of the like product) and, to the extent possible, a description of the volume and value of domestic production of the like product accounted for by such producers;*
- (ii) *a complete description of the allegedly dumped product, the names of the country or countries of origin or export in question, the identity of each known exporter or foreign producer and a list of known persons importing the product in question;*
- (iii) *information on prices at which the product in question is sold when destined for consumption in the domestic markets of the country or countries of origin or export (or, where appropriate, information on the prices at which the product is sold from the country or countries of origin or export to a third country or countries, or on the constructed value of the product) and information on export prices or, where appropriate, on the prices at which the product is first resold to an independent buyer in the territory of the importing Member.*
- (iv) *information on the evolution of the volume of the allegedly dumped imports, the effect of these imports on prices of the like product in the domestic market and the consequent impact of the imports on the domestic industry, as demonstrated by relevant factors and indices having a bearing on the state of the domestic industry, such as those listed in paragraphs 2 and 4 of Article 3.*

4.2.1 Pre-initiation Examination

Article 5.3 ADA

Article 5.3 imposes the obligation on the importing Member authorities to *examine, before* initiation, the accuracy and the adequacy of the evidence in the application. However, as Article 5.3 does not provide any details on the nature of this examination, it is difficult for Panels to judge whether importing Member authorities have complied with Article 5.3.

**Panel Report, Mexico-
Corn Syrup**

*...the quantum and quality of evidence required at the time of initiation is less than that required for a preliminary, or final, determination of dumping, injury, and causation, made after investigation. That is, evidence which would be insufficient, either in quantity or in quality, to justify a preliminary or final determination of dumping, injury or causal link, may well be sufficient to justify initiation of the investigation.³²In our view, Article 5.3 does not impose an obligation on the investigating authority to set out its resolution of **all** underlying issues considered in making that determination.³³*

4.2.2 Standing Determination

Article 5.4 ADA

Under Article 5.4 ADA, importing Member authorities must determine, again *before* initiation, on the basis of an examination of the degree of support for, or opposition to, the application expressed by domestic producers of the like product, that the application has been made by, or on behalf of, the domestic industry. GATT Panels have held several times that the failure to properly determine standing before initiation is a fatal error which cannot be repaired retroactively in the course of the proceeding.

**Panel Report, US –
Seamless Stainless
Steel**

The Panel observed that under Article 5:1 (apart from ‘special circumstances’) an anti-dumping investigation shall normally be initiated upon a written request “by or on behalf of the industry affected”. The plain language in which this provision is worded, and in particular the use of the word “shall”, indicates that this is an essential procedural requirement for the initiation of an investigation to be consistent with the Agreement.....The Panel considered, in light of the nature of Article 5:1 as an essential procedural requirement, that there was no basis to consider that an infringement of this provision could be cured retroactively.³⁴

An application is made by, or on behalf of, the domestic industry of the importing Member if it is supported by those domestic producers whose collective output constitutes more than 50 per cent of the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the application. However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 per cent of total production of the like product produced by the domestic industry. These tests are often called the 50 per cent and the 25 per cent test and the following example may explain their operation.

³² Panel Report, Mexico – Corn Syrup, para. 7.94, footnote omitted, quoting Panel Report, Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico (Guatemala Cement I), WT/DS60/R, which in turn relied on Panel Report, in United States – Measures Affecting Imports of Soft Lumber from Canada, Report of the Panel adopted by the Committee on Subsidies and Countervailing Measures on 27 October 1993 (SCM/162) (US - Softwood Lumber).

³³ Panel Report, Mexico – Corn Syrup, para. 7.102.

³⁴ Panel Report, United States-Imposition of Antidumping Duties on Imports of Seamless Stainless Steel Hollow Products from Sweden, August 20, 1990, ADP/47. Compare Panel Report, United States – Anti-Dumping Duties on Grey Portland Cement and Cement Clinker from Mexico, (US - Cement) ADP/82 issued: 7 September 1992, unadopted.

Example standing tests:

Suppose that there are two domestic producers X and Y, which produce 3,500 and 6,500 tons of the product concerned. Producer X files the application while producer Y neither supports nor opposes the application.

- The 50 per cent test is met because producer X represents 100 per cent of those supporting or opposing the application;
- The 25 per cent test is also met because producer X represents $(3,500:10,000 \times 100) = 35$ per cent of the total production.

If, however, producer Y would have expressed opposition to the application, producer X would not have met the 50 per cent test because in that case he would have represented only 35 per cent of those expressing support or opposing the application.

4.2.3 Notification

Article 5.5 expresses a preference for confidential treatment of applications prior to initiation of an investigation. On the other hand, before initiation, the importing Member authorities must *notify* the government of the exporting Member. The ADA does not contain rules on the form of such notification.

**Panel Report,
Thailand-H-Beams**

...While a written notification might arguably best serve this goal and the promotion of transparency and certainty among Members, and might also provide a written record upon which an importing Member could rely in the event of a subsequent claim of inconsistency with Article 5.5 of the AD Agreement, the text of Article 5.5 does not expressly require that the notification be in writing. We consider that a formal meeting between government officials could satisfy the notification requirement of Article 5.5, provided that the meeting is sufficiently documented to support meaningful review by a panel. For these reasons, we find that the fact that Thailand notified Poland under Article 5.5 orally in the course of a meeting between government officials, rather than in written form, does not render the notification inconsistent with Article 5.5.³⁵

4.2.4 De minimis/Negligibility Thresholds**Article 5.8 ADA**

Article 5.8 provides as a general rule that an application shall be rejected and an investigation terminated *promptly* as soon as the investigating authority is satisfied that there is not sufficient evidence of either dumping or injury to justify proceeding with the case.

Article 5.8 then provides two situations in which termination shall be *immediate*.

³⁵ Panel Report, Thailand - H-Beams, paras. 7.89-7.90, footnote omitted.

**De minimis and
negligibility rules
Article 5.8, ADA**

...where the authorities determine that the margin of dumping is de minimis. or that the volume of dumped imports, actual or potential, or the injury, is negligible. The margin of dumping shall be considered to be de minimis if the margin is less than 2 per cent, expressed as a percentage of the export price; The volume of dumped imports shall normally be regarded as negligible if the volume of dumped imports from a particular country is found to account for less than 3 per cent of imports of the like product in the importing Member, unless countries which individually account for less than 3 per cent of the import of the like product in the importing Member collectively account for more than 7 per cent of the imports of the like products in the importing Member.

The difference between the words ‘prompt’ and ‘immediate’ highlighted above possibly reflects recognition by the drafters that findings of *de minimis* dumping and *negligible* injury can often only be made when the investigation is well advanced.

Contrary to other commercial defence agreements such as the Agreement on Subsidies and Countervailing Measures and the Safeguards Agreement, these rules do not establish a higher threshold for developing countries.

4.2.5 Deadlines

Article 5.10 ADA

Article 5.10 provides that investigations shall normally be concluded within one year and in no case more than 18 months, after their initiation. The 18 months’ deadline seems absolute.

4.2.6 Interested Parties

Article 6.11 ADA

The parties most directly affected by an anti-dumping investigation are the domestic producers, foreign producers and exporters and their importers. However, the government of the exporting country and representative trade associations also qualify. Article 6.11 provides that other domestic or foreign parties may also be included as interested parties by the importing country Member.

4.3 Due Process Rights

Articles 6 and 12 ADA contain various due process rights of interested parties and the Appellate Body emphasized their importance in *Thailand-H-Beams*.

**Appellate Body
Report, Thailand-H-
Beams**

...Article 6...establishes a framework of procedural and due process obligations which, amongst other matters, requires investigating authorities to disclose certain evidence, during the investigation, to the interested parties. Article 6.2 requires that parties to an investigation “shall have a full opportunity for the defence of their interests”. Article 6.9 requires that, before



a final determination is made, authorities shall “inform all interested parties of the essential facts under consideration which form the basis for the decision”.....In a similar manner to Article 6, Article 12 establishes a framework of procedural and due process obligations concerning, notably, the contents of a final determination...Article 12, like Article 6, sets forth important procedural and due process obligations.³⁶

4.3.1 Public Notices and Explanation of Determinations

Article 12 ADA

Article 12 obliges importing Member authorities to publish public notices of initiation, and of preliminary and final determinations, with increasing degrees of specificity, as the investigation progresses. In addition, they must publish detailed explanations of their determinations.

Article 12.1.1, ADA

A public notice of the initiation of an investigation shall contain, adequate information on the following:

- (i) name of the exporting country/countries and product involved;*
- (ii) the date of initiation of the investigation;*
- (iii) the basis on which dumping is alleged in the application;*
- (iv) a summary of the factors on which the allegation of injury is based;*
- (v) the address to which representations by interested parties should be directed;*
- (vi) the time-limits allowed to interested parties for making their views known.*

Contents notice imposition provisional measures, Article 12.2.1, ADA

...sufficiently detailed explanations for the preliminary determinations on dumping and injury and shall refer to the matters of fact and law which have led to arguments being accepted or rejected. Such a notice or report shall...contain in particular:

- (i) names of the suppliers, or when this is impracticable, the supplying countries involved;*
- (ii) a description of the product which is sufficient for customs purposes;*
- (iii) the margins of dumping established and a full explanation of the reasons for the methodology used in the establishment and comparison of the export price and the normal value under Article 2;*
- (iv) considerations relevant to the injury determination as set out in Article 3;*
- (v) the main reasons leading to the determination.*

Contents notice definitive measures Article 12.2.2, ADA

...all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures...In particular, the notice or report shall contain the information described in subparagraph 2.1, as well as the reasons for the acceptance or rejection of relevant arguments or claims made by the exporters and importers, and the basis for any decision made under subparagraph 10.2 of Article 6.

³⁶ Appellate Body Report, Thailand-H-Beams, paras. 109-110.

Conceptually, Article 12 violations are often linked to substantive violations. If, for example, an exporter argues that the injury suffered by the domestic industry was not caused by dumped imports, but by its lack of productivity and the investigating authority does not examine this argument, the authority logically violates both Article 3.5 (the substantive obligation) and Article 12.2.2 (the procedural obligation).

While some panels have followed this logic, others, however, have not, as the following two different approaches show.

Panel Report, Mexico-Corn Syrup

Mexico's failure to set forth findings or conclusions on the issue of the retroactive application of the final anti-dumping measure is not consistent with the provisions of Articles 12.2 and 12.2.2 of the AD Agreement.³⁷

Panel Report, EC-Bed Linen

...we consider that where there is a violation of the substantive requirement, the question of whether the notice is sufficient under Article 12.2.2 is immaterial.³⁸

The difference between the two approaches is important because of the two-tiered WTO dispute settlement system and the lack of remand authority of the Appellate Body. If, under the second approach, the Appellate Body overturns the substantive violation, it may not be able to address the Article 12 violation because the Panel has not reached a finding on this issue.

4.3.2 Confidentiality

Anti-dumping investigations involve immense amounts of confidential and sensitive business information because they require companies to submit to the importing Member authorities pricing and costing information in various markets in exquisite detail. In order to mount an optimal legal defense, interested parties ideally need access to the confidential information submitted by the opposing side (foreign producers and their importers versus domestic producers and vice versa). On the other hand, they will be extremely reluctant to provide their own confidential information to their competitors. Thus, to ensure fair play and equality of arms, a balance must be struck between these competing interests and a legal system must give opposing parties equal levels of access to information.

Article 6.5 ADA

Article 6.5 ADA chooses for the principle³⁹ that information which is by its nature confidential or which is provided on a confidential basis shall, upon good cause shown, be treated as confidential by the authorities and shall not be disclosed without specific information of the party submitting it. However, the authorities shall require interested parties providing confidential information to provide meaningful non-confidential summaries thereof.

³⁷ *Panel Report, Mexico – Corn Syrup, para. 8.2 (e).*

³⁸ *Panel Report, EC-Bed Linen, para. 6.261.*

³⁹ *However, in an important footnote 17, Members recognize that, in the territory of certain Members, disclosure pursuant to a narrowly drawn protective order may be required. This is the case, inter alia, in the United States and Canada.*

Thus, whenever interested parties make a submission to the importing Member authorities, they should generally prepare both a confidential and a non-confidential version of the submission. The confidential version will be accessible only to the importing Member authorities. The non-confidential version, on the other hand, will be placed in the non-confidential file and can be accessed by all interested parties in the investigation.

4.3.3 Other Rights

Other important due process rights in Article 6 include the opportunity to present evidence in writing (Article 6.1), the right of access to the file (Article 6.1.2 *jo.* 6.4), the right to have a hearing and to meet opposing parties (confrontation meeting; Article 6.2), the right to be timely informed of the essential facts under consideration which form the basis for the decision whether to apply definitive measures (disclosure; Article 6.9), and the right to obtain, subject to exceptions,⁴⁰ an individual dumping margin (Article 6.10).

4.3.4 Facts Available/Administrative Deadlines

Article 6.8 *jo.* Annex II to the ADA provide that in cases where an interested party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available.

In *US – Hot-Rolled Steel*, the Appellate Body and the Panel essentially adopted a rule of reason approach in rejecting automatic recourse to facts available where deadlines are missed.

Panel Report, US-Hot-Rolled Steel

...we recognize that in the interest of orderly administration investigating authorities do, and indeed must establish...deadlines. However, a rigid adherence to such deadlines does not in all cases suffice as the basis for a conclusion that information was not submitted within a reasonable period and consequently that facts available may be applied. ...Particularly where information is actually submitted in time to be verified, and actually could be verified, we consider that it should generally be accepted, unless to do so would impede the ability of the investigating authority to complete the investigation within the time limits established by the Agreement...One of the principle elements governing anti-dumping investigations that emerges from the whole of the AD Agreement is the goal of ensuring objective decision-making based on facts. Article 6.8 and Annex II advance that goal by ensuring that even where the investigating authority is unable to obtain the “first-best” information as the basis of its decision, it will nonetheless base its decision on facts, albeit perhaps “second-best” facts.⁴¹

Appellate Body Report, US-Hot-Rolled Steel

...we conclude...that, under Article 6.8, USDOC was not entitled to reject this information for the sole reason that it was submitted beyond the deadlines →

⁴⁰ In certain cases, authorities may resort to sampling.

⁴¹ Panel Report, US – Hot-Rolled Steel, paras 7.54-7.55, footnotes omitted.

for responses to the questionnaires. Accordingly, we find that USDOC's action does not rest upon a permissible interpretation of Article 6.8 of the Anti-Dumping Agreement⁴²

4.4 Provisional Measures

Provisional measures should preferably take the form of a security (cash deposit or bond), may not be applied sooner than 60 days from the date of initiation and may not last longer than four months or, on decision of the importing Member authorities, upon request by exporters representing a significant percentage of the trade involved, maximally six months. Where authorities examine the lesser duty rule, these periods may be six and nine months.

Article 7 ADA

It is important to note that Article 7 uses the term 'measures' and not 'duties.' Under the system of the ADA, at the time that the importing Member decides to impose definitive duties, it must also decide whether to retroactively levy provisional anti-dumping duties (see section 4.6 below).

4.5 Price Undertakings

Anti-dumping investigations may be suspended or terminated without anti-dumping duties where exporters offer undertakings to revise prices or cease exports to the area in question at dumped prices so that the authorities are satisfied that the injurious effect of the dumping is eliminated. Use of the word 'may' indicates that authorities have complete discretion in this regard and, indeed, some authorities are reluctant as a matter of policy to accept price undertakings. Price undertakings are often the preferred solution by exporters. The *EC-Bed Linen* Panel ruled that acceptance of price undertakings may qualify as a constructive remedy in cases involving developing countries.

4.6 Anti-dumping Duties

"public interest clause"

Imposition of anti-dumping duties where injurious dumping has been found is discretionary and use of a lesser duty rule is encouraged. Many WTO Members include a public interest clause in their national legislation to enable them to refrain from imposing duties, even where injurious dumping is found.

If an anti-dumping duty is imposed, it must be collected on a non-discriminatory basis on imports of the product from all sources found to be injuriously dumped.

Article 9.4 ADA

Article 9.4 provides special rules in cases where the authorities have resorted to sampling. In such cases, the cooperating sampled producers will normally get their individual anti-dumping duties. This leaves two categories: cooperating/non-sampled producers and non-cooperating/non-sampled

⁴² *Appellate Body Report, US – Hot- Rolled Steel, para 89.*

producers. Article 9.4 addresses the situation of the first category. It provides that the anti-dumping duty applied to them shall not exceed the weighted average margin of dumping established with respect to the sampled producers or exporters, provided that the authorities shall disregard any zero and *de minimis* margins and margins established on the basis of facts available.

In *US-Hot-Rolled Steel*, the Appellate Body confirmed the Panel finding that a provision of the United States Tariff Act of 1930, as amended, requiring inclusion of margins established *partly* on facts available in calculating the rate for cooperating/non-sampled producers was inconsistent with Article 9.4 ADA.

**Appellate Body
Report, US-Hot-Rolled
Steel**

As section 735(c)(5)(A) of the United States Tariff Act of 1930, as amended, requires the inclusion of margins established, in part, on the basis of facts available, in the calculation of the “all others” rate, and to the extent that this results in an “all others” rate in excess of the maximum allowable rate under Article 9.4, we uphold the Panel’s finding that section 735(c)(5)(A) of the United States Tariff Act of 1930, as amended, is inconsistent with Article 9.4 of the Anti-Dumping Agreement. We also uphold the Panel’s consequent findings that the United States acted inconsistently with Article 18.4 of that Agreement and with Article XVI:4 of the WTO Agreement. We further uphold the Panel’s finding that the United States’ application of the method set forth in section 735(c)(5)(A) of the Tariff Act of 1930, as amended, to determine the “all others” rate in this case was inconsistent with United States’ obligations under the Anti-Dumping Agreement because it was based on a method that included, in the calculation of the “all others” rate, margins established, in part, using facts available.⁴³

Article 9.3 ADA

Article 9.3 introduces the distinction between retrospective and prospective duty collection systems and requires prompt refunds of over-payments in both cases.

Under the retrospective system, used mainly by the United States, the original investigation ends with an estimate of future liability; however, the actual amount of anti-dumping duties to be paid will be established in the course of annual reviews, covering the preceding one-year period.

Under the prospective system, used by the EC and most other countries, on the other hand, the findings made during the original investigation form the basis for the future collection of anti-dumping duties, normally for the five years following the publication of the final determination.

The retrospective system is more precise than the prospective system. On the other hand, it is costly and time-consuming for all parties, including the importing Member authorities.

⁴³ Appellate Body Report, US – Hot-Rolled Steel, para. 129, footnote omitted.

4.7 Retroactivity

Article 10 ADA

Article 10 ADA provides for two types of retroactivity.

First, where a final determination of injury (but not of a threat thereof or of a material retardation of the establishment of an industry) is made or, in the case of a final determination of a threat of injury, where the effect of the dumped imports would, in the absence of the provisional measures, have led to a determination of injury, anti dumping duties may be levied retroactively for the period for which provisional measures, if any, have been applied. This type of retroactivity is often applied by importing Members.

Panel Report, Mexico – Corn Syrup

...while Article 10.2 does not explicitly require a “determination” that “the effect of the dumped imports would, in the absence of the provisional measures, have led to a determination of injury”, there must be some specific statement in the final determination of the investigating authority from which a reviewing panel can discern that the issue addressed in Article 10.2 was properly considered and decided.⁴⁴

Second, a definitive anti dumping duty may be levied on products which were entered for consumption not more than 90 days prior to the date of application of provisional measures, when the authorities determine for the dumped product in question that:

- (i) there is a history of dumping which caused injury or that the importer was, or should have been, aware that the exporter practises dumping and that such dumping would cause injury, and
- (ii) the injury is caused by massive dumped imports of a product in a relatively short time which in light of the timing and the volume of the dumped imports and other circumstances (such as a rapid build up of inventories of the imported product) is likely to seriously undermine the remedial effect of the definitive anti dumping duty to be applied, provided that the importers concerned have been given an opportunity to comment.

This second type of retroactivity is seldom applied because the conditions are very stringent.

4.8 Reviews

Article 9.5 ADA

The ADA recognizes three types of reviews of anti-dumping measures. First, Article 9.5 requires importing Member authorities to promptly – and in accelerated manner - carry out reviews requested by newcomers, *i.e.* producers which did not export during the original investigation period and which will normally be subject to the residual duty (“all others” rate) that was imposed in the original investigation. During the course of the review, no anti-dumping

⁴⁴ Panel Report, Mexico – Corn Syrup, para. 7.191.

duties shall be levied on the newcomers. However, the importing Member authorities may withhold appraisal and/or request guarantees to ensure that, should the newcomer review investigation result in a determination of dumping, anti-dumping duties can be levied retroactively to the date of initiation of the review.

Article 11 ADA

Second, Article 11 provides for what can be called interim and expiry reviews. To start with the latter, definitive anti-dumping duties shall normally expire after five years from their imposition, unless the domestic industry asks for a review within a reasonable period of time preceding the expiry, arguing that the expiry of the duty would be likely to lead to continuation or recurrence of dumping and injury.

During the five year period (hence the term interim review), interested parties may request the authorities to examine whether the continued imposition of the duty is necessary to offset dumping, whether the injury would be likely to continue or recur if the duty were removed or varied, or both. In both cases, the measures may stay in force pending the outcome of the review.

The interim and expiry review investigations require prospective and counterfactual analysis. In this context, the fact that during the review investigation period, dumping and/or injury did not take place is not necessarily decisive because it might indicate that the measures are having effect.

Panel Report, US-DRAMS

...In our view, this confirms a finding that the absence of present dumping does not in and of itself require the immediate termination of an anti-dumping duty pursuant to Article 11.2.⁴⁵

4.9 Judicial Review

Article 13 ADA

Article 13 provides that Members, which do adopt anti-dumping legislation, must also maintain independent judicial, arbitral or administrative tribunals or procedures for the purpose of prompt review of administrative final and review determinations.

4.10 Flowchart

The flowchart below shows the various procedural stages in an anti-dumping investigation emanating from the ADA. It is emphasized that national implementing legislation often will be much more detailed:

⁴⁵ Panel Report, United States – Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea (US – DRAMS), WT/DS99/R, para. 6.32.

Day**Stage of the proceeding**

Submission of a written application by the domestic industry.



Examination of the application by the investigating authority. Before initiating the investigation, the investigating authority must notify the government of the exporting country concerned that an application for the initiation of an anti-dumping investigation has been received.



1

The investigating authority rejects the complaint if there is insufficient prima facie evidence that injurious dumping has taken place. In such a case, the proceeding is not initiated. Otherwise, the investigating authority initiates the investigation in which case public notice must be given.



Transmission of the full text of the written application to the known exporters and to the authorities of the exporting Member *as soon as the investigation has been initiated*. Upon request, the text of the application must be made available to other interested parties. The investigating authority must also send the questionnaires to exporters, importers, domestic industry and other interested parties. Exporters or foreign producers must be given at least 30 days to reply. This time-limit must be counted from the date of receipt of the questionnaire, which shall be deemed to have been received one week from the date on which it was sent to the respondent or transmitted to the appropriate diplomatic representative of the exporting Member. Extensions may be granted.



Expiry of deadline for questionnaire responses. Interested parties may submit comments. Non-confidential summaries of written submissions must generally be made available to other parties. Interested parties are also entitled to request to be heard and to hold confrontation meetings with opposing parties. Interested parties are entitled to have access to the non-confidential (public) file and to prepare presentations on the basis of the consulted information.

No sooner than 60 days from day 1, no later than 9 months

Analysis of all data collected. Provisional determination reached.



Publication of a notice imposing provisional anti-dumping measures for six months if a preliminary affirmative determination has been made of dumping and consequent injury to a domestic industry. Interested parties must be given the possibility to submit comments to the findings on the basis of which the investigating authority decided to impose provisional anti-dumping measures



Interested parties have the right to be heard, submit comments, access to the non-confidential (public) file and hold meetings.



Analysis by the investigating authority of the comments and evidence collected. Definitive determination reached.



Transmission of definitive disclosure to interested parties. This disclosure must take place in sufficient time for interested parties to be able to defend their interests.



Expiry of deadline for interested parties to submit their comments on the investigating authority's findings.



Analysis by the investigating authority of the comments submitted by interested parties.



No later than 12 months from day one or four months after date of imposition of provisional anti-dumping duties. In exceptional circumstances, no later than 18 months after initiation or six months after the imposition of provisional anti-dumping duties.

Adoption and publication of the notice imposing definitive measures for up to five years. In the event that it has been found that sales did not take place at dumped prices or that the domestic industry did not suffer injury due to the imports from the targeted country, then a notice of termination of the proceeding must be published.

4.11 Initiation of Anti-dumping Investigations at National Level

Until the 1990s, Australia, Canada, the European Union and the United States initiated most anti-dumping investigations. However, since that time, many other countries have also adopted anti-dumping legislation and applied anti-dumping measures. According to WTO statistics, a substantial number of anti-dumping investigations have been initiated also by other countries such as Argentina, Brazil, the Republic of Korea, India, Mexico and South Africa. According to recent UNCTAD estimates, from 1995 to 1999 1,229 anti-dumping proceedings were initiated, of which 651 by developing countries, and the recent trends show that "...developing countries now initiate about half of the total number of anti-dumping cases, and some of them employ anti-dumping more actively than most of the developed country users."⁴⁶

4.12 Test Your Understanding

1. **An administering authority prepares non-confidential summaries of confidential information that has been submitted by the domestic industry and puts these in the non-confidential file. Does this violate the ADA?**
2. **An administering authority gives exporters 45 days to respond to the questionnaires and domestic producers 60 days. Is this allowed under the WTO?**
3. **Can anti-dumping duties be imposed retroactively? For how long and under what conditions?**
4. **A WTO Member provides in its anti-dumping legislation that trade unions may qualify as an interested party in an anti-dumping investigation. Is this allowed under the ADA?**
5. **In the context of an anti-dumping investigation, the investigating authority accepts an undertaking from an exporter not to export more than 5,000 metric tons a year. Is this permissible under the ADA?**

⁴⁶ Miranda, Torres, Ruiz, *The International Use of Anti-Dumping—1987-1997*, 32:5 *Journal of World Trade*, 1998, 5–72, at 64.

5. THE WTO PROCEDURES

This Section gives an overview of WTO dispute settlement cases litigated under the ADA, the special dispute settlement provisions in the ADA and conceptual issues that have arisen in the case law of panels and the Appellate Body. It does not include substantive or national procedural issues because these have been covered in the previous sections.

5.1 Introduction

In light of the explosion of anti-dumping measures worldwide, it is noteworthy that relatively few anti-dumping measures have been challenged in the WTO. There may be several explanations for this phenomenon. More than in other areas of WTO law, anti-dumping measures directly and principally impact on the *private* sector and often result from skirmishes between domestic and foreign industries. Anti-dumping legislation is also complicated and cases are highly factual (as a result of which they are often multi-claim cases). Thus, before a WTO dispute settlement proceeding is initiated, the private industry must explain technicalities to and convince the government of the merits of its case and experience shows that this is no easy task. Furthermore, governments dislike losing WTO cases, especially as complainants where the initiative is theirs, and tend to proceed only if they can be convinced that the case is ironclad. WTO dispute settlement cases in this area are also labour-intensive and costly because so much depends on the details of the case. Last, as anti-dumping duties are producer-specific and there will often be producers with lower and higher duties, the industry as such may not necessarily have a common interest in challenging a measure.

However, the record shows that, once WTO dispute settlement cases *are* initiated, the applicant often is found to have a strong case. The table below provides details with respect to the cases, which led to Panel/Appellate Body Reports from 1995 to 2001.

WTO cases involving anti-dumping law or measures 1995-2002

Panel Report	AB Report	Date of Adoption	Applicant (Appellant)	Respondents (Appellee)	Third Parties (Participants)
<i>US-Dumping Offset Act</i>		WT/DS217/R WT/DS234/R (in circulation)	Australia, Brazil Chile EC India Indonesia Japan Republic of Korea Thailand	United States	Argentina Canada Costa Rica Hong Kong China Israel Mexico Norway
<i>Egypt-Rebar</i>		WT/DS211/R (in circulation)	Turkey	Egypt	Chile EC Japan United States
<i>US-Section 129</i>		30/08/2002 WT/DS221/R	Canada	United States	Chile EC India Japan
<i>US-Steel Plate from India</i>		29/07/2002 WT/DS206/R/Corr 1	India	United States	Chile EC Japan
	<i>Mexico– Corn Syrup (21.5 – US)</i>	21/11/2001 WT/DS132/ARW	United States	Mexico	EC Jamaica Mauritius
<i>Argentina – Ceramic Tiles</i>		05/11/2001 WT/DS189/R	EC	Argentina	Japan Turkey United States
	<i>US – Hot- Rolled Steel</i>	23/08/01 WT/DS184/AB/R	Japan United States	Japan United States	Brazil Canada Chile Republic of Korea
<i>Mexico– Corn Syrup (21.5 – US) (appealed)</i>		WT/DS132/RW	United States	Mexico	EC Jamaica Mauritius
	<i>Thailand - H-Beams</i>	15/04/2001 WT/DS122/AB/R	Thailand	Poland	EC Japan United States
	<i>EC - Bed Linen</i>	12/03/2001 WT/DS141/AB/R	EC India	EC India	Egypt Japan United States
<i>US - Hot- Rolled Steel (appealed)</i>		WT/DS/184/R	Japan	United States	Brazil Chile Canada Republic of Korea
<i>US –Stainless Steel)</i>		01/02/2001 WT/DS179/R	Republic of Korea	United States	EC Japan
<i>EC - Bed Linen (appealed)</i>		WT/DS141/R	India	EC	Egypt Japan United States
<i>Guatemala - Cement II</i>		17/11/2000 WT/DS156/R	Mexico	Guatemala	EC Ecuador El Salvador Honduras United States
<i>Thailand H- Beams (appealed)</i>		WT/DS122/R	Poland	Thailand	EC Japan United States
	<i>US – 1916 Act</i>	26/09/2000 WT/DS136/AB/R WT/DS/162/AB/R	EC Japan United States	EC Japan United States	EC India Japan Mexico
<i>US - 1916 Act (Japan) (appealed)</i>		WT/DS162/R	Japan	United States	EC India
<i>US - 1916 Act (EC) (appealed)</i>		WT/DS136/R	EC	United States	India Japan Mexico
<i>Mexico– Corn Syrup</i>		24/02/2000 WT/DS132/R	United States	Mexico	Jamaica Mauritius

<i>US - DRAMS</i>		19/03/1999 WT/DS99/R	Republic of Korea	United States	
	<i>Guatemala - Cement I</i>	25/11/1998 WT/DS60/AB/R	Guatemala	Mexico	United States
<i>Guatemala - Cement I (appealed)</i>		WT/DS60/R	Mexico	Guatemala	United States Canada El Salvador Honduras

The EC, India, Japan, the Republic of Korea and Mexico were the complainant in two cases, and Canada Poland and the United States each in one case. The United States was a defendant in eight cases, Guatemala in two cases, and Argentina, the EC, Mexico and Thailand each in one case. It is noteworthy that developing countries⁴⁷ were involved as principal parties in six and as third parties in 13 cases.

Third party representations were made mostly by the EC (five times) and Japan and the United States (four times each). This seems to reflect the perception of these countries that it is important to actively monitor and be heard in on-going dispute settlement proceedings because of systemic determinations that will often exceed the specifics of the case.

5.2 WTO ADA Jurisdiction and Standard of Review

5.2.1 *Identification of Measure in Request for Establishment*

Article 17.4 ADA

Article 17.4 contains a special rule providing that a Member may refer the matter to the DSB if final action has been taken by the administering authorities of the importing Member to levy definitive anti dumping duties or to accept price undertakings. When a provisional measure has a significant impact and the Member that requested consultations considers that the measure was taken contrary to the provisions of paragraph 1 of Article 7, that Member may also refer such matter to the DSB. Thus Article 17.4, which does not have a counterpart in other commercial defence agreements such as the Agreement on Subsidies and Countervailing Measures and the Agreement on Safeguards, explicitly identifies three types of measures.

In the first anti-dumping case before it, *Guatemala-Cement I*, the Appellate Body ruled that the request for establishment of a panel in an anti-dumping case must *always* identify one of these three measures. In other words, it is not possible to challenge a ‘proceeding.’ Similarly, it is not possible to challenge the initiation of a proceeding or subsequent procedural or substantive decisions as such. *Claims* relating to such issues may be made, but one of the three measures mentioned in Article 17.4 ADA must always be identified.

⁴⁷ For this purpose Argentina, Brazil, Chile, Ecuador, Egypt, El Salvador, Honduras, Guatemala, India, Jamaica, Mauritius, Poland, Thailand and Turkey are included.

**Appellate Body
Report, Guatemala-
Cement I**

...Article 17.4 of the Anti-Dumping Agreement specifies the types of “measure” which may be referred as part of a “matter” to the DSB. Three types of anti-dumping measure are specified in Article 17.4: definitive anti-dumping duties, the acceptance of price undertakings, and provisional measures. According to Article 17.4, a “matter” may be referred to the DSB only if one of the relevant three anti-dumping measures is in place. This provision, when read together with Article 6.2 of the DSU, requires a panel request in a dispute brought under the Anti-Dumping Agreement to identify, as the specific measure at issue, either a definitive anti-dumping duty, the acceptance of a price undertaking, or a provisional measure.⁴⁸

**Appellate Body
Report, US-1916 Act**

...In the context of dispute settlement proceedings regarding an anti-dumping investigation, there is tension between, on the one hand, a complaining Member’s right to seek redress when illegal action affects its economic operators and, on the other hand, the risk that a responding Member may be harassed or its resources squandered if dispute settlement proceedings could be initiated against it in respect of each step, however small, taken in the course of an anti-dumping investigation, even before any concrete measure had been adopted. ... Article 17.4 strikes a balance between these competing considerations.⁴⁹

In a jurisdictional challenge in the *US-1916 Act* cases, the United States took the position that Article 17.4 ADA should be interpreted as allowing WTO dispute settlement actions only against one of the three measures and not against legislation. The Appellate Body rejected this interpretation and upheld traditional GATT jurisprudence that *mandatory* (as opposed to *discretionary*) legislation can be challenged.

**Appellate Body
Report, US –1916 Act**

In the same way that Article XXIII of the GATT 1994 allows a WTO Member to challenge legislation as such, Article 17 of the Anti-Dumping Agreement is properly to be regarded as allowing a challenge to legislation as such, unless this possibility is excluded. No such express exclusion is found in Article 17 or elsewhere in the Anti-Dumping Agreement. ... We note that, unlike Articles 17.1 to 17.3, Article 17.4 is a special or additional dispute settlement rule listed in Appendix 2 to the DSU. ... Nothing in our Report in Guatemala – Cement suggests that Article 17.4 precludes review of anti-dumping legislation as such. Rather, in that case, we simply found that, for Mexico to challenge Guatemala’s initiation and conduct of the anti-dumping investigation, Mexico was required to identify one of the three anti-dumping measures listed in Article 17.4 in its request for establishment of a panel. Since it did not do so, the panel in that case did not have jurisdiction.⁵⁰

Thus, legislation may be challenged in se, if it is mandatory, as was the case in the *US-1916 Act* cases. It may also be contested as applied in a certain investigation. The latter occurred, for example, in cases such as *US-DRAMS* and *US-Hot-Rolled Steel*. This means that a Member challenges one of the

⁴⁸ Appellate Body Report, Guatemala Cement I, WT/DS60/AB/R, para. 79.

⁴⁹ Appellate Body Report, United States – Anti-Dumping Act of 1916 (US – 1916 Act), WT/DS136/AB/R, para. 73, footnote omitted.

⁵⁰ Appellate Body Report, US – 1916 Act, paras 62-72.

three measures identified in Article 17.4 and argues that certain elements of the national law on which the measure was based violate WTO provisions.

5.2.2 *Special Standard of Review*

Article 17.6 of the ADA provides a special standard of review for Panels examining anti-dumping disputes.

Article 17.6(i) ADA

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

Article 17.6(ii) ADA

...the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

Article 17.6(i) is designed to prevent *de novo* review by panels by placing limits on their examination of the evaluation of the facts by the authorities. Article 17.6(ii) obliges panels to uphold permissible interpretations of ADA provisions by national authorities in cases where such provisions permit more than one permissible interpretation.

Thus far two permissible interpretations have been found only once by a Panel, but the relevant Panel finding was overturned on appeal.

Panel Report, EC-Bed Linen

...we consider that an interpretation of Article 2.2.2(ii) under which sales not in the ordinary course of trade are excluded from the determination of the profit amount to be used in the calculation of a constructed normal value is permissible.⁵¹

Appellate Body Report, EC-Bed Linen

...we reverse the finding of the Panel...that, in calculating the amount for profits under Article 2.2.2(ii) of the ADA, a Member may exclude sales by other exporters or producers that are not made in the ordinary course of trade.⁵²

In contrast, in *US-Hot-Rolled Steel*, the Appellate Body overturned the Panel in finding that use of downstream sales prices by affiliates to unrelated customers on the domestic market was a permissible interpretation of Article 2.1.

⁵¹ Panel Report, EC-Bed Linen, para. 6.87.

⁵² Appellate Body Report, EC-Bed Linen, paras. 84.

**Appellate Body
Report, US-Hot-Rolled
Steel**

In the present case, as we said, Japan and the United States agree that the downstream sales by affiliates were made “in the ordinary course of trade”. The participants also agree that these sales were of the “like product” and these products were “destined for consumption in the exporting country.” In these circumstances, we find that the reliance by USDOC on downstream sales to calculate normal value rested upon an interpretation of Article 2.1 of the Anti-Dumping Agreement that is, in principle, “permissible” following application of the rules of treaty interpretation in the Vienna Convention.

We, therefore, reverse the Panel’s finding, in paragraph 8.1(c) of the Panel Report, that the reliance by USDOC on downstream sales between parties affiliated with an investigated exporter and independent purchasers to calculate normal value was inconsistent with Article 2.1 of the Anti-Dumping Agreement.⁵³

5.3 Procedural Issues

5.3.1 Specificity of Claims in Request for Establishment

The Appellate Body has held that claims must be specified with sufficient precision in the request for establishment of a Panel. While in some instances, it may be sufficient to mention the articles of the Agreements alleged to have been violated (*EC-Bananas*⁵⁴), in cases where articles contain multiple obligations, more detail will generally be necessary (*Korea-Dairy Safeguards*)⁵⁵, unless the rights of defence of the respondent are not impeded by the failure to do so. The latter determination must be made on a case-by-case basis (*Thailand-H-Beams*).

This ruling is very important for the ADA because many ADA articles, including key articles such as Articles 2, 3, 4, 5, 6 and 12, contain multiple obligations and may form the basis for numerous claims. It is therefore recommendable that an applicant not only refers to articles and paragraphs in an ADA dispute, but also shortly summarizes its claims in descriptive form. This is all the more so because disputes in this area tend to be multi-claim in nature.

5.3.2 ‘New’ Claims

The Appellate Body has confirmed that a *government* bringing an anti-dumping case is not necessarily confined to the claims made by its *producers* in the course of the national procedures. There is, in other words, no principle of exhaustion of administrative remedies.

⁵³ Appellate Body Report, US – Hot-Rolled Steel, paras. 172-173.

⁵⁴ Appellate Body Report, European Communities – Regime for Importation, Sale and Distribution of Bananas (*EC Bananas*), WT/DS27/AB/R, adopted 25 September 1997

⁵⁵ Appellate Body Report, Korea Definitive Safeguard Measures on Imports of Certain Dairy Products (*Korean-Dairy*), WT/DS98/AB/R, adopted 12 January 2000

**Appellate Body
Report, Thailand-H-
Beams**

...The Panel's reasoning seems to assume that there is always continuity between claims raised in an underlying anti-dumping investigation and claims raised by a complaining party in a related dispute brought before the WTO. This is not necessarily the case. The parties involved in an underlying anti-dumping investigation are generally exporters, importers and other commercial entities, while those involved in WTO dispute settlement are the Members of the WTO. Therefore, it cannot be assumed that the range of issues raised in an anti-dumping investigation will be the same as the claims that a Member chooses to bring before the WTO in a dispute.⁵⁶

5.3.3 Standing

WTO dispute settlement proceedings are between governments and, consequently, only WTO Members can initiate such proceedings. Thus, even though anti-dumping disputes are driven by the private sector and target foreign competitors, as opposed to foreign governments, neither the domestic industry nor foreign exporters and producers can initiate or respond in WTO dispute settlement proceedings or appear before Panels or the Appellate Body in their own right.

Indirectly, however, industry representatives may play a role in such proceedings in at least two manners. First of all, the Appellate Body has held that Members have the right to compose their own delegation. Thus, if a WTO Member decides to attach an industry representative to its delegation, this is allowed, it being understood that the representative will be subject to the same confidentiality requirements as governmental members of the delegation. Second, interested parties may file *amicus curiae* briefs. This happened, for example, in *EC-Bed Linen* in the panel phase⁵⁷ and in *Thailand-H-Beams* in the Appellate Body phase.⁵⁸

5.4 Panel Recommendations and Suggestions

Article 19.1 DSU

The distinction between Panel recommendations and suggestions (which are not legally binding) is made in Article 19.1 DSU⁵⁹ and is therefore not specific to the ADA. However, it is recalled that the main reason for this distinction is that a number of GATT panels in the AD/CVD area had recommended that, where investigations have been initiated illegally by the investigating authorities, AD/CVD measures imposed must be revoked and duties collected reimbursed. Such recommendations are no longer possible and only suggestions to that

⁵⁶ *Appellate Body Report, Thailand-H-Beams, para. 94.*

⁵⁷ *The Foreign Trade Association filed an amicus curiae submission in support of India's complaint, see Panel Report, EC-Bed Linen, footnote 10.*

⁵⁸ *The brief was filed by Consuming Industries Trade Action Coalition ("CITAC"), a coalition of United States companies and trade associations.*

⁵⁹ *Article 19.1 provides that where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement and that, in addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations.*

effect can now be made. Thus far, only the *Guatemala-Cement II* Panel has suggested that a measure be revoked. The same Panel refused to suggest that the anti-dumping duties collected be reimbursed on systemic grounds.

**Panel Report,
Guatemala-Cement II**

...In light of the nature and extent of the violations in this case, we do not perceive how Guatemala could properly implement our recommendation without revoking the anti-dumping measure at issue in this dispute. Accordingly, we suggest that Guatemala revoke its anti-dumping measure on imports of grey portland cement from Mexico. In respect of Mexico's request that we suggest that Guatemala refund the anti-dumping duties collected, we note that Guatemala has now maintained a WTO-inconsistent anti-dumping measure in place for a period of three and a half years. Thus, we fully understand Mexico's desire to see the anti-dumping duties repaid and considers that repayment might be justifiable in circumstances such as these... Mexico's request raises important systemic issues regarding the nature of the actions necessary to implement a recommendation under Article 19.1 of the DSU, issues which have not been fully explored in this dispute. Thus, we decline Mexico's request to suggest that Guatemala refund the anti-dumping duties collected.⁶⁰

5.5 Test Your Understanding

1. **A WTO Member adopts legislation mandating prison terms for exporters found to have injuriously dumped. Can this legislation be challenged in the WTO? What do you think a Panel would decide?**
2. **A WTO Member claims in its request for establishment of a Panel that another Member has violated Article 2 ADA. Is this claim sufficiently precise? What if he claims a violation of Article 2.2? Article 3.4? Article 5.9?**
3. **A WTO Member starts a dispute settlement proceeding against an anti-dumping measure taken by another Member and raises an issue that was not argued by its exporters in the course of the administrative proceeding. Does the Panel have jurisdiction to entertain this claim?**
4. **A WTO Member starts a dispute settlement proceeding against an anti-dumping measure taken by another Member which is also being challenged in the domestic courts of the latter by the exporters. Can the Panel proceed?**
5. **Can a Panel recommend the reimbursement of anti-dumping duties, which, in its view, have been illegally collected?**

⁶⁰ Panel Report, *Guatemala-Cement II*, paras 9.6-9.7.

6. DEVELOPING COUNTRY MEMBERS

This section examines Article 15 of the ADA which provides special and differential treatment for developing countries.

6.1 Article 15 ADA

Developing countries have been active participants in WTO dispute settlement proceedings involving anti-dumping issues. At the level of the ADA itself, however, the position of developing countries in most respects is not different from that of developed countries. They must abide by the same rules and, developing country exporters have the same rights and obligations as their counterparts in developed countries. The one exception is Article 15 ADA. This Article was unchanged from the Tokyo Round Code.

Article 15 ADA

It is recognized that special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti dumping measures under this Agreement. Possibilities of constructive remedies provided for by this Agreement shall be explored before applying anti dumping duties where they would affect the essential interests of developing country Members.

6.2 Panel Interpretation

Under the Tokyo Round Anti-Dumping Code, in *EC-Cotton Yarns*⁶¹, Brazil had challenged the failure of the EC to apply this Article; however, the Panel rejected Brazil's claims. As a result, many considered Article 15 a dead letter. However, in the recent *EC-Bed Linen* report, the Panel gave the provision new life:

Panel Report, EC-Bed Linen

...the "exploration" of possibilities must be actively undertaken by the developed country authorities with a willingness to reach a positive outcome. Thus, Article 15, in our view, imposes no obligation to actually provide or accept any constructive remedy that may be identified and/or offered. It does, however, impose an obligation to actively consider, with an open mind, the possibility of such a remedy prior to imposition of an anti-dumping measure that would affect the essential interests of a developing country.⁶²

The rejection expressed in the European Communities' letter of 22 October 1997 does not, in our view, indicate that the possibility of an undertaking was explored, but rather that the possibility was rejected out of hand...the European Communities simply did nothing different in this case, than it would have done in any other anti-dumping proceeding...Pure passivity is not sufficient,

⁶¹ GATT Panel Report Imposition of Anti-Dumping Duties on Imports of Cotton Yarn from Brazil, adopted by ADP Committee, October 30 1995, ADP/137 42S/17

⁶² Panel Report, EC-Bed Linen, para. 6.233, footnote omitted

in our view, to satisfy the obligation to “explore” possibilities of constructive remedies, particularly where the possibility of an undertaking has already been broached by the developing country concerned.⁶³

6.3 Constructive Remedies

The Panel further ruled that ‘constructive remedies’ could take the form of acceptance of undertakings or application of a lesser duty rule. On the other hand, according to the Panel, a decision not to impose an anti-dumping duty on a developing country was not required as constructive remedy.

6.4 Timing

As Article 15 provides that constructive remedies must be explored before *applying anti-dumping duties*, the question also arose whether the remedies must be explored before provisional or definitive measures are imposed. In this regard, the Panel held that the obligation arises only before definitive measures are imposed.

6.5 Test Your Understanding

- 1. What special obligation under the ADA do developed countries have if they wish to impose anti-dumping measures on developing countries?**
- 2. When does this obligation arise?**
- 3. Do you agree with the findings of the Panel?**

⁶³ Panel Report, EC-Bed Linen, para. 6.238.

7. CASE STUDY

Country A is a WTO Member. Alfa bikes and Zeta wheels are the largest producers of bicycles in the country. They produce mainly (90 per cent) mountain bikes.

Alfa bikes and Zeta wheels represent 85 per cent of the domestic industry. Their production is almost entirely destined for export. Domestic sales of bicycles represent 4.9 per cent of the total production. In particular, out of the total production of mountain bikes, domestic sales amount to only 3.8 per cent; 60 per cent are exports to the large neighbouring country E; and the remaining production is exported to a few other medium-sized markets.

Labour is relatively cheap in country A and, due to a recent devaluation of the national currency, exports are increasing.

In the neighbouring WTO Member country E, there are seven major bicycle producers that have traditionally dominated the market. The overall economic trend in country E starts to weaken, and the market for bicycles experiences a slump. In particular, the domestic producers face declining market shares and decreasing profits.

Four out of the seven major producers, representing 55 per cent of the total production, file a complaint before the competent authorities claiming that the bicycles from country A, in particular mountain bikes, are being dumped in country E's market.

The competent authorities examine the facts and make a preliminary determination that there is sufficient evidence to start an anti-dumping investigation based on the information available in the complaint. The authorities define the product concerned as 'mountain bike' bicycles.

You have been requested by Alfa bikes and Zeta wheels to prepare a report on the likelihood of an anti-dumping measure.

- (a) How would you establish the *normal value* in country A for the product concerned? The following information relating to domestic sales made in the ordinary course of trade is provided by the producers in country A in their questionnaire responses:

Product concerned:	Cost of production	Domestic SGA	Profits	Domestic Price (1 st independent customer)
Mountain bikes				
Alfa bikes	22/unit	3/unit	10,7%	28/unit
Zeta wheels	20/unit	4/unit	7.6%	26/unit

- (b)** For Alpha bikes the ex factory *export price* of the product concerned to country E (1st independent buyer) has been established to be 26 in the first half of the IP, and 22 in the second half of the IP due to the devaluation of the currency in country A. How would you calculate the dumping margin based on a fair comparison?
- (c)** With regard to the injury calculation, the competent authorities indicate that they will use data pertaining to the overall production of bicycles as a group, and not only to mountain bikes. What is your opinion on this?

8. FURTHER READING

- **Horlick, G and Clarke, P**, Standards for Panels Reviewing Anti-Dumping Determinations under the GATT and the WTO, in *International Trade Law and the GATT/WTO Dispute Settlement System*, 1997, (ed. Petersmann 1997).
- **Jackson, J, and Vermulst, E, (editors)**, *Anti-Dumping Law and Practice: A Comparative Analysis* University of Michigan Press 1989.
- **Koulen, M**, The New Anti-Dumping Code Through Its Negotiating History, in *The Uruguay Round Results*, 1995, 151-233 (Eds. Bourgeois, Berrod, Gippini Fournier).
- **Miranda, J, Torres, R and Ruiz, M**, The International Use of Anti Dumping—1987-1997, 32:5 *Journal of World Trade*, 1998, 5–72.
- **UNCTAD**, The Impact of Anti-Dumping and Countervailing Duty Actions on the Trade of Member States, In *Particular Developing Countries. Main Issues and Areas of Concern that Need to Be Addressed in the Light of Concrete Experiences Presented by National Experts*, Outcome of the Expert Meeting, TD/B/COM.1/EM.14/L.1, 12 December 2000.
- **UNCTAD**, Positive Agenda and Future trade Negotiations, Anti Dumping and Countervailing Duties, 2000, 287 – 308.
- **Vermulst, E and Graafsma, F**, WTO Dispute Settlement with respect to Commercial Defence Measures, Cameron May, forthcoming 2001.
- **Vermulst, E**, Adopting and Implementing Anti-Dumping Laws: Some Suggestions for Developing Countries, 31:2 *Journal of World Trade*, 1997, 5 – 24.

8.1 List of Relevant Panel and Appellate Body Reports

8.1.1 Appellate Body Reports

- Appellate Body Report, *Mexico – Anti – Dumping Investigation on High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States (Mexico – Corn Syrup (Article 21.5 – US))*, WT/DS132/AB/RW, adopted 21 November 2001.
- Appellate Body Report, *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan (US – Hot- Rolled Steel)*, WT/DS184/AB/R, adopted 23 August 2001.
- Appellate Body Report, *Thailand – Anti-Dumping Duties on Angels, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland (Thailand – H-Beams)*, WT/DS122/AB/R, adopted 5 April 2001.
- Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India (EC – Bed Linen)*, WT/DS141/AB/R, adopted 12 March 2001.

- Appellate Body Report, *United States – Anti-Dumping Act of 1916 (US – 1916 Act)* WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000.
- Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico (Guatemala – Cement I)*, WT/DS60/AB/R, adopted 25 November 1998.

8.2 Panel Reports

- Panel Report, *United States - Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/R, WTDS234/R, circulated 16 September 2002
- Panel Report, *Egypt – Definitive Anti-Dumping Measures on Steel Rebar from Turkey*, WT/DS211/R, circulated 8 August 2002
- Panel Report, *United States – Anti-Dumping and Countervailing Measures on Steel Plate from India*, WT/DS206/R/Corr.1, adopted 29 July 2002
- Panel Report, *United States – Section 129 (c) (1) of the Uruguay Round Agreement Act – Report of the Panel*, WT/DS221/R circulated 15 July 2002
- Panel Report, *Mexico – Anti – Dumping Investigation on High Fructose Corn Syrup (HFCS) from the United States, (Mexico – Corn Syrup)*, WT/DS132/R and Corr. 1, adopted 21 November 2001, as modified by the Appellate Body Report WT/DS132/AB/RW.
- Panel Report, *Argentina-Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy*, WT/DS189/R, adopted 5 November 2001
- Panel Report, *United States – Anti-Dumping Measures on Certain Hot Rolled Steel Products from Japan (US – Hot- Rolled Steel)*, WT/DS184/R, adopted 23 August 2001, as modified by the Appellate Body Report WT/DS184/AB/R.
- Panel Report, *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland (Thailand – H-Beams)*, WT/DS122/R, adopted 5 April 2001, as modified by the Appellate Body Report WT/DS122/AB/R.
- Panel Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India (EC – Bed Linen)*, WT/DS141/R, adopted 12 March 2001, as modified by the Appellate Body Report WT/DS141/AB/R.
- Panel Report, *United – States Anti-Dumping Measures on Stainless Steel Plate in Coils and Stainless Steel Sheet and Strips from Korea (US – Stainless Steel)*, WT/DS179/R, adopted 1 February 2001.
- Panel Report, *Guatemala – Definitive Anti-Dumping Measures on Grey Portland Cement from Mexico (Guatemala – Cement II)*, WT/DS156/R, adopted 17 November 2000.

- Panel Report, *United States – Anti-Dumping Act of 1916 (US – 1916 Act)*, WT/DS136/R and Corr.1, WT/DS136/R and Add.1, adopted 26 September 2000, as upheld by the Appellate Body Report WT/DS136/AB/R, WT/DS162/AB/R.
- Panel Report, *United States - Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMs) of one Megabyte or Above from Korea- (US-DRAMS)*, WT/DS99/R, adopted 19 March 1999
- Panel Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico (Guatemala – Cement I)*, WT/DS60/R, adopted 25 November 1998, as modified by the Appellate Body Report WT/DS60/AB/R.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.7 SUBSIDIES AND COUNTERVAILING MEASURES



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

The WTO Agreement on Subsidies and Countervailing Measures [hereinafter: ASCM] sets out the remedies, which WTO Members have against injurious subsidization and the procedures, which they must follow. It provides detailed rules on the concepts of *subsidization*, *actionable subsidies* and *material injury/serious prejudice*. It contains many procedural provisions that WTO Members, wishing to take countervailing duty action (the *unilateral track*), must comply with. It also provides provisions for attacking certain subsidies in the WTO (the *multilateral track*).

This Module volume gives an overview of the ASCM, as Panels and the Appellate Body have interpreted it over the last six years. It will review both substantive and procedural rules. Since the entry into force of the ASCM in 1995, 13 WTO Panel reports have been issued interpreting ASCM provisions, eight of which were appealed. These Panel and Appellate Body reports offer crucial interpretations of key provisions of the Agreement. Panel and Appellate Body findings form an important element of this volume and will be discussed in tandem with the relevant provisions.

The first Section gives a general overview of the ASCM, including selected systemic issues.

The second, entitled “the Determination of Subsidization”, explains important subsidy concepts, such as the definition and quantification of subsidies, the cost-to-the-government vs. benefit-to-the-recipient approach, actionable subsidies, specificity, and green, orange and red subsidies.

The third Section on the “Determination of Injury/serious prejudice” explains unilateral track requirements such as the material injury requirement, as well as related concepts such as the definitions of the like product and the domestic industry and the causal link between the subsidized imports and the injury suffered by the domestic industry. It also covers the multilateral track requirement of serious prejudice.

The Section entitled “Procedural Rules” highlights the various stages and procedures of the unilateral and multilateral tracks, and the final section analyses the position of developing countries.

After having studied this volume the reader will be able to distinguish between prohibited and admissible subsidies and learn how to assess the possibilities of taking action against a prohibited subsidy. Ultimately the reader will be capable of enumerating the procedural rules, which investigating authorities must comply with to avoid violating the rules established in the ASCM.

1. THE AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

1.1 History

Notably because of policy differences between the United States and the EC, the GATT treatment of subsidies (Articles VI and XVI) has historically been controversial and the disciplines weak. A Subsidies Code was agreed upon in the Tokyo Round, but it skirted around important issues. The Uruguay Round Agreement on Subsidies and Countervailing Measures [ASCM] has generally been hailed as a major improvement over previous regimes, because it provides for the first time a definition of ‘subsidy’, lays down detailed standards for the conduct of countervailing duty investigations and provides a workable multilateral discipline over subsidies.¹

Panel Report, US-FSC

...nowhere in Article XVI of GATT 1947 is there any definition whatsoever of the term “subsidy”. Rather, that term is first defined in the GATT/WTO context only in Article 1 of the SCM Agreement, and the inclusion of this detailed and comprehensive definition of the term “subsidy” is generally considered to represent one of the most important achievements of the Uruguay Round in the area of subsidy disciplines. Under these circumstances, it would in our view be inappropriate to place any weight in interpreting the definition of subsidy found in Article 1 of the SCM Agreement on an understanding regarding Article XVI:4 of GATT 1947 which was adopted more than a decade before that definition was formulated.²

It should be noted that the Agriculture Agreement contains its own disciplines with respect to subsidization of agricultural products, covered by that Agreement. However, Article 13 provides that, under certain circumstances, and provided that ‘due restraint’ is shown before initiation, agricultural subsidies may be countervailed under the ASCM. This Module will not cover cases brought under the Agriculture Agreement.

1.2 Structure of ASCM

The ASCM is divided into 11 parts as follows:

Part I *General*

This part includes the definition of subsidies in Article 1 as well as the concept of specificity in Article 2.

¹ Horlick, Clarke, *The 1994 Subsidies Agreement, World Competition, 1994*, at 41.

² Panel Report, United States – Tax Treatment for “Foreign Sales Corporations” (US- FSC), *WT/DS/108/R*, para. 7.80, footnote omitted.

- Part II** *Prohibited subsidies*
Article 3 provides that export subsidies and import substitution subsidies are prohibited. Article 4 provides the multilateral remedies against such prohibited subsidies.
- Part III** *Actionable subsidies*
Article 5 covers the concept of adverse effects while Article 6 discusses serious prejudice. Article 7 is the mirror provision of Article 4 in discussing the multilateral remedies against actionable subsidies.
- Part IV** *Non-actionable subsidies*
Article 8 provides that subsidies, which are not specific, are non-actionable. It furthermore exempts certain environmental, R&D and regional subsidies, even though they are specific; however, multilateral remedies remain open.
- Part V** *Countervailing Duties*
Articles 10-23 largely mirror procedural and material injury provisions of the Anti-Dumping Agreement. Article 14, however, contains important rules on the calculation of the amount of certain subsidy.
- Part VI** *Institutions*
Establishes the Committee on Subsidies and Countervailing Measures and authorizes the establishment of a Permanent Group of experts.
- Part VII** *Notification and surveillance*
Contains important notification and surveillance procedures
- Part VIII** *Developing countries*
Grants significant special and differential treatment to developing country Members
- Part IX** *Transitional arrangements*
Deals with accessions and transition economies.
- Part X** *Dispute settlement*
Article 30 provides that the DSU provisions apply, except as otherwise specified in the ASCM.
- Part XI** *Final provisions*
Includes the provision that Article 6.1 (serious prejudice definition) and Articles 8 and 9 (non-actionable subsidies) applied for five years only. Because of the failure of the Seattle Ministerial Meeting to renew them these provisions expired on 31 December 1999.

Furthermore, the ASCM contains important annexes covering:

- the illustrative list of export subsidies (Annex I),
- guidelines on consumption of inputs in the production process (Annex II),

- guidelines in the determination of substitution drawback systems as export subsidies (Annex III),
- calculation of the total ad valorem subsidization for purposes of Article 6.1(a) (Annex IV),
- procedures for developing information concerning serious prejudice (Annex V),
- procedures for on-the-spot investigations ex Article 12.6 (Annex VI), and
- coverage of developing and least developed country Members (Annex VII).

1.3 Interested Parties

The parties most directly affected by an anti-subsidy proceeding are the domestic producers, foreign producers and exporters and their importers as well as representative trade associations. Furthermore, the government of the exporting country will be the ‘interested Member’. Indeed, contrary to an anti-dumping proceeding, the exporting country government also will have to complete a questionnaire response, which will subsequently be verified by the importing country Member.

1.4 Users of CVD Action

Until the 1990s, the United States, followed, to a lesser extent, by Australia and Canada, were the main users of countervailing duty actions. However, since that time, the EC and some developing countries have also started to apply countervailing measures. According to WTO statistics, the current main users include the EC and Brazil in addition to the three traditional users.

1.5 WTO Disputes

The table below provides details with respect to the ASCM cases which led to Panel/AB reports from 1995 to 2001.

Panel Report	AB Report	Date of Adoption	Applicant	Respondents	Third Parties
<i>US-Offset Act of 2000 (circulated 16/09/2002)</i>		WT/DS217/R WT/DS234/R	Australia Brazil Chile EC India Indonesia Japan Republic of Korea Thailand	United States USA	Argentina Canada Costa Rica Hong Kong China Israel Mexico Norway
<i>US-Countervailing Measures from EC (appealed)</i>		WT/DS212/R	EC	United States	Brazil India Mexico
<i>US-Section 129 Act</i>		30/08/2002 WT/DS221/R	Canada	United States	Chile EC India Japan
<i>US-Carbon Steel (appealed)</i>		WT/DS213/R	EC	United States	Japan Norway
<i>US-Steel Plate from India</i>		29/07/2002 WT/DS206/R	India	United States	Chile EC Japan
	<i>US-FSC (Article 21.5-EC)</i>	29/01/2002 WT/DS108/AB/RW	EC, United States USA EC	EC, United States	Australia Canada India Japan
<i>Canada – Regional Aircraft</i>		19/02/2002 WT/DS222/R/Corr. 1	Brazil	Canada	Australia EC India United States
<i>US-Export Restraints</i>		23/08/2001 WT/DS194/R	Canada	United States	Australia EC India
	<i>Brazil-Aircraft (Article 21.5-Canada)</i>	04/08/2000 WT/DS46/AB/RW	Canada	Brazil	EC United States
	<i>Canada-Aircraft (Article 21.5-Brazil)</i>	04/08/2000 WT/DS70/AB/RW	Brazil	Canada	EC United States
	<i>Canada-Autos</i>	19/06/2000 WT/DS139/AB/R WT/DS142/AB/R	Canada EC Japan	Canada EC Japan	Republic of Korea USA United States
	<i>US-Lead and Bismuth II</i>	07/06/2000 WT/DS138/AB/R	United States	EC	Brazil Mexico
<i>Canada-Aircraft (Article 21.5-Canada) (appealed)</i>		WT/DS70/RW	Brazil	Canada	EC United States
<i>Brazil-Aircraft (Article 21.5-Canada) (appealed)</i>		WT/DS46/RW	Canada	Brazil	EC United States
	<i>US-FSC</i>	20/03/2000 WT/DS108/AB/R	United States	EC	Canada Japan
<i>Canada-Autos (appealed)</i>		WT/DS139/R WT/DS142/R	United States	Australia	EC Mexico
<i>Australia-Automotive Leather II (Article 21.5-US)</i>		11/02/2000 WT/DS126/RW	United States	Australia	EC Mexico
<i>US-Lead and Bismuth II (appealed)</i>		WT/DS138/R	EC	United States	Brazil Mexico
<i>US-FSC (appealed)</i>		WT/DS108/R	EC	United States	Barbados Canada Mexico
	<i>Brazil-Aircraft</i>	20/08/1999 WT/DS46/AB/R	Brazil Canada	Brazil Canada	EC United States
	<i>Canada-Aircraft</i>	20/08/1999 WT/DS70/AB/R	Brazil Canada	Brazil Canada	EC United States
<i>Australia Automotive Leather II</i>		16/06/1999 WT/DS126/R	United States	Australia	
<i>Brazil Aircraft (appealed)</i>		WT/DS46/R	Canada	Brazil	EC United States
<i>Canada Aircraft (appealed)</i>		WT/DS70/R	Brazil	Canada	EC United States

<i>Indonesia-Autos</i>		23/07/1998 WT/DS54/55/59/64/R	EC Japan United States	Indonesia	India Republic of Korea
	<i>Brazil- Desiccated Coconut</i>	20/03/1997 WT/DS22/AB/R	Brazil Philippines	Brazil Philippines	EC United States
<i>Brazil-Desiccated Coconut</i>		WT/DS22/R	Philippines	Brazil	Canada EC Indonesia Sri Lanka United StatesA

The EC was a complainant in four cases, Canada in three cases, and Japan, the United States and Brazil each in two cases. The Philippines were complainants in one case. The United States was a defendant in eight cases, Canada in three cases, and Australia and Indonesia each in one case. It is noteworthy that developing countries³ were involved as principal parties in five cases and as third parties in eight cases.

Third party representations were made mostly by the EC (seven times), the United States (five times), India (four times) and Canada (three times).

1.5.1 Multilateral Track

In terms of substance, two cases (*Brazil-Desiccated Coconut*⁴; *US-Lead and Bismuth II*⁵) involved the imposition of a countervailing duty, while *US-Export Restraints*⁶ involved potential countervailability of export restraints under United States law. All other cases were multilateral track cases.

1.5.2 Challenging Legislation

Panel Report, US-Export Restraints

In *US-Export Restraints*, Canada challenged a United States statute on the ground that it mandated treatment of export restraints as financial contributions within the meaning of Article 1 ASCM. The United States argued as, a matter of procedure, that the law was discretionary and that this should be examined first as a threshold question. The Panel rejected this argument, found against the United States on the substance, but then agreed with the United States that the law was not mandatory.

In sum, therefore, we find that the statute – including as read in light of the SAA and the Preamble – does not mandate the treatment of export restraints as financial contributions (which treatment we have found, however, would violate the SCM Agreement). Accordingly, we find that Section 771(5)(B)(iii) of the Tariff Act as such does not violate the SCM Agreement, and we reject the claims of Canada under SCM Article 1.⁷

³ For this purpose Barbados, Brazil, India, Indonesia, the Republic of Korea (self-declared), Sri Lanka and the Philippines are included. Mexico is not included.

⁴ Appellate Body Report, Brazil – Measures Affecting Desiccated Coconut (Brazil-Desiccated Coconut) WT/DS22/AB/R

⁵ Appellate Body Report, United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (US- Bismuth II) WT/DS138/AB/R

⁶ Panel Report, United States – Measures Treating Export Restraints as Subsidies (US-Export Restraints), WT/DS194/R

⁷ US – Export Restraints, para. 8. 131.

1.5.3 Specificity of Claims in Request for Establishment

The Appellate Body has held that claims must be sufficiently precisely specified in the request for establishment of a Panel. While in some instances it may be sufficient to mention the articles of the Agreements alleged to have been violated (*EC-Bananas*⁸), in cases where articles contain multiple obligations, more detail will generally be necessary (*Korea-Dairy*⁹). This ruling is very important for the ASCM because many ASCM articles, including key articles such as Articles 1, 3, 5, 6, 12, 15 and 22, contain multiple obligations and may form the basis for numerous claims. It is therefore recommendable that an applicant not only refers to articles and paragraphs in an ASCM dispute, but also summarizes its claims in descriptive form.

1.5.4 'New' Claims

The Appellate Body has confirmed in a dumping case, *Thailand-H-Beams*¹⁰, that a government bringing a dispute settlement case is not necessarily confined to the claims made by its producers in the course of administrative proceeding.

1.5.5 Special Standard of Review

Article 17.6 of the ADA provides a special standard of review for Panels examining anti-dumping disputes, designed to grant importing country Members that have imposed anti-dumping measures a certain leeway. Efforts by the United States to expand this standard to CVD disputes were rejected by the Appellate Body in *US-Lead and Bismuth II*. The AB ruled that the general Article 11 DSU standard applies.¹¹

1.6 Test Your Understanding

1. **The ASCM defines subsidies and sets up a criterion of specificity. Are subsidies, which fall under this definition, considered 'prohibited'?**
2. **In comparison with the other WTO trade defence agreements, what role does the exporting country's government play in the importing country investigation procedures?**
3. **A WTO Member claims in its request for establishment of a Panel that another Member has violated Article 1 ASCM. Is this claim sufficiently precise? What if it claims a violation of Article 1.1?**

⁸ Appellate Body Report, European Communities – Regime for the Importation, Sale and Distribution of Bananas (EC-Bananas III), *WT/DS27/AB/R*

⁹ Appellate Body Report, Korea- Definitive Safeguard Measure on Imports of Certain Dairy Products (Korea-Dairy), *WT/DS98/AB/R*

¹⁰ Appellate Body Report, Thailand-Anti-Dumping Duties on Angels, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland (Thailand –H-Beams), *WT/DS122/AB/R*

¹¹ Appellate Body Report, United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (US- Lead and Bismuth II), *WT/DS138/AB/R*, AB, para. 50.

4. **A WTO Member starts a dispute settlement proceeding against a final countervailing duty imposed by another Member and raises an issue that was not raised by its exporters in the course of the administrative proceeding. Does the Panel have competence to entertain this claim?**

2. THE DETERMINATION OF SUBSIDIZATION

This Section examines the term definition of a subsidy within the context of the ASCM.. The ASCM prohibits certain subsidies against which counteraction can be taken. Further, the ASCM provides that certain subsidies are to be regarded as legitimate depending on their purpose.

2.1 Definition of Subsidy

Article 1 ASCM

Article 1 of the ASCM defines the term ‘subsidy’ very broadly.

Article 1 ASCM

1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a) (1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as ‘government’), i.e. where:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);¹²

(iii) a government provides goods or services other than general infrastructure, or purchases goods;

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;

or

(a) (2) there is any form of income or price support in the sense of Article XVI of GATT 1994;

and

(b) a benefit is thereby conferred.

Thus, in order for a subsidy to exist, there must be a *financial contribution* by a government and a *benefit conferred* thereby.

2.1.1 Conferred Benefit

Panel Report, US – Export Restraints

In short, the negotiating history confirms that the introduction of the two-part definition of subsidy, consisting of “financial contribution” and “benefit”, was intended specifically to prevent the countervailing of benefits from any →

¹² In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

sort of (formal, enforceable) government measures, by restricting to a finite list the kinds of government measures that would, if they conferred benefits, constitute subsidies. The negotiating history confirms that items (i)-(iii) of that list limit these kinds of measures to the transfer of economic resources from a government to a private entity. Under subparagraphs (i)-(iii), the government acting on its own behalf is effecting that transfer by directly providing something of value – either money, goods, or services – to a private entity. Subparagraph (iv) ensures that the same kinds of government transfers of economic resources, when undertaken through explicit delegation of those functions to a private entity, do not thereby escape disciplines.¹³

The Appellate Body has unambiguously stated that the term ‘benefit’ means *benefit to the recipient*, as opposed to the *cost to the government*, thereby definitively putting to rest the old conflict between the United States and the EC.

**Appellate Body
Report, Canada-
Aircraft**

*A “benefit” does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a “benefit” can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term “benefit”, therefore, implies that there must be a recipient... Accordingly, we believe that Canada’s argument that “cost to government” is one way of conceiving of “benefit” is at odds with the ordinary meaning of Article 1.1(b), which focuses on the recipient and not on the government providing the “financial contribution”.*¹⁴

The structure of Article 1.1 as a whole confirms our view that Article 1.1(b) is concerned with the “benefit” to the recipient, and not with the “cost to government”. The definition of “subsidy” in Article 1.1 has two discrete elements: “a financial contribution by a government or any public body” and “a benefit is thereby conferred”. The first element of this definition is concerned with whether the government made a “financial contribution”, as that term is defined in Article 1.1(a). The focus of the first element is on the action of the government in making the “financial contribution”. That being so, it seems to us logical that the second element in Article 1.1 is concerned with the “benefit ...conferred” on the recipient by that governmental action...¹⁵ We also believe that the word “benefit”, as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no “benefit” to the recipient unless the “financial contribution” makes the recipient “better off” than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a “benefit” has been “conferred”, because the trade-distorting potential of a “financial contribution” can be identified by determining whether the recipient has received a “financial contribution” on terms more favourable than those available to the recipient in the market.¹⁶

¹³ Panel Report, US – Export Restraints para. 8.73.

¹⁴ Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft (Canada – Aircraft), WT/DS70/AB/R, para. 154.

¹⁵ Appellate Body Report, Canada – Aircraft para. 156.

¹⁶ Appellate Body Report, Canada – Aircraft para. 157.

While the term subsidy is broadly defined, covering a wide scale of governmental support, not all subsidies are countervailable. Rather, a subsidy must be *specific* in order to be countervailable.

2.1.2 Specificity

There are four types of “specificity” within the meaning of the ASCM:

Enterprise-specificity. A government targets a particular company or companies for subsidization;

Industry-specificity. A government targets a particular sector or sectors for subsidization.

Regional specificity. A government targets producers in specified parts of its territory for subsidization.

Prohibited subsidies. A government targets export goods or goods using domestic inputs for subsidization.¹⁷

2.1.3 De Jure Specificity

Where a subsidy is explicitly limited sectorally or regionally, either by the granting authority, or by legislation, it is *de jure* specific. On the other hand, where the authority, or legislation, establish objective criteria or conditions governing the eligibility for, and amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and the criteria and conditions are strictly adhered to.¹⁸ Footnote 2 of the ASCM clarifies that objective criteria or conditions are criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application. It is relatively easy to establish such *de jure* specificity or non-specificity.

Panel Report Canada-Aircraft

...in our opinion, export credits granted “for the purpose of supporting and developing, directly or indirectly, Canada’s export trade” are expressly contingent in law on export performance. We therefore find that the Canada Account debt financing in issue is “contingent in law...upon export performance” within the meaning of Article 3.1(a) of the SCM Agreement.¹⁹

Appellate Body Report, Canada-Autos

*In our view, 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. The simplest, and hence, perhaps, the uncommon, case is one in which the condition of exportation is set out expressly, in so many words, on the face of the law, regulation or other legal instrument. We believe, however, that a subsidy is also properly held to be *de jure* export contingent where the condition to export is clearly, though implicitly, in the instrument comprising the measure. Thus, for a subsidy to be *de jure* export contingent, the underlying legal instrument does not always have to provide*

¹⁷ WTO: ASCM Overview, http://www.wto.org/english/tratop_e/scm_e/subs_e.htm

¹⁸ ASCM, Art. 2.1 (b)

¹⁹ Panel Report, Canada – Aircraft, WT/DS70/R, para. 9.230.

expressis verbis that the subsidy is available only upon fulfilment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure.²⁰

2.1.4 De Facto Specificity

It is quite possible that a subsidy at face value is non-specific, but in fact is operated in a specific manner. If there are reasons to believe that this is the case, other factors may be considered, including the use of a subsidy programme by a limited number of certain enterprises, predominant use of certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy (notably information on the frequency with which applications for a subsidy are refused or approved and the reasons therefore). In the analysis, account must be taken of the extent of diversification of economic activities within the jurisdiction as well as of the length of time during which the subsidy programme has been in operation. The analysis may lead to a finding of *de facto* specificity.

2.2 Prohibited Subsidies

Article 3 ASCM

Prohibited - red light – subsidies, as defined in Article 3, are by definition specific and therefore countervailable. Article 3 singles out two types of subsidies: export subsidies and import substitution subsidies.

2.2.1 Export Subsidies

Export subsidies are subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including the programmes enumerated in the Illustrative List of export subsidies in Annex I. The *Canada-Autos* Panel has held that, while all practices identified in the Illustrative List are subsidies contingent upon export performance, there may be other practices not identified in the Illustrative List that are also subsidies contingent upon export performance.²¹ The concept of *de jure* export subsidies is relatively straightforward.

Footnote 4 provides that *de facto* export subsidies exist when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings; on the other hand, the fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy.

²⁰ Appellate Body Report, Canada – Certain Measures Affecting the Automotive Industry (Canada-Autos), WT/DS139/AB/R, WT/DS142/AB/R, para. 100.

²¹ Panel Report, Canada – Certain Measures Affecting the Automotive Industry (Canada – Autos), WT/DS139/R, WT/DS142/R, para. 10.196.

**Appellate Body
Report, Canada-
Aircraft**

Article 3.1(a) prohibits any subsidy that is contingent upon export performance, whether that subsidy is contingent “in law or in fact”. The Uruguay Round negotiators have, through the prohibition against export subsidies that are contingent in fact upon export performance, sought to prevent circumvention of the prohibition against subsidies contingent in law upon export performance. In our view, the legal standard expressed by the word “contingent” is the same for both de jure and de facto contingency. There is a difference, however, in what evidence may be employed to prove that a subsidy is export contingent. De jure export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or other legal instrument. Proving de facto export contingency is a much more difficult task. There is no single legal document which will demonstrate, on its face, that a subsidy is “contingent...in fact...upon export performance”. Instead, the existence of this relationship of contingency, between the subsidy and export performance, must be inferred from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case.²²

The Illustrative List in Annex I lists 11 types of export subsidies ranging from direct export subsidies to currency retention schemes, exemptions, remissions or deferrals of direct taxes on exports (*US-FSC*²³), excessive duty drawback, and provision of export credit guarantee or insurance programmes at premium rates or export credits below commercial rates (*Brazil-Aircraft*²⁴; *Canada-Aircraft*). Some developing countries have argued that to the extent that export subsidies are provided by them only to offset certain disadvantages that developing country exporters face, ought not to be countervailable. However, Panels have rejected this line of reasoning.

**Panel Report, Brazil-
Aircraft**

...In items (e), (f), (g), (h) and (i) of the Illustrative List, all of which relate to exemptions, remissions or deferrals of taxes or import charges, there is no hint that a tax advantage would not constitute an export subsidy simply because it reduced the exporter’s tax burden to a level comparable to that of foreign competitors.²⁵

“duty drawback”

Virtually every country in the world has a duty drawback or exemption scheme. The basic concept underlying such schemes is that import duties on imports of raw materials are either not payable or refundable on the condition that such raw materials are used in the manufacture of products, which are consequently exported. Duty drawback schemes assume special importance in cases where import duties are still high, as is often the case for developing countries. In the ASCM, footnote 1 and Annexes I-III are all relevant to determining the legality of duty drawback schemes. Duty drawback systems, particularly those

²² *Appellate Body Report, Canada – Aircraft, para. 167.*

²³ *Appellate Body Report, United States-Tax Treatment for “Foreign Sales Corporations” (US- FSC), WT/DS108/AB/R*

²⁴ *Appellate Body Report, Brazil – Export Financing Programme for Aircraft (Brazil - Aircraft) WT/DS46/AB/R*

²⁵ *Panel Report, Brazil – Export Financing Programme for Aircraft (Brazil – Aircraft), WT/DS46/R, para. 7.25.*

used by developing countries, have proven very problematic in the context of countervailing duty proceedings. First, many developing countries have simplified systems in use for small and medium-size enterprises to facilitate their paperwork. Typically, such systems work with standard input-output ratios to quantify the amount of drawback. However, importing country Members may determine that such systems are not sufficiently precise and violate Annex II. Second, the ASCM requires that imported raw materials be used in the exported finished product. However, in the production of bulk items, in cases where both domestically purchased and imported raw materials are used, producers may not always be able to prove conclusively that particular export shipments incorporated exclusively imported raw materials; again, this may be ground to consider the duty drawback scheme countervailable. Last, duty drawback schemes have been considered illegitimate on the ground that developing country Members did not have in place adequate verification procedures.

2.2.2 Import Substitution Subsidies

This second category of prohibited subsidies is defined as subsidies contingent whether solely or as one of several other conditions, upon the use of domestic over imported goods. Often, these take the form of local content requirements. However, Article 3.1(b) talks about ‘goods’ and as local content requirements often comprise not only goods, but also other costs items; the requirements themselves will need to be scrutinized in detail.

Appellate Body
Report, Canada-Autos

In our view, the Panel’s examination of the CVA requirements for specific manufacturers was insufficient for a reasoned determination of whether contingency “in law” on the use of domestic over imported goods exists. For the MVTO 1998 manufacturers and most SRO manufacturers, the Panel did not make findings as to what the actual CVA requirements are and how they operate for individual manufacturers. Without this vital information, we do not believe the Panel knew enough about the measure to determine whether the CVA requirements were contingent “in law” upon the use of domestic over imported goods. We recall that the Panel did make a finding as to the level of the CVA requirements for one company, CAMI. The Panel stated that the CVA requirements for CAMI are 60 per cent of the cost of sales of vehicles sold in Canada. At this level, it may well be that the CVA requirements operate as a condition for using domestic over imported goods. However, the Panel did not examine how the CVA requirements would actually operate at a level of 60 per cent.²⁶

The Appellate Body, overruling the Panel, has held that this provision also covers both *de jure* and *de facto* variants.

Appellate Body
Report, Canada-Autos

...we believe that a finding that Article 3.1(b) extends only to contingency “in law” upon the use of domestic over imported goods would be contrary to the object and purpose of the SCM Agreement because it would make circumvention of obligations by Members too easy.²⁷

2.3 Non-Actionable Subsidies

First, non-specific subsidies are not actionable. Second, certain narrowly defined R&D, environmental and regional subsidies are non-actionable (these expired on 31 December 1999), on the condition that they are notified in advance to the Subsidies Committee. Non-actionable subsidies are often referred to as green light subsidies.

2.4 Calculation of Benefit to Recipient for CVD Purposes

Article 14 ASCM

Article 14 of ASCM provides guidelines for calculating the benefit to the recipient of four types of subsidies:

- specific government provision of equity on terms inconsistent with the usual investment practices of private investors in the country;
- specific government loans for less than the beneficiary would pay on a comparable commercial loan which the firm could actually obtain on the market;
- specific government loan guarantees for less than the firm would pay on a comparable commercial loan absent the government guarantee;
- specific government provision of goods or services for less than adequate remuneration, or specific government purchase of goods for more than adequate remuneration. The adequacy of remuneration must be determined in relation to prevailing market conditions for the good or service in the country concerned, including price, quality, availability, marketability, transportation and other conditions of purchase or sale.

In all four cases the benchmark is the price in the market. Article 14 further provides that law or regulation must provide national calculation methods.

2.5 Calculation of Benefit to Recipient for Serious Prejudice Purposes

In contrast, Annex IV to the ASCM provides that, any calculation of the amount of subsidy for the purpose of paragraph 1(a) of Article 6 (ad valorem subsidization exceeding five per cent) shall be done in terms of cost to granting governments.

2.6 Test Your Understanding

1. **In determining if a benefit has been conferred, what is the most significant factor that the recipient is ‘better off’ or that the government has born a cost?**

²⁶ Appellate Body Report, Canada- Autos, para. 131.

²⁷ Appellate Body Report, Canada- Autos, para. 142.

2. Describe the difference between *de jure* and *de facto* specificity in the determination of a subsidy.
3. The cost of borrowing for the Government in a WTO Member is 6 per cent . The comparable commercial interest rate is 7.5 per cent The Government provides an interest – free loan to a company. What is the subsidy under the cost-to-the-government approach? What is the subsidy under the benefit-to-the recipient approach?
4. The law of a WTO Member provides for an exemption of import duties on imported machinery. Is this a subsidy? Is it countervailable? What if there a requirement that the company must be located in an export-processing zone? What if there is a requirement that the company must use at least 45 per cent local content? Suppose that the normal import duty is 20 per cent and the CIF value of the machinery imported in 1995 was US\$10,000,000. A countervailing duty investigation is initiated in 2002 with 2001 as the investigation period. Is there still a countervailable subsidy and, if so, how much?
5. As part of its duty drawback legislation, a WTO Member has a procedure under which companies with an annual turnover of less than US\$5,000,000 can claim duty drawback on the basis of standard input/output percentages, established by the Government on the basis of historical experience. Is this a countervailable subsidy?

3. THE DETERMINATION OF MATERIAL INJURY/ ADVERSE EFFECTS/SERIOUS PREJUDICE

The ASCM uses the three terms ‘adverse effects’, ‘serious prejudice’ and ‘material injury’ to indicate certain conditions that must be met for remedies to be applied. The first two terms relate to the multilateral track where actionable subsidies are concerned, while the last term relates to the unilateral – countervailing duty – track.

3.1 Adverse Effects

Article 5 ASCM

Article 5 provides that no Member should cause, through the use of actionable subsidies, adverse effects to the interests of other Members, *i.e.*

- (a) material injury in the sense of the CVD track;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under the GATT 1994;
- (c) serious prejudice, including threat thereof, to the interests of another Member.

3.2 Serious Prejudice

Article 6 ASCM

According to Article 6, serious prejudice *shall be deemed to exist* in the case of:

- (a) the total ad valorem subsidization of a product exceeding five per cent;
- (b) subsidies to cover operating losses sustained by an industry;
- (c) subsidies to cover operating losses sustained by enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems;
- (d) direct forgiveness of debt, *i.e.* forgiveness of government-held debt, and grants to cover debt repayment.

However, where the subsidizing Member can demonstrate that the subsidy did not have any of the *effects* below, serious prejudice shall not be found.

Serious prejudice *may arise* where an actionable subsidy has one or more of the following *effects*:

- (a) it displaces or impedes imports of a like product of another Member into the market of the subsidizing Member;
- (b) it displaces or impedes the exports of a like product of another Member from a third country market;

- (c) it results in a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
- (d) it leads to an increase in the world market share of the subsidizing Member in a particular primary product or commodity as compared to the average share it had during the previous period of three years, and this increase follows a consistent trend over a period when subsidies have been granted.

In *Indonesia-Autos*²⁸, the EC and the United States had argued that as result of Indonesian subsidies to the Timor, their exports to Indonesia had been displaced or impeded. However, the Panel determined that these assertions were not supported by sufficient evidence.

**Panel Report,
Indonesia-Autos**

We do not mean to suggest that in WTO dispute settlement there are any rigid evidentiary rules regarding the admissibility of newspaper reports or the need to demonstrate factual assertions through contemporaneous source information. However, we are concerned that the complainants are asking us to resolve core issues relating to adverse trade effects on the basis of little more than general assertions. This situation is particularly disturbing, given that the affected companies certainly had at their disposal copious evidence in support of the claims of the complainants, such as the actual business plans relating to the new models, government documentation indicating approval for such plans... and corporate minutes or internal decision memoranda relating both to the initial approval, and the subsequent abandonment, of the plans in question. We note the United States' stated concern for the confidentiality of company business plans. However, an invitation by the Panel for proposals to ensure adequate protection of such information was not taken up. While complainants cannot be required to submit confidential business information to WTO dispute settlement panels, neither may they invoke confidentiality as a basis for their failure to submit the positive evidence required, in the present case, to demonstrate serious prejudice under the SCM Agreement.²⁹

3.3 Material Injury, the Key Elements

The determination of material injury consists of a determination that the subsidized imports have caused material injury to the domestic industry producing the like product. These four elements and the possible calculation of injury margins for WTO Members applying the lesser duty rule are explained below.

²⁸ Panel Report, *Indonesia-Certain Measures Affecting the Automobile Industry (Indonesia-Autos)*, WT/DS54/R and Corr. 1,2,3,4, WT/DS55/R and Corr. 1,2,3,4, WT/DS59/R and Corr. 1,2,3,4, WT/DS64/R and Corr. 1,2,3,4

²⁹ Panel Report *Indonesia – Autos*, paras 14.234-14.235.

3.3.1 *The Like Product*

Footnote 46 ASCM

The term like product ('produit similaire') is defined in footnote 46 ASCM as a product which is identical, *i.e.* alike in all respects to the product under consideration, or in the absence of such a product, another product that, although not alike in all respects, has characteristics closely resembling those of the product under consideration. This definition is strict and may be contrasted, for example, with the broader term 'like or directly competitive' in the Safeguards Agreement. As the definition applies throughout the ASCM, it is also relevant, for example, for the serious prejudice analysis of Article 6. In *Indonesia-Autos*, the Panel had to determine which European and American cars were like the Indonesian-produced Timor. The Panel rejected the EC argument that all passenger cars were like products and rather took a more nuanced view, based on data from the automotive industry itself.

Panel Report, Indonesia-Autos

One reasonable way for this panel to approach the "like product" issue is to look at the manner in which the automotive industry itself has analysed market segmentation. The United States and the European Communities have submitted information regarding the market segmentation approach taken by DRI's Global Automotive Group, a company whose clients include all major auto manufacturers, including KIA, PT TPN's national car partner..... DRI has in its analysis considered the physical characteristics of the cars in question when designing its segmentation. It has used as an initial filter the size of the vehicle, but it has then divided cars of a given size into upper and lower end categories, and has moved luxury cars, regardless of size, from lower segments to the E segment. We consider such an approach, which segments the market based on a combination of size and price/market position, to be a sensible one which is consistent with the criteria relevant to "like product" analysis under the SCM Agreement.³⁰

The Panel also concluded that finished Timors and comparable CKD car imports were alike in the circumstances of the case.

3.3.2 *The Domestic Industry*

Article 16.1 ASCM

Article 16.1 ASCM defines the domestic industry as the domestic producers as a whole of the like products or those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products. There are two exceptions to this principle. First, and most importantly, where domestic producers are related to exporters or importers or themselves import the dumped products, they may be excluded from the definition of the domestic industry. Second, under restrictive circumstances, a regional industry comprising only producers in a certain area of a Member's territory may be found to exist. Last, it is noted that the definition of the domestic industry is closely linked to the standing determination that importing country authorities must make prior to initiation. This procedural issue is examined in the next section.

³⁰ *Panel Report, Indonesia – Autos*, paras. 14.177-14.178, footnotes omitted.

3.3.3 Material Injury Assessment

Article 15 ASCM

According to introductory Article 15.1 ASCM, the determination of material injury must be based on positive evidence and involve an objective examination of the volume of the dumped imports, their effect on the domestic prices in the importing country market and their consequent impact on the domestic industry.

However, the Appellate Body went on to emphasize due process rights of interested parties, emanating from Articles 6 and 12 ADA, against which the determination will be scrutinized.

Article 15.2 provides more details on the volume and price analysis, emphasizing the relevance of a significant increase in subsidized imports (either absolute or relative to production or consumption in the importing country Member) and price undercutting, depressing or suppressing³¹ effects of the dumped imports.

3.3.4 Subsidized Imports

All through Article 15, the notion of ‘subsidized imports’ is used. However, it happens often in CVD cases that some producers are found to have been subsidized while others did not benefit from subsidies. A conceptual issue then is whether such non-subsidized imports may be treated as subsidized in the injury analysis. By analogy to the *EC-Bed Linen*³² case, an anti-dumping case, this would appear not to be the case. In an important *obiter dictum* in that case, the Panel opined that imports from producers found not to have dumped, should not be included in the injury analysis.³³

“cumulation”

Article 15.3 legalizes the concept of cumulation. This principle means that where imports from several countries are simultaneously subject to anti-subsidy investigations, their effects may be assessed cumulatively for injury purposes as long as they do not qualify for the *de minimis* or *negligibility* thresholds and a cumulative assessment is appropriate in light of the conditions of competition among the imports and between imports and the like domestic product. Many WTO Members apply cumulation almost as a matter of course as long as the thresholds are not met.

3.4 The Injury Factors

Article 15.4 requires that the examination of the impact of the dumped imports on the domestic industry shall include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry and then mentions 15 specific factors. Article 15.4 concludes that this list is not

³¹ Prevention of price increases that would have otherwise occurred.

³² Panel Report, European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India (EC - Bed Linen), *WT/DS141/R*

³³ (EC - Bed Linen), *para. 6.138*.

exhaustive and that no single or several of these factors can necessarily give decisive guidance.

The 15 injury Factors, Article 15.4, ASCM

...actual and potential decline in output, sales, market share, profits, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments and, in the case of agriculture, whether there has been an increased burden on government support programmes

By analogy to Panel and Appellate Body reports interpreting similar provisions in the ADA and the Safeguards Agreement, it seems beyond doubt that the evaluation of the 15 factors is mandatory in each case and must be clear from the published documents.

3.5 Causation/Other Known Factors

Footnote 47 ASCM

The evaluation of import volumes and prices and their impact on the domestic industry is relevant not only for the determination whether the domestic industry has in fact suffered material injury, but often will also be indicative of whether the injury has been caused by the dumped imports or by other factors. Footnote 47 ASCM refers back to Articles 15.2 and 15.4 ASCM that the demonstration of the causal link must be based on an examination of all relevant evidence before the authorities. The authorities must also examine any known factors other than the subsidized imports which are injuring the domestic industry at the same time and the injury caused by these other factors must not be attributed to the dumped imports. Article 3.5 then provides a non-exhaustive list of other factors which may be relevant depending on the facts of the case.

Other Factors, Article 3.5 ASCM

The volumes and prices of non-subsidized imports of the like product, contraction in demand or changes in the patterns of consumption, trade-restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry

A WTO ADA Panel has held that, contrary to the Article 3.4 factors, the Article 3.5 factors need not be examined as a matter of course in each administrative determination. Rather, such examination will depend on the arguments made by interested parties in the course of the administrative investigation.³⁴

3.6 Threat of Injury

It may occur that a domestic industry alleges that it is not yet suffering material

³⁴ Panel Report, Thailand - Anti-Dumping Duties on Angels Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland (Thailand -H-Beams), WT/DS122/R, para. 7.273.

injury, but is threatened with material injury, which will develop into material injury unless anti-subsidy measures are taken. However, Article 15.7 offers special provisions for a threat case, because such statements are easy to make and any investigation based on threat of material injury will necessarily be speculative because it involves analysis of events that have not yet happened. Thus, a determination of threat must be based on facts and not merely on allegation, conjecture or remote possibility. The change in circumstances that would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent. In making a threat determination, the importing country authorities *should* consider, *inter alia*,

- nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom;
- a significant rate of increase of subsidized imports into the domestic market indicating the likelihood of substantially increased importation;
- sufficient freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidized exports to the importing Member's market, taking into account the availability of other export markets to absorb any additional exports;
- whether imports are entering at prices that will have a significant depressing or suppressing effect on domestic prices, and would likely increase demand for further imports; and
- inventories of the product being investigated.

No single factor will necessarily be decisive, but the totality of the factors considered must lead to the conclusion that further subsidized exports are imminent and that, unless protective action is taken, material injury would occur. The identical sentence in the ADA was an important reason for the *Mexico-Corn Syrup*³⁵ Panel to conclude that a threat analysis must also include evaluation of the injury factors.

3.7 Injury Margins

The determination whether dumping has caused material injury to the domestic industry producing the like product is generally made with respect to the country or countries under investigation. By nature, this is either an affirmative or a negative determination. If the determination is affirmative, WTO Members, which apply a lesser duty rule in accordance with Articles 8.1 and 9.1, will then calculate injury margins. The ADA does not give any guidance on such calculation and arguably leaves its Members substantial discretion. Suffice to say that injury margins are normally producer-specific and that they will compare the prices of imported and domestically-produced like products, focusing on whether the former are undercutting or underselling the latter.

³⁵ *Panel Report*, Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States (Mexico – Corn Syrup), *WT/DS132/R and Corr.1*

3.8 Test Your Understanding

- 1. What can the allegedly subsidizing Member State do when accused of causing serious prejudice to the interest of another Member State under the multilateral track?**
- 2. List the key elements, which have to be assessed in the determination of “material injury”, under the CVD unilateral track.**
- 3. In the assessment of injury, which factors are the authorities obliged to examine? In regards to the assessment of a causal link, are there more factors?**
- 4. When determining a “threat” of injury, how shall the possibility of injury be characterized for the “threat” to justify countervailing measures?**

4. PROCEDURAL RULES/REMEDIES

The ASCM establishes two tracks to deal with subsidies: the unilateral CVD track and the multilateral remedy track. The purpose of the CVD track is to re-establish the level playing field for domestic producers, which face competition from subsidized imports. Thus, the imposition of a countervailing duty supposedly will offset the unfair advantage that the foreign exporters gained as a result of the subsidization. As the relevant procedure is a domestic one, the ASCM contains various procedural obligations that authorities wishing to investigate injurious subsidization must comply with.

However, a Member injured by another Member's subsidization may prefer the abolition of the subsidy programme itself. It is also possible that the Member in a third market feels the effects of the subsidy. In such cases, the ASCM provides for multilateral, accelerated track, dispute settlement procedures.

4.1 CVD Track

The following Articles of the ASCM contain important procedural provisions as far as CVD action is concerned:

- Article 11* Initiation and subsequent investigation, including the standing determination
- Article 12* Evidence, including due process rights of interested parties
- Article 13* Pre-initiation consultations
- Article 17* Provisional measures
- Article 18* Undertakings
- Article 19* Imposition and collection of countervailing duties
- Article 20* Retroactivity
- Article 21* Duration and review of countervailing duties and undertakings
- Article 22* Public notice and explanation of determinations, pertaining to initiation, imposition of preliminary and final measures
- Article 23* Judicial review

It falls outside the scope of this volume to discuss these procedural provisions in detail. However, the general tendency of Panels has been to interpret these provisions strictly and little deference is given to national implementation shortcuts that do not do justice to their plain meaning.

4.1.1 Initiation Procedures

Article 11 ASCM

A countervailing duty case normally starts with the official submission of a written complaint by the domestic industry to the importing country authorities

that injurious subsidization is taking place. This complaint is called the application in the ASCM. Article 11.2 contains requirements for the contents of this application.

Article 11.3 imposes the obligation on the importing country authorities to *review*, before initiation, the accuracy and the adequacy of the evidence in the application. However, as Article 11.3 does not provide any details on the nature of this review, it is difficult for Panels to judge whether importing country authorities have complied with Article 11.3.

Under Article 11.4 ASCM, importing country authorities must determine, *again before initiation*, on the basis of an examination of the degree of support for, or opposition to, the application expressed by domestic producers of the like product, that the application has been made by or on behalf of the domestic industry. As GATT Panels held several times that the failure to properly determine standing before initiation is a *fatal error*, which cannot be repaired retroactively in the course of the proceeding, this is a potentially outcome-decisive claim.

Article 13 ASCM

Article 13 ASCM requires an importing Member to engage in consultations with the exporting Member, prior to initiation, with the aim of clarifying the situation and arriving at a mutually agreed solution. Practice in jurisdictions such as the United States and the EC has shown that such consultations may be an important tool to limit the harassment aspect of a CVD investigation. Domestic industries tend to allege laundry lists of subsidy programmes in their applications and pre-initiation consultations may weed out programmes that are at face value non-countervailable (for example, because they are not specific or because they are not used by the exporters concerned).

“de minimis”

Article 11.9 contains the important *de minimis* rule that the investigation shall be promptly terminated if the subsidization margin is less than 1 per cent *ad valorem*. Similarly, prompt termination is required where the volume of subsidized imports, actual or potential, from a particular country is *negligible*. However, higher thresholds are provided for developing countries.

Article 11.11 provides that investigations shall normally be concluded within one year and in no case more than 18 months, after their initiation. The 18 months’ deadline appears to be absolute.

4.1.2 Due Process Rights

Article 12 and 22 ASCM

Articles 12 and 22 ASCM contain important due process rights of interested parties.

Article 22 obliges importing country authorities to publish public notices of initiation, and of preliminary and final determinations, with increasing degrees of specificity, as the investigation progresses. In addition, they must publish detailed explanations of their determinations. Conceptually, Article 12 violations will often be linked to substantive violations. Panel practice, however, is not entirely clear whether in such cases one or two violations exist.

Countervailing duty investigations, particularly at the company level, involve confidential and sensitive information because they require companies to submit to the importing country authorities company-specific information on customers, pricing and - sometimes - costing information in detail. In order to mount an optimal legal defence, interested parties ideally need access to the confidential information submitted by the opposing side (foreign producers and their importers versus domestic producers and vice versa). On the other hand, they will be extremely reluctant to provide their own confidential information to their competitors. Thus, to ensure fair play and equality of arms, a balance must be struck between these competing interests and a legal system must give opposing parties equal levels of access to information. Article 12.4 ASCM chooses the principle³⁶ that information which is by nature confidential or which is provided on a confidential basis shall, upon good cause shown, be treated as confidential by the authorities and shall not be disclosed without specific information of the party submitting it. However, the authorities shall require interested parties providing confidential information to provide meaningful non-confidential summaries thereof.

Other important due process rights in Article 12 include ample opportunity to present evidence in writing (Article 12.1), right of access to the file (Article 12.1.2 *jo.* 12.3), the right to a hearing (Article 12.2) and the right to be timely informed of the essential facts under consideration which form the basis for the decision whether to apply definitive measures (disclosure; Article 12.8).

Article 12.7 provides that in cases where an interested Member or party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available.

4.1.3 *Provisional Measures*

Provisional measures should preferably take the form of a security (cash deposit or bond) and may not be applied sooner than 60 days from the date of initiation and may not last longer than four months.

Article 18 ASCM

With regard to price undertakings, Article 18.1 envisages two types of undertakings: (a) an undertaking by the exporting country government to eliminate or limit the subsidy or to take other measures concerning its effects or (b) an undertaking by an exporter to revise its prices to eliminate the injurious effect of the subsidy or the amount of the subsidy itself, whichever is lower. Under the Agreement, imposition of anti-subsidy measures is discretionary and it is preferable that the measures are set at levels less than the subsidy margin, if such levels are adequate to remove the injury to the domestic industry.

³⁶ However, in an important footnote 17, Members recognize that in the territory of certain Members disclosure pursuant to a narrowly drawn protective order may be required. This is the case, *inter alia*, in the United States and Canada.

4.1.4 Countervailing Duties

Imposition of countervailing duties where injurious subsidization has been found is discretionary and use of a lesser duty rule is encouraged. Many WTO Members include a public interest clause in their national legislation to enable them to refrain from imposing duties, even where injurious subsidization is found.

If a countervailing duty is imposed, it must be levied on a non-discriminatory basis.

4.1.5 Retroactivity

Article 20 ASCM

Article 20 of ASCM provides for two types of retroactivity. First, where a final determination of injury (but not of a threat thereof or of a material retardation of the establishment of an industry) is made or, in the case of a final determination of a threat of injury, where the effect of the subsidized imports would, in the absence of the provisional measures, have led to a determination of injury, countervailing duties may be levied retroactively for the period for which provisional measures, if any, have been applied.

Second, definitive countervailing duties may be assessed on imports which were entered for consumption not more than 90 days prior to the date of application of provisional measures in critical circumstances where for the subsidized product the authorities find that injury which is difficult to repair is caused by massive imports in a relatively short time of a product benefiting from subsidies paid or bestowed inconsistently with the provisions of GATT 1994 and of the ASCM, and where it is deemed necessary, in order to preclude the recurrence of such injury, to assess countervailing duties retroactively on those imports.

4.1.6 Reviews

The ASCM recognizes three types of reviews of anti-dumping measures.

Article 19.3 ASCM

First, Article 19.3 requires importing country authorities to promptly – and in accelerated manner - carry out reviews requested by newcomers, *i.e.* exporters which are subject to a definitive countervailing duty, but which were not actually investigated (other than for refusal to cooperate).

Article 21 ASCM

Second, Article 21 provides for what can be called interim and expiry reviews. To start with the latter, definitive countervailing duties shall normally expire after five years from their imposition, unless the domestic industry asks for a review within a reasonable period of time preceding the expiry, arguing that the expiry of the duty would be likely to lead to continuation or recurrence of subsidization and injury. During the five year period (hence the term interim review), interested parties may request the authorities to examine whether the continued imposition of the duty is necessary to offset subsidization, whether

the injury would be likely to continue or recur if the duty were removed or varied, or both. In both cases, the measures stay in force pending the outcome of the review. In *US-Lead and Bismuth II*, the Appellate Body had the opportunity to expand on the nature of interim review investigations.

**Appellate Body
Report, US-Lead and
Bismuth II**

...we agree with the Panel that while an investigating authority may presume, in the context of an administrative review under Article 21.2, that a “benefit” continues to flow from an untied, non-recurring “financial contribution”, this presumption can never be “irrebuttable”. In this case, given the changes in ownership leading to the creation of UES and BSplc/BSES, the USDOC was required under Article 21.2 to examine, on the basis of the information before it relating to these changes, whether a “benefit” accrued to UES and BSplc/BSES...³⁷

...We do not agree with the Panel’s implied view that, in the context of an administrative review under Article 21.2, an investigating authority must always establish the existence of a “benefit” during the period of review in the same way as an investigating authority must establish a “benefit” in an original investigation. We believe that it is important to distinguish between the original investigation leading to the imposition of countervailing duties and the administrative review. In an original investigation, the investigating authority must establish that all conditions set out in the SCM Agreement for the imposition of countervailing duties are fulfilled. In an administrative review, however, the investigating authority must address those issues which have been raised before it by the interested parties or, in the case of an investigation conducted on its own initiative, those issues which warranted the examination.³⁸

Article 23 provides that Members, which do adopt countervailing duty legislation, must also maintain independent judicial, arbitral or administrative tribunals or procedures for the purpose of prompt review of administrative final and review determinations.

4.2 Multilateral Track

Article 4 and 7 ASCM

Article 4 provides the remedies in case of prohibited subsidies while Article 7 provides the remedies in case of actionable subsidies. In both cases, the procedures have ‘teeth’, with short deadlines and workable remedies. As may be obvious, the procedure for dealing with prohibited subsidies is the strongest.

³⁷ Appellate Body Report, US- Lead and Bismuth II, para. 62.

³⁸ Appellate Body Report, US- Lead and Bismuth II, para. 63.

	<i>Prohibited subsidies</i>	<i>Actionable subsidies</i>
1	<i>Request for consultations, including statement of available evidence existence and nature of subsidy</i>	<i>Request for consultations, including statement of available evidence (a) existence and nature of subsidy (b) injury caused to domestic industry, nullification or impairment, or serious prejudice</i>
2	<i>Consultations as quickly as possible</i>	<i>Consultations as quickly as possible</i>
3	<i>If no solution within 30 days → referral to DSB for immediate establishment of Panel</i>	<i>If no solution within 60 days → referral to DSB for establishment Panel; composition of Panel and terms of reference within 15 days</i>
4	<i>Panel may request assistance PGE for binding advice on whether prohibited subsidy (this has not happened thus far)</i>	
5	<i>Circulation Panel report within 90 days of date of composition Panel/establishment terms of reference</i>	<i>Circulation Panel report within 120 days of date of composition Panel/establishment terms of reference</i>
6	<i>If prohibited subsidy, Panel recommends that Member withdraw subsidy without delay and specify the time period for withdrawal. Thus far, Panels have generally given 90 days.³⁹</i>	
7	<i>Within 30 days of circulation, report shall be adopted by DSB, unless appeal</i>	<i>Within 30 days of circulation, report shall be adopted by DSB, unless appeal</i>
8	<i>AB must normally issue decision within 30 days from notice of intention to appeal; in no event more than 60 days</i>	<i>AB must normally issue decision within 60 days from notice of intention to appeal; in no event more than 90 days</i>
9		<i>After adoption Panel/AB report finding adverse effects, subsidizing Member must take appropriate steps to remove the adverse effects or withdraw the subsidy</i>
10	<i>If DSB recommendation is not followed within time-period specified by panel (which commences from data adoption Panel/AB report), DSB grants authorization to complaining Member to take appropriate – proportionate – countermeasures.</i>	<i>If Member does not do so within six months from date of DSB adoption Panel/AB report, DSB grants authorization to complaining Member to take appropriate countermeasures, commensurate with degree and nature of adverse effects</i>
11	<i>Applicable DSU time-periods shall be half</i>	

4.2.1 Failure to Cooperate

Information concerning subsidization is in the hands of the Member providing the subsidies and often will not be publicly available. In the case of actionable subsidies, Annex V contains detailed provisions for unearthing all relevant evidence, including an admonition to the Panel to “draw adverse inferences

³⁹ *With the exception of the US-FSC Panel.*

from instances of non-cooperation”. While similar procedures are lacking in the context of prohibited subsidies, the AB has filled this lacuna.

**Appellate Body
Report, Canada-
Aircraft**

There is no logical reason why the Members of the WTO would, in conceiving and concluding the SCM Agreement, have granted panels the authority to draw inferences in cases involving actionable subsidies that may be illegal if they have certain trade effects, but not in cases that involve prohibited export subsidies for which the adverse effects are presumed. To the contrary, the appropriate inference is that the authority to draw adverse inferences from a Member’s refusal to provide information belongs a fortiori also to panels examining claims of prohibited exports subsidies. Indeed, that authority seems to us an ordinary aspect of the task of all panels to determine the relevant facts of any dispute involving any covered agreement: a view supported by the general practice and usage of international tribunals.⁴⁰

4.2.2 Retroactivity

Article 4.7 provides that prohibited subsidies must be withdrawn without delay. The *Australia-Automotive Leather (Article 21.5-US)* Panel, in an Article 21.5 proceeding, determined that the term ‘withdraw’ encompasses repayment of the prohibited subsidy, thereby effectively adopting a retroactive remedy.

**Panel Report,
Australia-Automotive
Leather II (Article 21.5
– US)**

We believe it is incumbent upon us to interpret “withdraw the subsidy” so as to give it effective meaning. A finding that the term “withdraw the subsidy” may not encompass repayment would give rise to serious questions regarding the efficacy of the remedy in prohibited subsidy cases involving one-time subsidies paid in the past whose retention is not contingent upon future export performance...⁴¹

This decision was heavily criticized in the DSB and elsewhere. It went beyond what any of the parties to the dispute had argued, opened the door for retroactive remedies in violation of general WTO practice and might have far-reaching repercussions for future cases, if followed by other Panels. The Panel made much of the distinction between recurring and non-recurring (one-time) subsidies, but the United States position, advocating repayment only of the prospective portion, would have taken care of this. Furthermore, the Panel’s ruling arguably would create enormous liabilities for Members which granted prohibited recurring subsidies, for example, illegal duty drawback schemes. Interestingly, the United States and Australia in the aftermath of the report ignored the Panel decision and bilaterally settled the case by agreeing on repayment of the prospective portion only. Two subsequent Panels also declined to follow the road taken by the *Australia-Automotive Leather II* Panel.

⁴⁰ Appellate Body Report, Canada – Aircraft, para. 202.

⁴¹ Panel Report, Australia – Subsidies provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States (Australia – Automotive Leather II (Article 21.5 – US)), WT/DS126/RW and Corr. 1, para. 6.35.

**Panel Report, Canada-
Aircraft, (21.5 – Brazil)**

...Brazil has explicitly expressed the “hope” that the Panel does not consider itself bound to follow Australia - Leather Article 21.5. Indeed, Brazil “believes that the Panel in Australia - Leather [Article 21.5] reached a result that is not required by the language of the [SCM] Agreement”, and “does not believe that this or any other Panel should follow Australia - Leather [Article 21.5]”.

In light of these comments by Brazil, we consider that Brazil does not in fact want us to make any finding along the lines of Australia - Leather Article 21.5. The same is more obviously true of Canada. As noted above, we consider that a panel’s findings under Article 21.5 of the DSU should be restricted to the scope of the “disagreement” between the parties. In the present case, therefore, we do not consider it necessary to make any finding as to whether Article 4.7 of the SCM Agreement may encompass repayment of subsidies found to be prohibited.⁴²

**Panel Report, Brazil-
Aircraft (Article 21.5 –
Canada)**

...In this dispute, Canada has not claimed that the non-repayment, in whole or in part, of subsidies granted by Brazil represents a failure to “withdraw” the prohibited export subsidies in question. We recall that, under Article 3.7 of the DSU, the aim of the dispute settlement mechanism is to secure a positive resolution to a dispute, and that our role under Article 21.5 is to render a decision “where there is disagreement” as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations or rulings of the DSB. Accordingly, we shall address only claims that are put before us. Our silence on issues that are not before us should not be taken as expressing any view, express or implied, as to whether or not a recommendation to “withdraw” a prohibited subsidy may encompass repayment of that subsidy.⁴³

4.3 Test Your Knowledge

- 1. Before initiating an investigation, what procedural steps shall the importing countries authorities take? Could disregarding any of these steps lead to a substantial error?**
- 2. Which two types of price undertakings are foreseen in Article 18.1 ASCM?**
- 3. Under which condition can a final determination of threat of injury lead to retroactive application of the anti-subsidy measure?**
- 4. In the multilateral track, what different consequences are there between prohibited and actionable subsidies when a Member State does not comply with the recommendations adopted by the DSB?**
- 5. Explain the position taken by recent Panels with regard to repayment of prohibited subsidies as established by the Panel in *Australia – Automotive Leather II*.**

⁴² *Panel Report, Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU (Canada – Aircraft (Article 21.5 – Brazil)), WT/DS70/RW, paras. 5.47-5.48.*

⁴³ *Panel Report, Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU (Brazil – Aircraft (Article 21.5 - Canada)), WT/DS46/RW, footnote 17.*

5. DEVELOPING COUNTRY MEMBERS/ECONOMIES IN TRANSITION

Article 27 ASCM

Article 27 ASCM provides special and differential treatment to developing countries in a number of ways. To properly understand the operation of this Article, it must be borne in mind that the ASCM distinguishes between two types of developing countries: Annex VII developing countries and other developing countries.

Developing Countries, Annex VII, ASCM

(a) Least developed countries designated as such by the United Nations which are Members of the WTO. Each of the following developing countries which are Members of the WTO shall be subject to the provisions which are applicable to other developing country Members according to paragraph 2(b) of Article 27 when GNP per capita has reached \$1 000 per annum:⁴⁴ Bolivia, Cameroon, Congo, Côte d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe.

5.1 Export Subsidies' Prohibition

Article 3.1 (a) ASCM

The Article 3.1(a) prohibition on export subsidies does not apply to Annex VII countries. Other developing countries have until 31 December 2002. However, these other developing countries must phase out their export subsidies within the eight-year period, preferably progressively. No developing country Member may increase the level of its export subsidies and it should eliminate them within a shorter period when the use of such export subsidies is inconsistent with its development needs.

Panel Report, Brazil-Aircraft

...The exemption for developing country Members other than those referred to in Annex VII from the application of the Article 3.1(a) prohibition on export subsidies is clearly conditional on compliance with the provisions in paragraph 4 of Article 27. Thus, we consider that, where the provisions in Article 27.4 have not been complied with, the Article 3.1(a) prohibition applies to such developing country Members.⁴⁵

Panel Report, Brazil-Aircraft

...we consider that, in order to assert and prove a claim of violation of Article 3.1(a) with respect to a Member that is a developing country Member within the meaning of Article 27.2(b), the Member asserting the claim must demonstrate that the substantive obligations contained in Article 3.1(a) of the SCM Agreement apply to the Member in question. In order to do this, the Member asserting the claim must demonstrate that the developing country Member concerned has not complied with the conditions stipulated in Article 27.4.⁴⁶

⁴⁴ Footnote 68 in ASCM: The inclusion of developing country Members in the list in paragraph (b) is based on the most recent data from the World Bank on GNP per capita.

⁴⁵ Panel Report, Brazil – Export Financing Programme for Aircraft (Brazil – Aircraft), WT/DS46/R, para. 7.40.

⁴⁶ Panel Report, Brazil – Aircraft, para. 7.56.

If a developing country wishes to apply export subsidies beyond the eight-year period, it must enter into consultations with the Subsidies Committee not later than 31 December 2001. The Committee must determine whether an extension is justified on the basis of an examination of all the relevant economic, financial and development needs of the country in question. If the Committee agrees that an extension is justified, annual consultations must be held. If no determination is made, the developing country must phase out the remaining export subsidies within two years. The ASCM also introduces the notion of export competitiveness, defined as at least 3.25% in world trade of a given product (a section heading in the Harmonized System), for two consecutive years: where a developing country has reached such export competitiveness, it must phase out its export subsidies for that product within two years. However, Annex VII countries will then have eight years. Export competitiveness may be self-declared or determined on the basis of a computation by the WTO Secretariat at the request of a Member.

5.2 Import Substitution Subsidies

Article 3.1 (a) ASCM

The Article 3.1(b), prohibition on import substitution subsidies, did not apply to developing countries until 31 December 1999, and to least-developed countries until 31 December 2002.

5.3 No Presumption of Serious Prejudice

Article 6.1 ASCM

The Article 6.1, presumption of serious prejudice, does not apply to developing countries. Any finding of serious prejudice instead must be based on positive evidence. Regarding other actionable subsidies by developing countries, multilateral remedies may be authorized only where the subsidies result in nullification or impairment, in such a way as to displace or impede imports of a like product of another Member into the market of the developing country or unless injury to the domestic industry in the importing country market occurs.

5.4 Part III Actionable Subsidies

The Part III provisions do not apply to direct forgiveness of debt, subsidies to cover social costs, in whatever form, including relinquishment of government revenue and other transfer of liabilities when such subsidies are granted within and directly linked to a privatisation programme of a developing country, provided that both the programme and the subsidies involved are granted for a limited period, are notified to the Subsidies Committee and that the programme actually results in eventual privatisation of the company concerned.

5.5 De minimis/Negligibility

"de minimis"

For developing countries, the *de minimis* subsidy level is two per cent, while negligibility is defined as four per cent of total imports of the like product,

unless imports from developing countries together account for more than 9 per cent. For Annex VII countries the *de minimis* level is three per cent. It is emphasized that, as far as CVD action is concerned, this is the only special and differential treatment foreseen under the ASCM. The other exceptions discussed above only apply to the multilateral track. In other words, it is, for example, perfectly possible for Members to impose countervailing duties against export or import substitution subsidies.

5.6 Transition Economies

Article 6.1(d) ASCM

Transition economies have until 31 December 2001 to phase out export and import substitution subsidies. Until that same date, direct forgiveness of debt and grants to cover debt repayment within the meaning of Article 6.1(d) shall not be actionable and regarding other actionable subsidies, multilateral remedies may be authorized only where the subsidies result in nullification or impairment, in such a way as to displace or impede imports of a like product of another Member into the market of the developing country or unless injury to the domestic industry in the importing country market occurs.

5.7 Test Your Understanding

- 1. What are the different time limits for phasing out export subsidies when an Annex VII country has obtained “export competitiveness” in comparison to a developing country which is not included in Annex VII?**
- 2. Under what conditions can forgiveness of debts and subsidies to cover social costs be excluded from the application of Part III provisions?**
- 3. Under the unilateral track what is the only special treatment with regard to developing countries?**
- 4. Does this treatment apply to all developing countries under the ASCM regime?**

6. CASE STUDY

Country A is a Member of the WTO. In the year 2000, in order to boost the slumping domestic industry of cellulose, the government of country A issues certain measures. **These consist of:**

- A programme involving stocking of domestically produced ‘lumber’, setting a maximum price and guaranteeing supply of raw material;
- A scheme granting credit to exporters of finished paper to be offset against the payment of customs duties on subsequent imports;
- The reimbursement mechanism for production taxes is made more efficient for exporters. For cellulose exporters, the mechanism prescribes that when a company exports more than 60 per cent of its production, the tax payable on the cellulose sold on the domestic market is made payable at the end of the year instead of on a monthly basis;
- To 150 companies producing mainly cellulose, certain financial contributions, amounting to 0,9 per cent *ad valorem*, are made. The expressed purpose of these contributions is research and development, although it appears that some of the companies have used the financing for increased production.

Country B, an industrialized neighboring WTO Member, has a small domestically orientated cellulose industry with insignificant exports, producing 60 per cent of the country’s consumption of cellulose. Following the introduction of country A’s measures, domestic producers in country B experience a loss of market-share and a decrease in price of both cellulose and finished paper. Simultaneously, the world market share of country A and country A’s imports of cellulose in country B increase rapidly.

The producers in country B file a complaint before the competent authorities, and tension builds between the two countries.

- 1) You work for the government of country B and receive the complaint. You are made responsible for making a first evaluation of the situation. What is your position with regard to the following?
 - (a) The character of the four measures issued by country A. Do these measures fall under the definition of ‘subsidies’ provided by the ASCM?
 - (b) What are the possibilities to take action concerning the different measures, and can action be taken to stop the losses sustained by the finished paper industry in country B?
 - (c) If country A is a developing Country but does not figure in Annex VII of the ACSM, would your answer in (a) and (b) be different?

- 2) Suppose country C has an export oriented cellulose industry, originally mainly focused on neighbouring country A's market. Following the adoption of the measures in country A, country C's exports to country A registered a remarkable decrease. Can country D, neighbouring country of A and C, initiate countervailing duty action against country A alleging displacement of country C's exports of cellulose from country A to its own market?

7. FURTHER READING

- **Horlick, G and Clarke, P**, The 1994 WTO Subsidies Agreement, 17 World Competition, 1994, 41.
- **Jackson, J**, The World Trading System,
- **Quick**, Calculation of Subsidy, in Subsidies and International Trade, A European Lawyer's Perspective (ed. Bourgeois), 1991, 83 -
- **UNCTAD**, The Impact of Anti-Dumping and Countervailing Duty Actions on the Trade of Member States, In Particular Developing Countries. Main Issues and Areas of Concern that Need to Be Addressed in the Light of Concrete Experiences Presented by National Experts, Outcome of the Expert Meeting, TD/B/COM.1/EM.14/L.1, 12 December 2000.
- **UNCTAD**, Positive Agenda and Future trade Negotiations, Anti Dumping and Countervailing Duties, 2000, 287 – 308.
- **Vermulst, E and Graafsma, F**, WTO Dispute Settlement with respect to Commercial Defence Measures, Cameron May.
- **Vermulst**, EC Countervailing Duty Law and Practice Revisited: Leges bonae ex malis moribus proceantur, 27:3 Legal Issues of Economic Integration, 217 - 238 (2000)
- **Trebilcock, M., and Howse, R.**, The Regulation of International Trade, 2nd ed., Routledge

7.1 List of Relevant Panel and Appellate Body Reports

7.1.1 Appellate Body Reports

- Appellate Body Report, *United States – Tax Treatment for “Foreign Sales Corporations”- Recourse to Article 21.5 of the DSU by the European Communities (US- FSC (Article 21.5 - EC))* WT/DS/108/AB/RW, adopted 29 January 2002.
- Appellate Body Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU (Brazil – Aircraft (Article 21.5 - Canada))*, WT/DS46/AB/RW, adopted 4 August 2000.
- Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU (Canada – Aircraft (Article 21.5 – Brazil))*, WT/DS70/AB/RW, adopted 4 August 2000.
- Appellate Body Report, *Canada – Measures Affecting the Automotive Industry (Canada – Autos)*, WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000.

- Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (US- Lead and Bismuth II)*, WT/DS138/AB/R, adopted 7 June 2000.
- Appellate Body Report, *United States – Tax Treatment for “Foreign Sales Corporations” (US- FSC)* WT/DS/108/AB/R, adopted 20 March 2000.
- Appellate Body Report, *Brazil – Export Financing Programme for (Brazil – Aircraft)*, WT/DS46/AB/R, adopted 20 August 1999.
- Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft (Canada – Aircraft)*, WT/DS70/AB/R, adopted 20 August 1999
- Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut (Brazil – Desiccated Coconut)*, WT/DS22/AB/R, adopted 20 march 1997, DSR 1997:I, 167.

7.1.2 Panel Reports

- Panel Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/R and WT/DS234/R, circulated 16 September 2002
- Panel Report, *United States - Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/R, appealed 9 September 2002
- Panel Report, *United States – Section 129 (c) (1) of the Uruguay Round Agreement Act*, WT/DS221/R, adopted 30 August 2002
- Panel Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/D213/R, appealed 30 August 2002
- Panel Report, *United States – Anti-Dumping and Countervailing Measures on Steel Plate from India*, WT/DS206/R/Corr.1, adopted 29 July 2002
- Panel Report, *Canada – Export Credits and Loans Guarantees for Regional Aircraft*, WT/DS222/R/Corr.1, adopted 19 February 2002
- Panel Report, *United States – Tax Treatment for “Foreign Sales Corporations”- Recourse to Article 21.5 of the DSU by the European Communities (US- FSC (Article 21.5 - EC))*, WT/DS108/RW adopted 29 January 2002, as modified by the Appellate Body Report WT/DS/108/AB/RW.
- Panel Report, *United States – Measures Treating Export Restraints as Subsidies (US-Export Restraints)*, WT/DS194/R, and Corr.2, adopted 23 August 2001.

- Panel Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU (Brazil – Aircraft (Article 21.5 - Canada))*, WT/DS46/RW, adopted 4 August 2000, as modified by the Appellate Body Report WT/DS46/AB/RW.
- Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU (Canada – Aircraft (Article 21.5 – Brazil))*, WT/DS70/RW, adopted 4 August 2000, as modified by the Appellate Body Report WT/DS70/AB/RW
- Panel Report, *Canada – Measures Affecting the Automotive Industry (Canada – Autos)*, WT/DS139/R adopted 19 June 2000, as modified by the Appellate Body Report WT/DS139/AB/R, WT/DS142/AB/R
- Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (US- Lead and Bismuth II)*, WT/DS138/R and Corr.2 adopted 7 June 2000, as upheld by the Appellate Body Report WT/DS138/AB/R.
- Panel Report, *United States – Tax Treatment for “Foreign Sales Corporations” (US- FSC)*, WT/DS108/R, adopted 20 March 2000, as modified by the Appellate Body Report WT/DS108/AB/R.
- Panel Report, *Australia – Subsidies provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States (Australia – Automotive Leather II (Article 21.5 – US))*, WT/DS126/RW and Corr. 1, adopted 11 February 2000.
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- Panel Report, *Australia – Subsidies provided to Producers and Exporters of Automotive Leather – (Australia – Automotive Leather II)*, WT/DS126/R, adopted 16 June 1999.
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- Panel Report, *Brazil – Measures Affecting Desiccated Coconut (Brazil – Desiccated Coconut)*, WT/DS22/R, adopted 20 March 1997, as upheld by the Appellate Body Report WT/DS22/AB/R, DSR 1997:I, 189.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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3.8 SAFEGUARD MEASURES



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WHAT YOU WILL LEARN

The WTO *Agreement on Safeguards* [hereinafter SA], together with Article XIX of the *General Agreement on Tariffs and Trade 1994* [hereinafter GATT 1994],¹ sets out the general WTO regime pursuant to which WTO Members may apply safeguard measures to prevent or remedy “serious injury” to an import-competing industry sector resulting from unforeseen import surges in their markets.

Compared to Article XIX of GATT 1994, drafted in 1947 and remaining virtually unchanged,² the SA provides the first elaboration on the substantive requirements for the adoption of safeguard measures, and on the requirements that these measures have to follow. It further sets out procedural obligations (both concerning domestic proceedings and the WTO level) that WTO Members wishing to take safeguard action must comply with. It also contains specific obligations that Members have to respect in case safeguard action is taken against imports from developing countries.

Special rules on the taking of safeguard measures against textile imports are laid down in Article 6 of the *Agreement on Textiles and Clothing* [hereinafter ATC]. In addition, pursuant to Article 5 of the *Agreement on Agriculture* [hereinafter AA] Members can adopt special safeguards in respect of agricultural products, provided their right in this respect has been recorded in their tariff schedules. As regards services, there are currently no safeguard rules. However, Article X of the *General Agreement on Trade in Services* [hereinafter GATS] provides for multilateral negotiations on such rules.

This Module provides an overview of the *Agreement on Safeguards*, as it has been interpreted by panels and the Appellate Body in particular since the entry into force of the *WTO Agreement* in 1995. It will review both substantive and procedural rules. Since the entry into force of the SA in 1995, six WTO panel reports have been issued interpreting SA provisions and Article XIX:1 of GATT,³ all of which were appealed. They add to the rare panel reports

¹ In this Module the *Agreement on Safeguards*, the *GATT 1994* and the other WTO texts are referred to with their official names, it being understood that legally they constitute a single text together with the *Marrakesh Agreement Establishing the World Trade Organization*, to which they are annexed.

² See *Analytical Index to the GATT*, Vol. 1, 1995, p. 537.

³ Panel Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products* (“Korea – Dairy”), WT/DS98/R, adopted 12 January 2000; Appellate Body Report, WT/DS98/AB/R, adopted 12 January 2000; Panel Report, *Argentina – Safeguard Measures on Imports of Footwear* (“Argentina – Footwear (EC)”), WT/DS121/R, adopted 12 January 2000; Appellate Body Report, WT/DS121/AB/R, adopted 12 January 2000; Panel Report, *United States – Definitive Safeguard Measures on Import of Wheat Gluten from the European Communities* (“US – Wheat Gluten”), WT/DS166/R, adopted 19 January 2001; Appellate Body Report, WT/DS166/AB/R, adopted 19 January 2001; Panel Report, *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia* (“US – Lamb”), WT/DS177/R, WT/DS178/R, adopted 16 May 2001; Appellate Body Report, WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001; Panel Report, *United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea* (“US – Line Pipe”), WT/DS202/R, adopted 8 March 2002; Appellate Body Report, WT/DS202/AB/R, WT/DS178/AB/R, adopted 8 March 2002; another case, Panel Report, *Chile – Price Band System and Safeguard Measures Relating to certain Agricultural Products* (“Chile – Price Band”), WT/DS207/R adopted 3 May 2002, and appealed 24 June 2002.

addressing safeguard measures under GATT 1947.⁴ Given that, notwithstanding the addition of the SA, the WTO safeguard regime is still rather limited and not very detailed, it comes as no surprise that panel and Appellate Body reports offer very important clarifications of key provisions of the Agreement. This Module takes into account reports issued until 15 February 2002.

Section 1 gives a general overview of the Agreement and briefly recalls the history of safeguard measures in GATT 1947.

Section 2 explains the substantive requirements for the determination of “increased imports” (Article XIX of the GATT 1994, Article 2.1 of the SA).

Section 3 covers the serious injury requirement, as well as related concepts such as the definitions of “domestic industry” and of “like or directly competitive product” and the causal link between the increased imports and the injury suffered by the domestic industry (Article 4 of the SA).

Section 4 addresses the type and scope of safeguard measures authorized, as well as the right to compensation (Articles 2, 5, 6, 7, 8, 10 and 11 of the SA, Articles XIX and XIII of the GATT 1994).

Section 5 highlights the requirements concerning domestic procedures imposed on WTO Members seeking to take safeguard action (Articles 3, 6 and 12 of the SA).

Section 6 examines certain issues, which have arisen in WTO dispute settlement procedures reviewing safeguard measures (amongst which the standard of review of safeguard measures by panels). It also summarizes the role of the Committee on Safeguards (Articles 12, 13 and 14 of the SA).

Section 7 analyses the position of developing countries under the SA (Article 9 of the SA).

Objectives

After having studied this Module the reader will be able:

- **to list the factors that shall be assessed for a WTO Member to justify the application of a safeguard measure.**
- **to explain to what extent a safeguard measure can be challenged within the DSU.**
- **to describe the rules aimed at strengthening developing countries' positions in regards to the application of safeguards.**

⁴ *Working Party Report*, Report on the Withdrawal by the United States of a Tariff Concession under Article XIX of the General Agreement on Tariffs and Trade, 27 March 1951, CP 106, adopted October 1951; *Panel Report*, Norway - Restrictions on imports of certain textile products, adopted June 18, 1980 L/4959, BISD 27S/119; Increase in the United States duty on dried figs, *Decision of November 8, 1952 SR.7/15, BISD 1S/28* (the latter one in fact is concerned with the suspension of substantially equivalent concessions by Turkey in response to a safeguard measure taken by the United States). The reports issued under GATT 1947 are available on the internet at the address http://www.wto.org/english/tratop_e/dispu_e/gt47ds_e.htm.

1. INTRODUCTION

This section presents an historical overview of safeguard regulation in the GATT. A descriptive summary of the *Agreement on Safeguards* [SA] is also provided.

1.1 History

The *WTO Agreement*,⁵ like all trade agreements, is meant to promote international trade and therefore is also expected to increase import flows by mutually advantageous concessions. It might therefore appear astonishing and somewhat contradictory that the same agreement allows WTO Members to “back-pedal” and place restrictions on imports in the form of safeguard measures if those imports increase.

“safety valve”

While an increase in imports is the natural effect of trade liberalization, it has generally been recognized in trade treaty practice that there are certain circumstances in which import liberalization may become difficult to sustain - to a point of straining the very functioning of those agreements. This is why, prior to the GATT 1947, bilateral trade agreements normally provided for a “safety valve” in the form of safeguard measures. This is meant to avoid those circumstances where the contracting parties, faced with the dilemma of either having their domestic market heavily disrupted or withdrawing from their agreements, choose the latter option, thus ultimately reducing the overall level of liberalization.

Article XIX GATT 1947

This is why the GATT 1947 contained a special provision on “Emergency Action”, in Article XIX. However, recognizing the potential for trade-restrictive application of such provision, the GATT 1947 prescribed in some detail the conditions under which safeguard measures may be imposed.

Article XIX, which has remained unchanged in GATT 1994, sets out such conditions in summary form. Paragraph 1 provides:

Emergency Action on Imports of Particular Products, Article XIX:1, GATT 1994

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

⁵ In this volume, the term “WTO Agreement” is used to refer collectively to the Results of the Uruguay Round Multilateral Trade Negotiations.

Unlike in the case of e.g. anti-dumping measures, safeguard measures do not address a specific pricing behaviour of exporting companies, but a more general increase in imports taking place under certain special circumstances. In addition, it is generally considered that safeguard measures address so-called “fair trade”, that is exports occurring under normal competitive conditions. In view of this, the Appellate Body has concluded that:

**Appellate Body
Report, Argentina –
Footwear (EC)**

[t]he application of a safeguard measure does not depend upon “unfair” trade actions, as is the case with anti-dumping or countervailing measures. Thus, the import restrictions that are imposed on products of exporting Members when a safeguard action is taken must be seen, as we have said, as extraordinary. And, when construing the prerequisites for taking such actions, their extraordinary nature must be taken into account⁶.

Although the basic Article XIX provision was never supplemented during GATT 1947, this does not mean that the matter of safeguards did not raise the attention of the GATT Contracting Parties.

One of the very first cases taken to dispute settlement – the “*Hatter’s Fur*” or “*Fur Felt Hats*” case⁷ - concerned a measure taken by the United States against imports of women’s fur felt hats and hat bodies, challenged by Czechoslovakia.

“grey area”

Furthermore, some 150 safeguard measures were officially notified to the Contracting Parties to the GATT 1947.⁸ Soon, however, it became clear that measures other than Article XIX safeguard measures were resorted to by certain contracting parties to address import surges considered to be particularly injurious. Those were often designated with the term “grey area” measures and included the so-called Voluntary Export Restraints (VERs), Voluntary Restraint Arrangements (VRAs) and Orderly Marketing Arrangements (OMAs). These measures, instead of being formally adopted by the importing country, were formally taken by the exporting country or negotiated by exporting companies with the importing country.

The reason for shifting to this type of measures is generally found in the difficulty to face the request for compensation from the rest of the contracting parties, as allowed by Article XIX [infra, section 4.6], and moreover, in the perceived additional difficulty in imposing safeguard measures targeting only the main exporting countries (the so-called “selective” application of safeguard measures).

Attempts to enact supplementary safeguard rules during the “Tokyo Round” of multilateral trade negotiations (1979) to, *inter alia*, contain this phenomenon

⁶ *Appellate Body Report, Argentina – Footwear(EC), WT/DS121/AB/R, para. 94.*

⁷ Report on the Withdrawal by the United States of a Tariff Concession under Article XIX of the General Agreement on Tariffs and Trade (*Hatter’s Fur*), 27 March 1951, CP 106, adopted October 1951.

⁸ See Analytical Index to the GATT, 1995, Vol. 1, pp. 539 ff.

did not succeed and no “Safeguards Code” existed until the establishment of the WTO. The SA thus represents the first supplementary safeguard discipline since 1947.

Thus, compared to the other trade defence rules (anti-dumping and countervailing duty rules), which started being supplemented in the late 1960s, safeguard rules are understandably less sophisticated. Some osmosis between the various trade defence rules has nonetheless resulted from dispute settlement interpretation under the WTO.

1.2 Current Situation

Given the issues arisen in the application of safeguards under the GATT 1947, an *Agreement on Safeguards* was negotiated during the Uruguay Round with the following objectives:⁹

- improve and strengthen GATT 1994
- clarify and reinforce GATT 1994, and specifically Article XIX (Emergency Action on Imports of Particular Products)
- re-establish multilateral control over safeguards and eliminate measures that escape such control
- enhance rather than limit competition on international markets.

Article XIX of GATT 1947 was carried forward into GATT 1994. As a result of the Uruguay Round, further safeguard rules were written in the *Agreement on Safeguards*, which forms an integral part of the *WTO Agreement*. Article XIX of GATT 1994 and the SA apply together. As clarified by the Appellate Body:

**Appellate Body
Report, Korea - Dairy**

...[t]he ordinary meaning of the language in Article 11.1(a) – “unless such action conforms with the provisions of that Article applied in accordance with this Agreement” – is that any safeguard action must conform with the provisions of Article XIX of the GATT 1994 as well as with the provisions of the Agreement on Safeguards. Thus, any safeguard measure imposed after the entry into force of the WTO Agreement must comply with the provisions of both the Agreement on Safeguards and Article XIX of the GATT 1994.¹⁰*

**With the exception of special safeguard measures taken pursuant to Article 5 of the Agreement on Agriculture or Article 6 of the Agreement on Textiles and Clothing.*

1.3 Outline of the SA

The SA is a rather short text, partly confirming or building on the provisions of Article XIX of GATT 1994 and partly developing entirely new rules. It covers three areas. Together with Article XIX:1 of GATT 1994, Articles 2

⁹ SA, Preamble.

¹⁰ Appellate Body Report, Korea – Dairy, para. 77

and 4 lay down the substantive requirements that must be shown to be met in order to adopt a safeguard measure. Fulfilment of such requirements must be assessed through an investigation procedure carried out by the authorities of the country seeking to impose a measure. Furthermore this procedure must be accounted for in a written document issued by the authorities at the end of the process. Both aspects are addressed by Article 3. Articles 5 to 9 lay down various conditions relating to the measures that may be taken to prevent or remedy serious injury or threat thereof. They have to be applied together with Article XIII of the GATT 1994. In addition, Article 8 provides for mutually agreed trade compensation by the WTO Member taking the measure to those affected by the measure.

Article 12 sets out the procedural requirements that must be complied with by a WTO Member seeking to take a safeguard measure. Article 13 establishes multilateral surveillance over the implementation of the agreement by setting up a Committee on Safeguards under the authority of the Council for Trade in Goods.

1.4 Scope of the Safeguard Regime

Article XIX of the GATT 1947 applied to all goods. In practice, however, as for textile and agricultural products trade was largely restrained (in the latter case by the bilateral agreements under the *Multifibre Arrangement*), the need for action under Article XIX was somehow reduced.

In the WTO system, GATT 1994, as strengthened and modified by the SA, remains the generally applicable safeguard regime. However, special regimes are provided for in the *WTO Agreement*, notably in:

(1) *Agreement on Agriculture* (AA)

Article 5 of the AA provides for a special transitional regime for certain agricultural products. This regime will eventually expire once the reform of support and protective measures to agricultural products referred to in Article 20 of the AA is completed. This regime is applicable to the agricultural imports covered by the AA, for which the restraining WTO Member has “tariffed” (i.e. converted into tariffs written in its schedule) certain restrictive measures (referred to in Article 4.2 of the AA) **and** for which the mention “SSG” is included in its tariff schedule next to the other import and production conditions. For such products, a special safeguard measure (SSG) may be imposed if (1) the volume of imports during a year exceeds a certain trigger level **or** (2) the price at which imports may enter falls below a certain trigger price. The measure may only take the form of a tariff duty, to be applied until the end of the year in which it has been imposed.

Imports which have not been designated as “SSG” can still be restrained under the *Agreement on Safeguards* if the relevant conditions are met.

(2) *Agreement on Textiles and Clothing (ATC)*

Article 6 of the ATC provides for a transitional safeguard regime for certain textile products, which will expire in 2005 as will the rest of the ATC. It is applicable to products covered by the ATC, which the restraining Member has not yet “integrated into GATT 1994” (that is, not yet accepted to subject to the more liberalizing GATT provisions). For such products, a transitional safeguard measure may be imposed if (1) there is an increase in import quantities (2) causing or threatening to cause (3) serious damage to the domestic industry producing like or directly competitive products.

Safeguard measures under this clause are applied to selected products and on a Member-by-Member basis (i.e. they are “selective”). Such measures may be applied for a maximum of three years.

Given the similarity in wording with the provisions of the SA, interpretations provided in respect of ATC safeguard provisions have influenced the interpretation of the provisions of the SA.¹¹

(3) *Protocol of Accession of the People’s Republic of China*¹²

China’s Accession Protocol provides for a transitional safeguard clause that other WTO Members can rely upon to limit imports from China. This clause is applicable for 12 years after China’s accession.

Accordingly, a transitional safeguard measure may be imposed if (1) imports from China increase in quantities or (2) enter in such conditions (3) as to cause or threaten to cause (4) market disruption to the domestic producers of like or directly competitive products.

In case a measure is taken under this clause by an individual WTO Member, other WTO Members can in turn restrict imports of Chinese origin if they show that such a safeguard measure taken by the first WTO Member causes or threatens to cause significant diversions of trade into their markets.

(4) *General Agreement in Trade in Services (GATS)*

Obviously, services are not covered by either the GATT 1994 or the SA, which both form part of the goods regime in the *WTO Agreement*.

¹¹ Three panel reports interpreting Article 6 of the ATC have been issued so far, all of which were appealed: Panel Report, United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear from India (“US – Underwear”), WT/DS24/R, adopted 25 February 1997; Appellate Body Report, WT/DS24/AB/R, adopted 25 February 1997; Panel Report, United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India (“US – Shirts and Blouses”), WT/DS33/R, adopted 23 May 1997; Appellate Body Report, WT/DS33/AB/R, adopted 23 May 1997; Panel Report, United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan (“US – Cotton Yarn”), WT/DS192/R, 31 May 2001; Appellate Body Report, WT/DS192/AB/R, 8 October 2001).

¹² WT/ACC/CHN/49, Section 16 of the Protocol of Accession, p. 80. A safeguard-type mechanism for textile products subject to the ATC regime is also provided for in the same document (Section 11 of the Working Party Report, p. 45).

At the time of writing, services do not have a specific multilateral safeguard regime. However, Article X of the GATS provides for the WTO Members to negotiate such a regime. The deadline set for completion of such negotiations was set at three years after the entry into force of the *WTO Agreement*. It was subsequently extended and negotiations are currently going on.

1.5 Test Your Understanding

- 1. A WTO Member receives a complaint for safeguard protection from the domestic industry producing certain agricultural products. The WTO Member has reserved no right to impose special safeguard measures in its agricultural schedules. Can it still follow up its industry's request?**
- 2. Can coffee producers in a WTO Member bring a safeguard complaint against increased imports of tea from another WTO Member?**
- 3. If Country A imposes a safeguard measure due to the increase in imports from China, can the neighbouring country B impose a similar safeguard measure? If so, what shall country B show to justify such a measure?**

2. THE DETERMINATION OF “INCREASED IMPORTS”

In this section, the determination of whether imports have increased in accordance with Article XIX of the GATT 1994 and Article 2.1 of the SA will be reviewed.

For a determination of “increased imports” under the WTO safeguard regime, not any import increase is sufficient. The provisions set out two main conditions, which must be met for the increased imports to justify the imposition of safeguard measures. Firstly, such increase must have occurred “as a result of unforeseen developments and of the effect of the obligations incurred by” a WTO Member. Secondly, imports should enter into the importing country “in such increased quantities and under such conditions” as to cause or threaten serious injury to the domestic industry.

2.1 Overview of Article 2.1, SA and Article XIX, GATT 1994

The characteristics that import trends must possess to justify a safeguard measure are described in Article 2.1 of the SA.

Article 2.1, SA

A Member may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products ...

Article 2.1 must then be read together with Article 4.2 of the SA, which sets out the operational requirements for determining whether the conditions identified in Article 2.1 exist. Article 4.2(a) requires in relevant part that:

Article 4.2, SA

...[i]n the investigation to determine whether increased imports have caused or are threatening to cause serious injury to a domestic industry under the terms of this Agreement, the competent authorities shall evaluate (...) in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports ...

Article 2.1, SA

Two requirements must be fulfilled under Article 2.1. The first one is a quantitative requirement, while the second is more generally related to the “conditions” under which foreign products come into the territory of the Member seeking to take a safeguard measure.

The link with Article 4.2(a) also suggests that to be relevant under Article 2.1, import increases must have such characteristics as to cause or threaten to cause serious injury.¹³

Article 2.1 of the SA essentially reproduces and confirms the language of Article XIX:1 of the GATT 1994. There is one notable exception, namely the clause in Article XIX:1(a) requiring that the increase in imports occurs as a result of “unforeseen developments” and “of the effect of the obligations incurred by a contracting party”:

Article XIX:1(a)
GATT 1994

If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products ...

2.2 The Determination of “Unforeseen Developments”

Increased imports (just as increased exports) are the normal and indeed expected consequence of trade liberalization – for example of tariffs reductions. Accordingly, it is not any increase in imports, but only increases in imports qualified by certain conditions and circumstances that authorize the adoption of import safeguards. The first condition is set out in Article XIX:1 of GATT 1994, providing that the increase in imports must result from “unforeseen developments”.

This clause is not further defined or illustrated by examples either in Article XIX of the GATT 1994 or in the SA. Its broad language is presumably meant to cover a wide range of unexpected circumstances, which by definition is difficult to anticipate precisely in the abstract. The clause was first interpreted in the *US - Hatters’ Fur* case. The Working Party observed that

**Working Party, US –
Hatter’s Fur**

...the term ‘unforeseen development’ should be interpreted to mean developments occurring after the negotiation of the relevant tariff concession which it would not be reasonable to expect that the negotiators of the country making the concession could and should have foreseen at the time when the concession was negotiated...¹⁴

In the WTO era, the Appellate Body has also had several chances to interpret the clause. As a general matter, it considered that:

**Appellate Body
Report, Korea – Dairy**

...the ordinary meaning of the phrase “as a result of unforeseen developments” requires that the developments which led to a product being imported in such

¹³ Cf. Appellate Body Report, Argentina – Footwear (EC), para. 131.

¹⁴ Working Party Report, US – Hatters’ Fur, p. 10, para. 9.

**Appellate Body
Report, Argentina –
Footwear (EC)**

*increased quantities and under such conditions as to cause or threaten to cause serious injury to domestic producers must have been “unexpected”.*¹⁵

...[These] circumstances ... must be demonstrated as a matter of fact in order for a safeguard measure to be applied consistently with the provisions of Article XIX of the GATT 1994...¹⁶

In addition, in the *US –Lamb* case the Appellate Body clarified that the “demonstration” must be provided by the competent domestic authorities before taking the measure. This means that the measure itself must contain an express finding to this effect, otherwise its legal basis is flawed.¹⁷

What does this requirement mean in practice? So far, the only case where the “unforeseen developments” requirement was held to have been met is the *US – Hatter’s Fur* case. The United States had argued that the change in hats fashion which had led to the increase in imports of felt hats and hat bodies was unforeseen, particularly in view of its magnitude. The Working Party agreed with the United States:

**Working Party, US –
Hatter’s Fur**

...the fact that hat styles had changed did not constitute an “unforeseen development” within the meaning of Article XIX.”¹⁸

... the effects of the circumstances indicated in the above, and particularly the degree to which the change in fashion affected the competitive situation, could not reasonably be expected to have been foreseen by the United States authorities in 1947.¹⁹

In all other cases in which non-compliance with the “unforeseen developments” language has been claimed, the total lack of any prior demonstration or explanation on this point has been sufficient to uphold such claims without any in-depth evaluation.

The Appellate Body has also had the chance to pronounce on the language “as a result ... of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions”²⁰. It considered that this phrase simply means that it must be demonstrated, as a matter of fact, that the importing Member has incurred obligations under the GATT 1994, including tariff concessions.

¹⁵ *Appellate Body Report, Korea – Dairy, para. 84; Appellate Body Report, Argentina – Footwear(EC), para. 91.*

¹⁶ *Appellate Body Report, Korea – Dairy, para. 85; Appellate Body Report, Argentina – Footwear (EC), para. 92.*

¹⁷ *Appellate Body Report, US – Lamb, paras. 72, 76.*

¹⁸ *Working Party Report, US – Hatters’ Fur, para. 11*

¹⁹ *Working Party Report, US – Hatters’ Fur, para.12*

²⁰ *Appellate Body Report, Korea – Dairy, para. 84; Appellate Body Report, Argentina – Footwear (EC), para. 91.*

2.3 The Investigation Period

“investigation period”

Analysis of increased imports by domestic authorities assumes that such authorities select a so-called “reference period” or “investigation period” (“IP”), that is, a time span prior to the determination whose import trends will be studied. The SA contains no indication as to how the reference period should be selected. Therefore, the WTO Members remain in principle free to select whatever period they deem appropriate notwithstanding the importance of the issue. Accordingly, the only guidance so far has been provided in panel and Appellate Body reports.

If it is one considered [**infra, section 2.4.2**] that the increase relevant under Article 2.1 must be “recent” and “sudden”, it may be argued that it should not go too far backwards, but should rather be the one for which the most recent import data are available.

It may also be noted that, in practice, the reference period for examination of the import trends tends to coincide with that for the examination of the “serious injury” to the domestic industry producing like or directly competitive products [**infra, section 3**]. This contrasts with the practice in anti-dumping investigations, where two reference periods are clearly distinct.

2.4 The Assessment of the Increase in imports

Article 2.1 SA

The increase in imports, which is relevant under Article 2.1 of the SA, may be assessed either in absolute terms (for example, an increase by tons or units of imported products) or in its magnitude relative to domestic production of like/directly competitive products. A determination of “increased imports” raises several questions:

- (1) how much must imports have increased?
- (2) besides an increase in quantities, is an increase in value also relevant?
- (3) over which time span?

Each of these questions is addressed below.

2.4.1 The Absolute or Relative Nature of the Increase

“absolute increase”

Absolute increases and relative increases are two different situations and do not necessarily coexist. For example, it may happen that in an exporting WTO Member, production increases, or simply a larger share of the production, becomes available for export. This may result in a higher quantity of imports into another WTO Member without simultaneously also leading to a relative increase, if the importing Member’s domestic production also increases.

“relative increase”

Conversely, there may be cases where the quantity of imports actually entering the border remains constant, but because domestic production shrinks, the

ratio between imports and domestic production results in a higher figure. Assume for example that in 1999 imports into X amount to 100t and domestic production amounts to 200t. The import-to-domestic-production ratio is therefore 1:2 or 0.5. If in 2000 imports remain 100 t, but domestic production falls down to 150t, the ratio is 1:1.5, or 0.66. There will thus have been a 0.16 increase in imports *relative to* domestic production without, however, one extra import entering the importing Member's territory. Depending on the magnitude of the change in ratio, this type of development may be sufficient to fulfil the "increased imports" requirement in Article 2.1 of the SA.

Under Article 2.1 of the SA, absolute imports and relative imports are alternative conditions. Accordingly, in order to meet the "increased imports" requirement it is sufficient that one form of increase has occurred. Thus, for example, in *US – Line Pipe*, the panel considered that even if it had found that imports of line pipe into the United States had not increased in absolute terms, its conclusion that there had been "increased imports" consistent with the SA would have been supported by the fact that imports had increased *relative to* domestic production.²¹

It should be noted that while the presence of an absolute increase or a relative increase are equally relevant to meet Article 2.1, a difference in the application of Article 8.3 of the SA may result depending on the type of increase [infra, section 4].

In *Argentina – Footwear (EC)*, the Panel considered that, since the wording of Article 2.1 of the SA refers to quantities, the analysis of domestic authorities and panel review must focus on quantities rather than value.²²

2.4.2 Substantial Characteristics; Quantity and Duration of the Increase

Two main questions arise in connexion with the requirement that imports have increased. The first is "how much increased?", *i.e.* the volume of the increase. The second question to be answered is "over which time span?" or rather the duration of the increase. A first general response to both questions was provided by the Appellate Body in *Argentina – Footwear (EC)*:

**Appellate Body
Report, Argentina –
Footwear (EC)**

...the increase in imports must have been recent enough, sudden enough, sharp enough, and significant enough, both quantitatively and qualitatively, to cause or threaten to cause "serious injury".²³

"quantity"

A first answer to the question of relevant quantity is indirectly provided by the Appellate Body's clarification in *Argentina – Footwear (EC)*. Accordingly,

²¹ Panel Report, *US – Line Pipe*, WT/DS202/R, para. 7.211.

²² Panel Report, *Argentina – Footwear (EC)*, WT/DS121/R, para 8.152.

²³ Appellate Body Report, *Argentina – Footwear (EC)*, para. 131.

the increase must be “sharp”, a term confirming that the *magnitude* of the increase as such is important to an “increased imports” determination. In addition, the term “sudden” suggests that the relevant increase must take place over a relatively short time span.

No method to assess the increase in imports is set out in the SA. Reports so far have clarified that both the *rate* and the *amount* of the increase in imports (in absolute and relative terms) must be evaluated. This further entails that the competent authorities are required to consider the *trends* in imports over the period of investigation, rather than just comparing the situation of imports at the beginning and at the end of the reference period (the so-called “end points” of the period).²⁴

As a practical example, a panel found that the “recent, sudden and sharp” increase requirement was met in a case where (1) imports had risen (in absolute terms) from 124 to 177 million pounds, with the highest increase occurring towards the end of the reference period, and (2) the ratio of imports to production had risen from 100.6 per cent to 145.4 per cent at the end of the reference period.²⁵

“duration”

With regard to the second question of the duration of the increase, some guidance is indirectly provided by the Appellate Body’s recognition that the increase must be “recent” and also that it must be “sudden”.

The requirement that the increase in imports must be sudden and recent is understandable if it is borne in mind that the adoption of safeguard measures is supposed to respond to an “emergency” situation in the importing WTO Member.²⁶ When a trend of increased imports is observed for quite a long time, it can hardly be termed as “sudden”. In such a case, it is legitimate to infer that the problem is in fact a structural one, not one arising from an unexpected and emergency situation, and therefore not suitable for being redressed by an “emergency” measure.²⁷ On the other hand, if the increase in imports stopped well before the initiation of the investigation, the emergency is likely to have disappeared. It may further be inferred that the domestic industry has had the time to adjust to the new market situation, and thus temporary safeguard relief is not warranted.

The fact that historical import trends must be assessed assumes the selection of an appropriate IP, that is a period in the past whose import data will be used as the basis for the determination.

WTO Members have discretion as to the choice of IP, providing that the selected period complies with the general indications given by the AB as to the recent and sudden character of the increase. However, the choice of IP may have

²⁴ Cf. *Appellate Body Report, Argentina – Footwear (EC)*, para. 126.

²⁵ *Panel Report, US - Wheat Gluten*, para. 8.32 (not appealed).

²⁶ *Appellate Body Report, Korea – Dairy*, para. 86; *Appellate Body Report, Argentina – Footwear (EC)*, para. 93.

²⁷ Cf. also *Panel Report, Argentina – Footwear (EC)*, para. 8.162.

considerable implications. In particular, in some cases the choice of the beginning of the period (the “base year”) may be decisive as to whether the determination of “increased imports” over the entire IP will be affirmative or negative. Assume the following example:

Total Imports of widgets into X, 1991-1996

Year	Quantity (million items)
1991	8.86
1992	16.63
1993	21.78
1994	19.84
1995	15.07
1996	13.47

The import data above show mixed trends. On the one hand, if one looks at the end points of the IP, the overall 1991-96 period shows an increase in quantity at the end of it ($13.47 > 8.86$). On the other hand, within the period selected the increase only occurs in the first two years (between 1991 and 1992, and between 1992 and 1993), while the last three years (the most “recent” period) show a decline.

However, the choice of the base year (1991) has an influence on whether the end-point-to-end-point comparison shows an increase or a decrease. More specifically, if 1992 rather than 1991 is taken as the base year, one must conclude that total imports declined even based on an end-point-to-end-point comparison ($13.47 < 16.63$). Thus, only if 1991 is taken as the base year can an absolute increase in total import volume be found.²⁸

Accordingly, observing whether an affirmative determination would be “sensitive” to the change in the years used as the end-points is quite important, as it might confirm or reverse the apparent initial conclusion. If changing the starting-point and/or end-point of the investigation period by just one year entails that the comparison between end-points shows a decline in imports rather than an increase, this calls into question the conclusion that there are increased imports.

If an increase in imports is really present, this should be evident both in an end-point-to-end-point comparison and in an analysis of intervening trends over the period. That is, the two analyses should be mutually reinforcing. Where, as in the example, their results diverge, this at least raises doubts as to whether imports have increased in the sense of Article 2.1.²⁹

²⁸ Panel Report, Argentina – Footwear (EC), para. 8.154.

²⁹ Appellate Body Report, Argentina – Footwear(EC), para. 129.

Assuming that a change in the base year does not affect the determination, an additional question that arises concerns the relative importance of *trends at the end of the reference period* compared to opposite trends during other parts (or the whole) reference period. In other words, *what if imports decreased towards the end of the reference period but had overall increased at the end of the period, compared to the beginning of it?*

Here again, there is no single definitive answer, and a case-by-case examination appears necessary. The general decisive criterion appears to be whether the countertrend which is visible at the end of the reference period is merely temporary, or it is rather sufficiently long term within the selected reference period to cast doubts as to the reality of the increase. This was the opinion of the Panel in *Argentina – Footwear (EC)*:

**Panel Report,
Argentina –
Footwear(EC)**

We too believe that the question of whether any decline in imports is “temporary” is relevant in assessing whether the “increased imports” requirement of Article 2.1 has been met. In this context, we recall Article 4.2(a)’s requirement that “the rate and amount of the increase in imports” be evaluated. In our view this constitutes a requirement that the intervening trends of imports over the period of investigation be analysed. We note that the term “rate” connotes both speed and direction, and thus intervening trends (up or down) must be fully taken into consideration. Where these trends are mixed over a period of investigation, this may be decisive in determining whether an increase in imports in the sense of Article 2.1 has occurred.³⁰*

** We recognise that Article 4.2(a) makes this reference in the specific context of the causation analysis, which in our view is inseparable from the requirement of imports in “such increased quantities” (emphasis added). Thus, we consider that in the context of both the requirement that imports have increased, and the analysis to determine whether these imports have caused or threaten to cause serious injury, the Agreement requires consideration not just of data for the end-points of an investigation period, but for the entirety of that period.*

How is this general statement (which was upheld by the Appellate Body) applied in practice?

In the *Argentina - Footwear (EC)* case, the panel noted that a 38 per cent import decline observed over the last three years of a five-year reference period was of such a magnitude as to be considered a long term rather than a “temporary” reversal of the increasing trend.

Another panel considered that the Article 2.1 requirement was met notwithstanding the fact that towards the very end of the reference period (the last year over a five and a half-year IP) imports had clearly decreased.³¹ This finding was not reviewed by the Appellate Body.

Also, it must be borne in mind that according to the Appellate Body the increase

³⁰ Panel Report, Argentina – Footwear, para.(EC) 8.159.

³¹ Panel Report, US – Line Pipe, para. 7.214.

in imports must be “recent” and “sudden” to be relevant under Article 2.1. Therefore, for example, the Appellate Body considered a five-year reference period to be *too long*, particularly as import trends were analyzed over that entire period without special focus on the end of that period, i.e. the *most recent* import trends. It considered that:

**Appellate Body
Report, Argentina –
Footwear (EC)**

*...the use of the present tense of the verb phrase “is being imported” in both Article 2.1 of the Agreement on Safeguards and Article XIX:1(a) of the GATT 1994 indicates that it is necessary for the competent authorities to examine recent imports, and not simply trends in imports during the past five years – or, for that matter, during any other period of several years. * In our view, the phrase “is being imported” implies that the increase in imports must have been sudden and recent.³²*

**The Panel, in footnote 530 to para. 8.166 of the Panel Report, recognizes that the present tense is being used, which it states “would seem to indicate that, whatever the starting-point of an investigation period, it has to end no later than the very recent past.” (emphasis added) Here, we disagree with the Panel. We believe that the relevant investigation period should not only end in the very recent past, the investigation period should be the recent past.*

On the other hand, the Appellate Body has recognized that, for the purposes of assessing “serious injury”, the reference period should be sufficiently long to allow drawing appropriate conclusions on the state of the domestic industry.³³ Otherwise, for example temporary or cyclical downturns in the domestic industry’s performance may risk being incorrectly taken to indicate a situation of serious injury.³⁴

2.4.3 *Supplementary Characteristics, “and under such conditions”*

Article 2.1 of the SA also contains the wording “and under such conditions”. The exact meaning of this requirement has not been entirely clarified. In *US-Wheat Gluten*, the Appellate Body interpreted the phrase “under such conditions” (which it considered to be “context” to the provisions of Article 4.2 of the SA on causation [*infra*, section 3]). The Appellate Body considered that Article 2.1’s reference to the “conditions” under which imports come is, in fact, a reference to the conditions in the marketplace *in the importing country*. It further inferred that the term “conditions” is a “shorthand reference to the ... factors [other than increased import *quantities*] listed in Article 4.2(a), which are relevant to assess the overall state of the domestic industry.³⁵

The Appellate Body did not apply its interpretation of the clause “under such conditions” to the case before it. If it must be inferred from the Appellate

³² *Appellate Body Report, Argentina – Footwear(EC), para. 130.*

³³ *Appellate Body Report, US-Lamb, footnote 88, referring to the reference period for assessment of injury.*

³⁴ *Appellate Body Report, US-Lamb, para. 138.*

³⁵ *Appellate Body Report, US – Wheat Gluten, paras. 76-78.*

Body's statements that the clause is *exclusively* related to the conditions on the *importing* market and of the domestic industry, which conditions also need to be analyzed under Article 4.2(a) [*infra*, section 3], one may wonder whether this clause really constitutes an additional requirement to the ones set out in Article 4.2(a). The Appellate Body has however not expressly ruled out that the clause might also refer to other conditions than those present on the importing market.

2.5 Test Your Understanding

1. **A company files a petition for safeguard relief and argues that because of an international financial crisis, which has struck many WTO Members with consequent high depreciation of their currencies, domestic production of such countries is bound to be massively exported. Is this sufficient to warrant an affirmative determination of “increased imports”**
2. **A company files a petition for safeguard relief arguing that, because of the removal of a balance-of-payment measure restricting the importation of a given product, it is anticipated that imports of such products will dramatically increase. Is this sufficient to warrant an affirmative determination of “increased imports”?**³⁶
3. **Imports of widgets into country X start massively to increase in 1997, with a 30 per cent increase over the entire year. In 1998 there is a further increase of one per cent, and so in 1999, while in 2000 imports decrease by one per cent each year. Assume domestic production remains constant over the 1997-2000 period. In 2001 a safeguard investigation is conducted and, relying upon the 1997-2000 data, an “increased imports” finding is made. Is this consistent with Article 2.1?**
4. **In 1998-2001 imports of widgets into country X increase by 5 per cent each year (all compared to the 1997 volume). Assume domestic production remains constant over the 1998-2001 period. Can a finding of “increased imports” consistent with Article 2.1 be made?**
5. **In 1998-2001 imports of widgets into country X increase by 5 per cent each year (all compared to the 1997 volume). Assume domestic production remains constant over the 1998-2001 period. However, in 2000 and 2001 the value of these imports on the domestic market increases. Does the answer to question 4 change in this case?**

³⁶ Cf. Panel Report, Argentina – Footwear(EC), paras.8.163-164.

3. THE DETERMINATION OF “SERIOUS INJURY”

The determination of injury consists of an assessment that the increased imports have caused or threatened to cause serious injury to the domestic industry producing the like or directly competitive product.

The presence of serious injury or threat thereof to the domestic industry as a result of the increased imports is a major substantive requirement for the imposition of a safeguard measure. A finding that the domestic industry is suffering or is threatened with serious injury requires a positive answer to the following main questions:

- (1) what is the domestically produced product which is “like” or “directly competitive” to the imports under investigation?**
- (2) which “domestic industry” is producing such a product?**
- (3) can the situation of the domestic industry be described as one of “serious injury” or of “threat of serious injury”?**
- (4) is this situation caused by imports?**

Each of these questions is addressed below.

3.1 *Overview of Article 4 of the SA*

Article 4.1 provides the definitions of “serious injury” and of “threat of serious injury”, as well as elements to identify the “domestic industry”.

Article 4.2(a) provides that the injury assessment must be based on the evaluation of all relevant factors of an objective and quantifiable nature having a bearing on the domestic industry situation (the so-called “injury factors”). It then lists a series of such factors, all of which must at a minimum be evaluated by domestic authorities ((1) rate and amount of the increase in imports of the product concerned in absolute and relative terms; (2) share of the domestic market taken by increased imports; changes in the level of (3) sales, (4) production, (5) productivity, (6) capacity utilization, (7) profits and losses, and (8) employment). For threat of serious injury some additional indications are contained in Article 4.1(c), providing that a threat determination must be based on facts and not on conjecture or remote possibility.

Article 4.2(b) lays down the causation requirement, which is twofold. On the one hand, a demonstration of the causal link between increased imports and serious injury is required. On the other hand, it is also required that any injury caused by factors other than the increased imports must not be attributed to such imports.

3.2 Definition of Serious Injury/ Threat of Serious Injury

“serious injury”

In order for a safeguard measure to be lawfully taken, increased imports fulfilling the requirements of Article 2.1 of the SA must have caused serious injury or threat of serious injury to the domestic industry. These terms are defined in Article 4.1 of the SA.

Article 4.1(a) defines “serious injury” as

Article 4.1(a), SA

...a significant overall impairment in the position of a domestic industry;

In addition, Article 4.1(b) of the SA provides that “threat of serious injury”

Article 4.1(b), SA

...shall be understood to mean serious injury that is clearly imminent, in accordance with the provisions of paragraph 2. A determination of the existence of a threat of serious injury shall be based on facts and not merely on allegation, conjecture or remote possibility;

As a general matter, the standard of “serious injury” built in the SA has been recognized by the Appellate Body to be “very high” (“exacting”),³⁷ and in particular to be stricter than the “material injury” standard in the *Anti-Dumping Agreement*.³⁸

In view of the definitions set out in Article 4 of the SA, before concluding that the situation of the domestic industry is such as to amount to “serious injury” or “threat of serious injury”, three steps must be completed: (1) identifying the domestic products which are “like” or “directly competitive” to the imports under investigation, (2) identifying the industry producing such products, (3) assessing a “significant overall impairment” of the domestic industry conditions (or of a threat thereof in the case where the domestic authorities rely on the threat of serious injury).

3.3 Definition of the Domestic Industry

Article 4.1(c) of the SA provides two criteria to identify the relevant “domestic industry”. First, it defines the domestic industry as the producers making products, which are “like” or “directly competitive” to the imports targeted by the investigation. Second, it adds that the serious injury must be assessed with respect to either the whole of such domestic industry, or to that part thereof which amounts to a “major proportion”.

³⁷ Appellate Body Report, US – Wheat Gluten, para. 149.

³⁸ Appellate Body Report, US – Lamb, para. 124.

3.3.1 “Like” or “Directly Competitive” Products

The first criterion laid down in Article 4.1(c) to identify the domestic industry is product-centred. Although mention is made of “producers”, this term is immediately qualified by a reference to the particular products that must be produced by the relevant industry: only those producers making products that are “like or directly competitive” to imports form part of the domestic industry. Domestic authorities enjoy discretion as to the product scope of safeguard investigations, that is, as to which foreign products they investigate. However, once the basic choice as to the product scope is made, it determines the scope of their analysis of the domestic market.

Accordingly, the first step in determining the scope of the domestic industry is the identification of the domestic products which are “like or directly competitive” to the imported product. Only when those products have been identified is it possible to identify their “producers”.³⁹ This in turn raises the question of what are the products, which are “like”, or “directly competitive” to the investigated imports.

Unlike for “serious injury” or for “domestic industry”, the terms “like” and “directly competitive” are no further defined in the SA. So far, the Appellate Body has hardly had any chance to interpret those terms as they appear in Article XIX of the GATT 1994 and in Articles 2 and 4 of the SA.

The Appellate Body has however had a chance to rule generally on the meaning of those terms in the WTO provisions, where they appear several times. While it has admitted that the exact scope of these terms (particularly of the term “like product”) may vary (like an “accordion”) depending on the particular provision in which it appears, it has pointed to certain common criteria which apply to decide whether, in a given case, domestic and imported products are “like” or “directly competitive”:⁴⁰

- First, the “like products” category is a “subset” of the broader group of “directly competitive” products. In other words, only a part of products, which are directly competitive, is also “like”.
- Second, the notion of “likeness” is mainly focused on the physical characteristics of the products under comparison. “Like products” share properties, nature, qualities, and end uses. Their falling under the same tariff heading for classification purposes may also be revealing, in the case of a tariff schedule, which is sufficiently detailed. Thus, for example, white spirits have been found to be “like”, whereas white and brown spirits have been considered to be directly competitive. More recently, the Appellate Body has clarified that a difference in physical characteristics between two

³⁹ *Appellate Body Report, US – Lamb, para. 87.*

⁴⁰ *Appellate Body Report, Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages II), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R-11, adopted 1 November 1996, DSR 1996:I, 97 (pp. 20 ff.)*

similar products, which has a different impact on human health, may cast doubts on the “likeness” of such products.⁴¹

- Third, “direct competitiveness” focuses on “the marketplace”, that is on the competitive conditions on the importing country, starting from elasticity of substitution between the imports and the allegedly directly competitive domestic products.⁴² The way in which the domestic and imported products under comparison are advertised and consumed on the importing market is also relevant.

With regard to more specifically the notion of “like products” in the SA, there has been only one challenge to the findings of the domestic authorities concerning the likeness or the direct competitiveness of the domestic and imported products. In reviewing this challenge, the Appellate Body has excluded the contention that certain domestic products can be “like” investigated imports simply because they are in a “*continuous line of production*” to the domestic products which are “like” on the basis of the criteria outlined above.⁴³ This exclusion is unqualified. In particular, it is not conditional on whether or not separate data are or can be collected by domestic authorities for the genuine “like product” industry (unlike in the case of anti-dumping investigations).

Second, the Appellate Body has ruled out that domestic products can be considered “like” investigated imports because they are manufactured by producers who have a “*substantial coincidence of economic interests*” with that of the domestic producers of the genuinely “like” domestic products.⁴⁴

Third, the Appellate Body has excluded generally that *production structures* may have an impact on deciding whether two products are “like” or “directly competitive”. Thus, for example, the fact that a domestic producer, who makes, *inter alia*, products which are “like” the imports, has a vertically integrated structure, does not warrant the conclusion that the other products it makes through that vertically integrated structure are also “like” or “directly competitive” to the imports.⁴⁵

The rationale of these Appellate Body’s findings is that the focus of the SA is on products, not on production processes.

Under Article 2.1 of the SA, the domestic industry is made solely of the producers of the “like” or “directly competitive” products.⁴⁶ A safeguard measure is imposed on a specific “product”, namely, the imported product under investigation, and only if that specific imported product is having the required injurious effects on the domestic industry producing the like or directly

⁴¹ *Appellate Body Report*, European Communities – Measures Affecting Asbestos and Asbestos Containing Products (EC –Asbestos), *WT/DS135/AB/R*, adopted 5 April 2001, para. 118.

⁴² *Appellate Body Report*, Japan – Alcoholic Beverages II, (p. 25.)

⁴³ *Appellate Body Report*, US – Lamb, para. 90.

⁴⁴ *Appellate Body Report*, US – Lamb, paras. 89-90.

⁴⁵ *Appellate Body Report*, US – Lamb, para. 94.

⁴⁶ *Appellate Body Report*, US – Lamb, para. 81.

competitive products. It would thus be a clear departure from the text of Article 2.1 if a safeguard measure could be imposed because of the prejudicial effects of imports on domestic producers of products that are not like or directly competitive.

3.3.2 *The “Domestic Industry”*

The other criterion laid down in Article 4.1(c) to define the “domestic industry” is essentially a quantitative one, and focuses on the number and the representative nature of the producers constituting the domestic industry covered by the investigation. It is the requirement that the serious injury be found to occur either to the totality of the domestic producers or at least to a major proportion thereof.

There is, however, no clear indication as to what can constitute a “major proportion” of the domestic industry for the purposes of Article 4.1(c). As a consequence, the evaluation of whether this criterion is met is necessarily a case-by-case one, which depends on the specific circumstances of each investigation.

Nonetheless, the Appellate Body has at least clarified that the collection of data relating to the so called “injury factors” in Article 4.2(a) need neither cover the totality of the producers of the like or directly competitive products, nor even a major proportion. A serious injury finding can also be based on data collected for a part of the “major proportion”, provided that it is sufficiently representative.⁴⁷ The possibility of employing “statistically valid samples” has impliedly been recognized by the Appellate Body.⁴⁸

3.4 *The Determination of “Serious Injury”*

Once the like or directly competitive domestic products and the industry producing them are identified, the situation of such industry needs to be investigated to assess whether it corresponds to a situation of “serious injury” or of “threat of serious injury”. As regards specifically serious injury, Article 4.2(a) of the SA provides that

Article 4.2(a) SA

...the competent authorities shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment. Article 4.2(a)SA

⁴⁷ Appellate Body Report, US – Lamb, paras. 91-92, 132.

⁴⁸ Appellate Body Report, US – Lamb, para. 132.

The list above, which is not exhaustive, comprises the so-called “injury factors”.

“injury factors”

The domestic authorities must conduct a substantive evaluation of the “bearing” or the “effect” that such factors have on the situation of the domestic industry. By conducting such a substantive evaluation of the relevant factors, competent authorities are able to make a proper overall determination as to whether the domestic industry is seriously injured or threatened with such injury.⁴⁹

The Appellate Body has extended to the safeguard sector its finding, made in the Thailand - H-Beams⁵⁰ case in connexion with the review of an anti-dumping measure, that the arguments reviewed are not confined to those raised in the proceedings before the domestic authorities:

Appellate Body Report, US-Lamb

...The parties involved in an underlying anti-dumping investigation are generally exporters, importers and other commercial entities, while those involved in WTO dispute settlement are the Members of the WTO. Therefore, it cannot be assumed that the range of issues raised in an anti-dumping investigation will be the same as the claims that a Member chooses to bring before the WTO in a dispute.⁵¹ Appellate Body Report, US - Lamb

“formal aspect”

The examination of the injury factors by the domestic authorities has a formal and a substantive aspect.⁵² The formal aspect requires the domestic authorities to evaluate all relevant factors (and possibly relevant “other factors”).⁵³ Failure to account, in full or in part, for the trend in one of the relevant factors automatically results in a violation of Article 4.2(a).⁵⁴

The substantive aspect entails an evaluation and a reasoned and adequate explanation by the domestic authorities of how the facts support their conclusion that the domestic industry is suffering or is threatened with “serious injury”.⁵⁵

Likewise, panel review of safeguard measures entails a formal aspect and a substantive aspect. It should be noted that a claim under Article 4.2(a) might not relate at the same time to both the formal and the substantive aspect of the review. For instance, the claim may be that, although the competent authorities evaluated all relevant factors, their explanation is either not reasoned or not adequate.

Since the injury factors list is not exhaustive, it is possible that other, additional

⁴⁹ Appellate Body Report, US – Lamb, para. 104.

⁵⁰ Appellate Body Report, Thailand – Anti-Dumping Duties on Angels, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland (Thailand - H-Beams), WT/DS122/AB/R, 12 March 2001, adopted 5 April 2001

⁵¹ Appellate Body Report, US – Lamb, paras. 112, quoting from Appellate Body Report Thailand - H-Beams, para.94

⁵² Appellate Body Report, US – Lamb, para. 103.

⁵³ Appellate Body Report, Argentina – Footwear (EC), para. 136; Appellate Body Report, US – Wheat Gluten, para. 55; Appellate Body Report, US – Lamb, para. 103.

⁵⁴ Panel Report, Korea – Dairy, paras. 7.58, 7.63, 7.68, 7.69, 7.75, 7.76, 7.78.

⁵⁵ Appellate Body Report, US – Lamb, para. 103.

“factors” may have an impact on the situation of the domestic industry and thus be relevant in a particular case. These other factors are often brought to the attention of the domestic authorities by responding exporters in order to show that a finding of serious injury is not warranted. They may either have a bearing on the interpretation of the listed factors, or have a relevance of their own.

For example, in calculating the profitability of the domestic industry, domestic authorities may be confronted with aggregated data also relating to different products of the same plants. Clearly, unless the costs and profits are allocated to the different production lines, there is a risk that the profitability performance for the like or directly competitive products may be biased by data relating to other products. Thus, the fact that “co-products” may result from the same broad production process, but have different costs, is one “other factor” which must be investigated and evaluated by the domestic authorities.

The Appellate Body has also clarified that domestic authorities do not have an unlimited open-ended duty to investigate all possible other factors.⁵⁶ However, if some element is brought to their attention, or if they have reason to suspect that some other factor may be relevant, they must investigate, evaluate and take into account such other factor, or explain why it is not relevant. This requirement to investigate on one's own volition suffers from an inherent limit, since complete control over the information available to domestic authorities may prove arduous, so may also be reviewing whether such authorities correctly examined the “other factors”.

It is not necessary for a finding of “serious injury” that all such factors - whether listed or not - show a declining trend for the domestic industry.⁵⁷ Thus, for example, declining capacity utilization and employment coupled with a marked increase in imports may be sufficient to justify a finding of serious injury even if profitability may still show a positive sign.

So far, panel review of how domestic authorities evaluated the injury factors has not been extremely sophisticated. The reason is presumably that the claims brought under Article 4.2(a) so far mostly related to measures which were clearly in violation of such requirements. Thus, for example, in the first dispute settlement proceeding brought under the SA (Korea - Dairy), several factors in the list had simply not been examined and accounted for by the domestic authorities in the measure under review.

It is not to be excluded that, as happened in other areas, some interpretations developed relative to dumping practice be imported into the safeguards practice also with respect to the analysis of the injury factors.

⁵⁶ *Appellate Body Report, US – Wheat Gluten, paras. 55-56.*

⁵⁷ *Appellate Body Report, US – Lamb, paras. 132, 144, 146.*

3.5 Threat of Serious Injury

Article 4.1 (b)

The analysis required for a finding of “threat of serious injury” is largely similar to that required for a “serious injury” finding. Article 4.1(b) of the SA, when defining threat of serious injury, refers to Article 4.2, regulating determinations of actual “serious injury”. The Appellate Body has underlined such similarity, recalling that the very high standard implied in the term “serious injury” must be borne in mind also when making a determination of “threat of serious injury”.⁵⁸ Some differences result, however, from the different focus of the two notions.

A determination of “threat of serious injury” is future-oriented,⁵⁹ in the sense that it is concerned with a future event. Furthermore, the materialization of serious injury in the future is not entirely sure.

However, under Article 4.1(b) such a determination must be based on facts, not on conjecture. Since facts relate to the present or past, there is a tension between the future oriented analysis, which ultimately calls for a degree of extrapolation about the likelihood of a future event, and the need for a fact-based determination.⁶⁰

Article 4.2 provides that it must be “clearly imminent”. The Appellate Body has interpreted such requirement in US-Lamb. The use of the term “imminent” has to do with the timing of the materialization, and it implies that the anticipated “serious injury” must be on the very verge of occurring.

The use of the term “clearly” indicates that there must be a high degree of likelihood that the threat will materialize very soon. Together with the requirement that a finding of serious injury must be based on facts, not on conjectures, it also relates to the factual demonstration of the existence of the threat, and it suggests that the imminence must be manifest.⁶¹

Another difference with the case of actual serious injury is that in the case of threat determinations, the most recent part of the investigation period is even more important, because it will provide the strongest indications of the future state of the domestic industry.⁶²

3.6 Causation

Apart from examination of all relevant “injury factors”, under Article 4.2(b) of the SA, a determination of the existence of “serious injury” requires a demonstration of “the causal link between increased imports and serious injury or threat”.

⁵⁸ Appellate Body Report, US - Lamb, para. 126.

⁵⁹ Appellate Body Report, US - Lamb, para. 136.

⁶⁰ Appellate Body Report, US - Lamb, para. 136.

⁶¹ Appellate Body Report, US - Lamb, para. 125.

⁶² Appellate Body Report, US - Lamb, para. 137.

“causal link”

The assessment of “causation” is a two-step process, since Article 4.2(b) establishes two distinct legal requirements for competent authorities in the application of a safeguard measure. First, there must be a demonstration of the “existence of the causal link between increased imports of the product concerned and serious injury or threat thereof”. Second, the injury caused by factors other than the increased imports must not be attributed to increased imports.⁶³ The latter is often referred to as the “non attribution” requirement.

In addition, under Article 4.2(c) of the SA domestic authorities are required to publish promptly a detailed analysis of the case under investigation and a demonstration of the relevance of the factors examined. This is a specification of the general requirement to set forth reasoned conclusions on all pertinent issues of fact and law in Article 3.1 [infra, section 5].

As a practical matter, the examination of the “injury factors” pursuant to Article 4.2(a) will often be relevant not only for the determination of “serious injury” or of “threat of serious injury”, but also for the determination of whether the injury has been caused by the increased imports or by the “other factors”. This link is acknowledged by the text of Article 4.2(b), which regulates causation but refers back to the “injury factors” mentioned in subparagraph (a).

The issue of causation is a difficult one and has given rise to considerable controversy. This has offered the Appellate Body an opportunity to clarify the interpretation of the requirement in Article 4.2(b). This interpretation has been summarized in its reports in US - Lamb and US - Line Pipe.

With respect to the first step of the causation analysis, the Appellate Body has indicated that to establish causation pursuant to Article 4.2(b), it is not necessary to show that increased imports alone - on their own - must be capable of causing serious injury.⁶⁴ It should be clarified that this finding only relates to the issue of whether causation exists between the increased imports and the situation of the domestic industry. As will be clarified below, it does not affect the question of the permissible extent of the safeguard measure.

“non attribution”

With regard to the “non-attribution” step, the Appellate Body has summarized the interpretation of Article 4.2 as follows:

Appellate Body Report, US-Lamb

...In a situation where several factors are causing injury “at the same time”, a final determination about the injurious effects caused by increased imports can only be made if the injurious effects caused by all the different causal factors are distinguished and separated. Otherwise, any conclusion based exclusively on an assessment of only one of the causal factors - increased imports - rests on an uncertain foundation, because it assumes that the other causal factors are not causing the injury which has been ascribed to increased

⁶³ Appellate Body Report, US - Line Pipe, para. 208.

⁶⁴ Appellate Body Report, US - Wheat Gluten, para. 70; Appellate Body Report, US - Line Pipe, para. 209.

imports. The non-attribution language in Article 4.2(b) precludes such an assumption and, instead, requires that the competent authorities assess appropriately the injurious effects of the other factors, so that those effects may be disentangled from the injurious effects of the increased imports. In this way, the final determination rests, properly, on the genuine and substantial relationship of cause and effect between increased imports and serious injury.⁶⁵

In other words, domestic authorities must:

**Appellate Body
Report, US - Lamb**

...[ensure] that the injurious effects of the other causal factors...[are]...not included in the assessment of the injury ascribed to increased imports.⁶⁶

The Appellate Body also concluded that, since the domestic authorities are required to separate and distinguish the effects of “other factors” from those of increased imports, the authorities are required to identify:

**Appellate Body
Report, US - Line Pipe**

... “the nature and extent of the injurious effects of the known factors” as well as “a satisfactory explanation of the nature and extent of the injurious effects of the other factors, as distinguished from the injurious effects of the increased imports”.⁶⁷

The Appellate Body has further referred to the procedural obligation of competent domestic authorities to provide an explanation as regards their determinations. Building on such obligation, it concluded that:

**Appellate Body
Report, US - Line Pipe**

...to fulfil the requirement of Article 4.2(b), last sentence, the competent authorities must establish explicitly, through a reasoned and adequate explanation, that injury caused by factors other than increased imports is not attributed to increased imports. This explanation must be clear and unambiguous. It must not merely imply or suggest an explanation. It must be a straightforward explanation in express terms.⁶⁸

Thus, for example, if the domestic authorities recognize that certain “other factors” are actually causing injury to the domestic industry, they must also assess the injurious effects of these other factors and explain what injurious effects these had on the domestic industry. They cannot only state that a given “other factor” hurts the domestic industry, they must evaluate it and estimate how it may evolve or disappear.⁶⁹

Also, domestic authorities cannot replace an appreciation of what the effects of the “other factors” on the domestic industry are by simply comparing the

⁶⁵ Appellate Body Report, US - Lamb, para. 179.

⁶⁶ Appellate Body Report, US - Lamb, para. 185.

⁶⁷ Appellate Body Report, US - Line Pipe, para. 213.

⁶⁸ Appellate Body Report, US - Line Pipe, para. 217.

⁶⁹ Appellate Body Report, US - Lamb, para. 185.

impact of each of them to the impact of increased imports. A comparative test (weighing the relative impact of imports and of other factors against one another) is no substitute for the test set out in Article 4.2(b).⁷⁰

The Appellate Body also excluded that the mere assertion by the domestic authorities that injury caused by other factors has not been attributed to increased imports, with no further explanation, be sufficient to meet the requirement of Article 4.2(b). To decide whether domestic authorities have met the standard of Article 4.2(b) the investigation report, not the information provided in subsequent dispute settlement procedures, is relevant.⁷¹ This is consistent with the principle that the causal link must be demonstrated and accounted for by the domestic authorities before taking the measure.

3.7 Test Your Understanding

1. **The competent domestic authorities of country X open a safeguard investigation against imports of lamb meat. Many domestic producers of lamb meat directly grow the cattle that they then slaughter and sell as meat. Can domestic authorities incorporate the cattle-growing activity in the definition of domestic industry for the purpose of assessing “serious injury” or “threat of serious injury”? Should the answer change if the domestic authorities included growers, which did not also slaughter and sell their cattle as meat?**
2. **An administering authority, investigating injury allegedly caused by dumped tomato imports, determines that inventories are not a relevant injury factor for such a highly perishable product and therefore does not evaluate it in the definitive measure. Is this legal?**
3. **The investigating authority finds that the volume of imports has consistently decreased during the past three years. Can it nevertheless find that injury has been caused by imports?**
4. **Country X imposes a safeguard measure on imports of line pipe, on the basis of a threat finding. The line pipe market has cyclical trends, because it follows the trends in the oil industry (drilling and refining).**
 - (a) **During the last three years of the investigation period, imports decreased, both in absolute terms and relative to domestic production.**
 - (b) **During the last two years of the investigation period, imports increased, but this period corresponded to the peak in the industry's cycle, to which in the past a recession used to follow, irrespective of import trends.**

⁷⁰ Appellate Body Report, *US - Lamb*, para. 184.

⁷¹ Appellate Body Report, *US - Line Pipe*, para. 220; Appellate Body Report, *US - Lamb*, para. 184.

5. **Could the domestic authorities rely on an increase in imports in the (a) case? and (b)**
6. **The competent authorities of country X realize that part of the significant overall impairment to the domestic industry results from the fact that a longstanding subsidy to the production of products, which are directly competitive to the imports, was discontinued. However, they conclude that the impact of such event is not as important as that of the imports, and therefore make a finding of “serious injury”. Is this consistent with Article 4 of the SA?**

4. REMEDIES

This Section shows the detailed requirements relating to safeguard measures. It covers, inter alia, duration and types of permitted safeguard measures, as well as formalities in connexion with the imposition of measures and actions allowed to re-establish the balance of rights and obligations after the taking of such measures. Concepts such as “provisional measure”, “compensation” and “suspension of substantially equivalent concessions or obligations” are analysed.

4.1 Introduction

As “emergency” actions against “fair trade” [supra, section 1.1], safeguard measures are typically temporary import restraints to allow some “breathing time” to the domestic industry for adapting to a new market situation, including through appropriate restructuring.

In principle, the adoption of safeguard measures must be preceded by a thorough investigation to assess in particular that the conditions set out in Articles 2 to 4 of the SA are fulfilled. Exceptionally, however, the SA allows anticipation of safeguard relief through provisional measures (Article 6). Both definitive and provisional measures are addressed below.

Unlike in the case of anti-dumping or countervailing measures, safeguard measures are not typified, that is, they are not limited to particular types or forms. Indeed, Article XIX:1 of the GATT 1994 very generally refers to the possibility of suspending obligations or withdrawing or modifying tariff concessions granted under its provisions, and this for such time as may be necessary to prevent or remedy the serious injury inflicted or threatened by the imports under investigation. In practice, under GATT 1947 safeguard import relief in the proper sense of the term has mostly taken the form of increased tariffs (including tariff quotas), surcharges, quantitative restrictions, and import authorizations.⁷²

Article 11.1 (b)

The situation has not fundamentally been changed by the SA (which, in Article 11.1(a), refers back to Article XIX of the GATT 1994), except in one important respect. Article 11.1(b) has expressly prohibited the so-called “grey area” measures (“voluntary export restraints”, “orderly marketing arrangements” or similar measures, that is measures entailing limitations of exports by the exporting countries or sometimes by the exporters directly, rather than import limitations by the importing country). Existing “grey area” measures were to be phased out by 1999 at the latest.

⁷² See *Analytical Index to the GATT, 1995, Vol. 1, pp. 539 ff.*

4.2 Definitive Measures

Article 5.1 SA

Pursuant to the first sentence of Article 5.1 of the SA, all safeguard measures can be applied “only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment of the domestic industry”.

This sentence has been interpreted in the sense that it does not require the competent domestic authorities to provide, at the time they impose a measure, a clear and specific justification as to how such measure is necessary (having regard to its scope, level and type) to prevent or remedy the serious injury and to facilitate adjustment of the domestic industry.⁷³ However, in case a measure is imposed without the substantive requirements of the SA being satisfied, in particular if the measure counters injury or threat thereof not caused by the imports found to have increased, the measure exceeds what is “necessary”. As a consequence, there is a rebuttable presumption (a “prima facie case”) that such measure violates the first sentence of Article 5.1.⁷⁴

Furthermore, if a Member chooses to provide safeguard relief in the form of a quantitative restriction, pursuant to the second sentence of Article 5.1, the measure must not reduce the quantity of imports below the level of a recent period (i.e. the average of imports in the last three representative years for which statistics are available), unless clear justification is given that a different level is necessary to prevent or remedy serious injury. In other words, in this particular case a specific justification of the necessity of the measure at the time it is taken is required.⁷⁵

Article 5.2 (a) SA

As to quantitative restrictions, Article 5.2(a) also lays down specific rules applicable to the allocation of quotas between supplying countries. The Member intending to apply the measure may seek agreement of substantial supplying Members as to such allocation. In the absence of an agreement, the allocation should be based on the respective shares of the supplying Members over a previous representative period, adjusted so as to take account of special factors which may have affected or may be affecting the trade in the product concerned.

Article 5.2 (b) SA

The quota levels may be modulated differently from past market shares upon the importing Member showing good cause in accordance with Article 5.2(b) of the SA and with other substantive and procedural requirements. First, departure from Article 5.2(a) is only allowed if a measure is taken to remedy serious injury, not merely a threat. Second, prior consultations must have been held with the supplying Members. Third, the importing Member must show clearly to the Committee on Safeguards that (1) imports from certain Members have increased in disproportionate percentage compared to the overall increase in imports, (2) the derogation is overall justified, and (3) the

⁷³ Appellate Body Report, *Korea - Dairy*, para. 99; Appellate Body Report, *US - Line Pipe*, paras. 133-134.

⁷⁴ Appellate Body Report, *US - Line Pipe*, paras. 242-243, 261.

⁷⁵ Appellate Body Report, *Korea - Dairy*, para. 99.

conditions of such a departure are equitable to all suppliers of the product concerned. Last, a measure taken on this basis cannot last longer than four years.

Article 5.2 of the SA echoes Article XIII:2(d) of GATT 1994. The latter article, primarily aiming at quantitative restrictions, also applies to tariff quotas by virtue of the express extension to such measures in its paragraph 5. By contrast, in the absence of an express extension, the applicability of Article 5.1, first sentence and 5.2 of the SA to tariff quotas was ruled out in the US - Line Pipe case.⁷⁶ Accordingly, the allocation of tariff quotas taken as safeguard measures can only be challenged under Article XIII of the GATT 1994, not under Article 5.2 of the SA.

4.3 Duration of Definitive Safeguard Measures

Article 7.1 SA

In line with the nature of safeguard measures as emergency temporary relief to the domestic industry, several provisions are laid down in the SA to regulate duration.⁷⁷ Article 7.1 of the SA only allows safeguards “for such period of time as may be necessary to prevent or remedy serious injury and to facilitate adjustment”.

4.3.1 The General Rules

Article 7.4 SA

More specifically, the initial period of application of definitive safeguard measures must not exceed four years, including the duration of provisional measures, if applied (Articles 6 and 7.1 of the SA).

In addition, safeguard measures exceeding one year's duration must be progressively liberalized at regular intervals during the period of their application (Article 7.4 of the SA). If, moreover, the duration of the measure exceeds three years, the Member applying the measure must review the situation not later than the mid-term of the measure and, if appropriate, withdraw it or increase the pace of liberalization.

For measures existing at the entry into force of the WTO Agreement, Article 10 provided for termination at the latest five years after such entry into force.

4.3.2 Extensions

The original duration of a definitive safeguard measure may be extended, but only if (1) such a measure continues to be necessary to prevent or remedy serious injury and (2) there is evidence that the domestic industry is adjusting (Article 7.2). These conditions are partly different from those set out in the first sentence of Article 5.1 of the SA for initial application. Since reference is made to the fact that the measure continues to be necessary, one must arguably

⁷⁶ Panel Report, *US - Line Pipe*, para. 7.75.

⁷⁷ Working Party Report, *US - Hatters' Fur*, p. 18, para. 50.

have regard to economic data relating to the period subsequent to the initial imposition of the measure. In addition, adjustment of the domestic industry must demonstrably have begun.

Article 7.3 SA

In the case of extension, the total period of application, including provisional measures, must in any event not exceed eight years (Article 7.3 of the SA).

If the period of application of a measure is extended, the extended measure shall not be more restrictive than it was at the end of the initial period, and should continue to be liberalized if exceeding one year in total.

4.3.3 New Measures

“cooling off period”

Not only is the duration of safeguard measures regulated by the SA. The SA also makes sure that the repeated application of safeguard measures with respect to the same product is limited. This is to avoid that temporary import protection is in practice turned into a permanent closure of the domestic market by way of a series of separate measures. Allowing reiterated safeguard measures on the same products would also circumvent the four-year and eight-year deadlines set out for initial application and extension of a (single) measure. This is why Article 7 of the SA also imposes a “cooling off” period after expiry of a measure before a new one can be applied to the same products.

In principle, a safeguard measure may not be applied again to a product until a period of time equal to the duration of the initial measure (or at least two years) has expired (Article 7.5 of the SA). However, if the first safeguard measure lasted no longer than 180 days, a new one may be applied to the same product if (1) at least one year has elapsed since the introduction of the first safeguard measure, and (2) the same product has not been the subject of a safeguard measure more than twice in the five-year period immediately preceding the introduction of the new measure.

4.3.4 Developing Countries

Article 9.2 SA

Article 9.2 of the SA allows developing country Members, as users of safeguard measures, additional flexibility as to the duration. Such Members may apply safeguard relief for a total of up to ten years, rather than eight as provided for in Article 7.3 of the SA. Furthermore, the “cooling off” period for applying a new safeguard measure on the same period is only half of the duration of the original measure (though the minimum two-year interval must be maintained).

4.4 Provisional Measures

Article 6 SA

The requirements for imposing provisional safeguard measures are set out rather summarily in Article 6 of the SA and have not yet been clarified through panel or Appellate Body interpretation. It is therefore not easy to comment and anticipate how they may be interpreted should provisional measures be reviewed in dispute settlement procedures.

Article 6 of the SA authorizes the taking of provisional safeguard measures in “critical circumstances”. Those are defined as circumstances “where delay would cause damage which it would be difficult to repair”.

In addition, the application of a provisional measure is premised on a preliminary determination that there is clear evidence that the increased imports have caused or are threatening to cause serious injury.

Provisional measures may only take the form of tariff increases. They may be applied for a maximum of 200 days. This duration cannot be extended, and Article 6 of the SA further provides that it is counted for the purposes of calculating the initial period and any extension referred to in Article 7.1, 2 and 3.

Pending the duration of the provisional measure, the Member applying it must make sure that the conditions set out in Articles 2 through 7 and 12 of the SA are met. However, if the subsequent investigation does not determine that increased imports have caused or threaten to cause serious injury, provisional measures shall lapse and the duties perceived must be promptly refunded.

The reference to the “subsequent investigation” (that is, following the imposition of the provisional measure) may indicate that a provisional measure may be imposed without a fully-fledged investigation [*supra*, sections 2 and 3; *infra*, section 5]; provided, of course, that the domestic authorities have made a preliminary determination that there is clear evidence that increased imports have caused or are threatening to cause serious injury, and presumably, that there are “critical circumstances”. This inference may be confirmed by the fact that only after the imposition of the provisional measures is a Member required under Article 6 of the SA to meet the conditions in Articles 2 through 7 (amongst which are those relating to the investigations).

4.5 Non-Discriminatory Application of Safeguard Measures

Article 2.2 SA

Article 2.2 of the SA provides that safeguard measures must be applied to imports “irrespective of their source”. The application of safeguards on a “most-favoured-nation” (MFN) basis, that is, without discriminating between supplying Members, is a major guiding principle of the SA and indeed a fundamental achievement compared to Article XIX of the GATT. The possibility to apply “selective” safeguard measures (that is, only against certain supplying countries) was hotly debated under GATT 1947.⁷⁸

A specific question relating to non-discriminatory application of safeguard measures is whether a Member can exclude products originating in its partners in a Free Trade Area (FTA) or a Customs Union (CU) from a safeguard measure (thus discriminating against other WTO Members). It must be recalled that

⁷⁸ See *Analytical Index to the GATT, 1995, Vol. 1, p. 519.*

Article XXIV of the GATT 1994 allows, in order to facilitate deeper economic integration between members of a FTA or a CU and under certain conditions, departures from the MFN obligation and other GATT provisions. In other words, it allows members of a FTA or a CU to agree further liberalization, which need not be extended to other WTO Members.

It is however debated whether the exclusion of FTA or CU partners from safeguard measures is one of the permissible departures. The issue is further complicated by the fact that Article XXIV only refers to GATT rules (thus, in principle, it does not cover derogations from other WTO provisions, such as Article 2.2 of the SA). The Appellate Body recently reversed a panel's finding that such departure was permissible, but did not itself rule on the issue.⁷⁹

Article 2.1 SA

"parallelism"

In addition to the non-discrimination principle in paragraph 2, Article 2.1 of the SA has been interpreted by the Appellate Body to embody the so-called "parallelism" requirement. In accordance with this principle, the scope of a safeguard measure must correspond to the scope of imports which were investigated and in respect of which the requirements for the imposition of safeguard measures ("increased imports", "serious injury" or threat thereof, and "causation") were established.⁸⁰

This means, for example, that exclusion of imports from certain supplying Members from a measure is not warranted if the requirements for imposition of the measure have been assessed also considering the imports from such Members.

Thus, ultimately, discrimination between "sources" within the meaning of Article 2.2 may also result from failure to respect the "parallelism" between the imports subject to the investigation and those subject to the safeguard measure. The Appellate Body has considered that if a WTO Member has imposed a measure after conducting an investigation on imports from all sources, it is also required under Article 2.2 of the SA to apply such measure to all sources (including partners in a FTA).⁸¹

Notwithstanding the non-discrimination obligation in Article 2, WTO Members are obliged not to apply safeguard measure to imports from developing countries if below certain thresholds [infra, section 7].

4.6 Compensation and Suspension of Substantially Equivalent Obligations

Article 8.1 SA

The adoption of safeguard measures represents a temporary departure of the importing WTO Member from its obligations. This breaches the balance of rights and obligations vis-à-vis the affected WTO Members. Therefore, Article

⁷⁹ Appellate Body Report, *US - Line Pipe*, para. 263, point (f).

⁸⁰ Appellate Body Report, *Argentina - Footwear (EC)*, para. 111; Appellate Body Report, *US - Line Pipe*, para. 197.

⁸¹ Appellate Body Report, *Argentina - Footwear (EC)*, para. 112.

8.1 of the SA requires such Member first of all to endeavour to maintain a substantially equivalent level of concessions and other obligations with respect to affected exporting Members.

To attain this objective, the importing Member may first negotiate trade compensation with the affected Members for the adverse effects of the measure.

However, without an agreement within 30 days, the affected exporting Members individually may suspend substantially equivalent concessions and other obligations vis-à-vis the Member imposing the safeguard measure. The right to suspend “substantially equivalent concessions” was already set out in Article XIX:3 of the GATT and was exercised under GATT 1947. The right is conditional upon the notification of the proposed suspension measure to the Council for Trade in Goods and the non-disapproval by such body. The authorization procedure must be completed within 90 days of the application of the safeguard measure (Article 8.2 of the SA).⁸²

Article 8.3 SA

While confirming the right to suspend equivalent concessions, the SA has introduced an additional constraint on its exercise. Article 8.3 of the SA provides that the right to suspend substantially equivalent concessions and other obligations cannot be exercised during the first three years of application of a safeguard measure if two conditions are met: (1) the measure is taken based on an absolute increase in imports, and (2) otherwise conforms to the provisions of the Agreement.

Practice under Article 8.3 of the SA is very limited so far and has not been reviewed in dispute settlement. The two above-mentioned conditions in Article 8.3 just mentioned have been interpreted in the sense that suspension of equivalent concessions may be exercised without waiting for three years if either condition is not fulfilled. A consequence of such interpretation is, for example, that a measure based on a relative increase in imports [supra, section 2.4.1] may entitle the immediate exercise of the right to suspend equivalent concessions or other obligations.

It has also been advanced that the decision as to whether a measure “otherwise conforms to the provisions of the Agreement” is reserved to multilateral dispute settlement, not to the Member seeking suspension of equivalent concessions. In accordance with this interpretation, a Member affected by a safeguard measure deferred actual suspension of substantially equivalent concessions, which had been authorized within the 90-day deadline in Article 8.2, until after the adoption of dispute settlement reports by the DSB finding the measure incompatible.⁸³

⁸² *Certain WTO Members have notified their agreement to postpone the 90-day deadline applicable in a particular case. In practice, this means that the Member affected by a safeguard measure renounces to carry out Article 8.2's authorization procedure, and thus enforcement of its right, until a later date. While it is unclear from the text of Article 8.2 that such deadline may be derogated by agreements among some or all the Members concerned by a safeguard measure, it is clear that such “agreements” are not “covered agreements” within the meaning of Article 1.1 of the DSU. Accordingly, in case of violation they are not enforceable through dispute settlement procedures.*

⁸³ See Doc. G/L/251, G/SG/N/12/EEC/1, 3 August 1998, p. 2.

4.7 Formal Requirements of the Imposition of Safeguard Measures

Article 8 and 12 SA

The various activities in connexion with the application of the SA are subject to transparency requirements in the form of notifications and consultations. These are primarily regulated in Articles 12 and 8 of the SA.

The initiation of safeguard investigations, the making of a finding that the domestic industry has suffered or is threatened with serious injury caused by increased imports, and the decision to apply or extend safeguard measures (including provisional measures) are all subject to an obligation of immediate notification to the Committee on Safeguards (Articles 12.1 and 12.4 of the SA) [infra, section 6.3].

To facilitate the discharge of this duty, special forms and guidelines have been drawn up by the Committee on Safeguards, and a Technical Cooperation Handbook on Notification Requirements has also been prepared by the WTO Secretariat.⁸⁴

The notifications concerning the injury findings and the measure proposed must supply “all pertinent information”, including evidence of serious injury or threat, product description and details of the proposed measure (entry into force, duration, timetable for progressive liberalization). In the case of an extension, evidence of adjustment of the domestic industry must additionally be provided.

Prior to imposing safeguard measures, WTO Members must also offer the exporting Members adequate opportunity for consultation (Article 12.3 of the SA). The consultations must cover all the matters to be addressed in the notifications (including the measure proposed), as well as the possible ways, for the importing Member, to maintain the balance of its concessions vis-à-vis the exporting Members, in accordance with Article 8.1 of the SA. It would appear that, for provisional measures, consultations may still be held immediately after adoption of the measures, as provided for in Article XIX:2 of the GATT 1994.

The result of consultations pursuant to Article 12, Article 8 the proposed suspension of substantially equivalent concessions under Article 8.2 and, the results of mid-term reviews under Article 7.4, are also subject to notification, pursuant to Article 12.5 of the SA.

4.8 Test Your Understanding

- 1. A WTO Member takes a provisional measure in the form of a tariff quota. Is this allowed?**

⁸⁴ See Docs. G/SG/1, 1 July 1996 and WT/TC/NOTIF/SG/1, 15 October 1996.

2. **A provisional measure is not confirmed within the 200 days of its duration. Must duties levied be refunded?**
3. **A developing country imposes a safeguard measure for five years. Is this allowed?**
4. **A WTO Member notifies a safeguard measure it proposes to take. After that, a measure is eventually taken and it differs from the one which had been notified. Is the notification obligation complied with?**
5. **A WTO Member initiates an investigation against widgets. In the course of the investigation it realizes that its domestic industry is particularly affected by very low priced imports of widgets from one particular WTO Member, whereas the rest of the imports of widgets, coming from three other WTO Members, are in very small quantities and at prices comparable to those charged by the domestic industry. Can it focus its safeguard measure on the low priced imports from one particular Member?**

5. THE DOMESTIC PROCEDURES

The adoption of a safeguard measure by a WTO Member is premised on the carrying out, by its competent authorities, of an investigation to assess whether the relevant conditions and WTO requirements are met. The following sections review the main obligations imposed on the domestic authorities and the rights conferred on the interested parties in this connexion.

5.1 Overview of Articles 3, 6 and 12SA

The SA contains far fewer procedural rules than the other two WTO texts regulating the use of trade defence instruments - the Anti-Dumping Agreement and the Subsidies and Countervailing Measures Agreement. For example, the SA contains no indication or limitation as to who has standing to request the initiation of a safeguard investigation - a choice that is left to the several domestic safeguard regulations. Unlike in the area of anti-dumping measures (and indeed of countervailing measures), the SA is the first text developing the basic GATT provision. This is presumably one reason why procedural obligations are very little developed. Essentially, they are contained in Articles 3, 6 and 12 of the SA.

The SA first provides that the investigations have to be conducted in accordance with procedures previously established and published. These must also be notified to the Committee on Safeguards (Article 12.6), the body established to oversee the functioning of the SA [infra, section 6.3].

Furthermore, initiation of safeguard investigations must be the subject of public notice (Article 3.1).

Third, during the investigation interested parties must be given an opportunity to present evidence and arguments and to respond to the evidence and arguments presented by other parties.

Fourth, if, in the course of an investigation, the competent authorities receive information, which is confidential by its nature or is provided on a confidential basis, they cannot disclose it without permission of the party submitting it, provided certain conditions are met (Article 3.2).

Fifth, a detailed report setting forth the domestic authorities' findings and reasoned conclusions on all pertinent issues of fact and law must be published at the end of the safeguard investigation (Article 3.1).

For provisional measures, at least a preliminary affirmative determination that there is clear evidence of serious injury caused by increased imports and that there are "critical circumstances" must be provided (Article 6).

Finally, it may be added that the SA provides that initiation of investigations, findings of serious injury/threat of serious injury and decisions to apply or extend safeguard measures must be notified to the Committee on Safeguards (Article 12.1).

5.2 Obligation to State Reasons

Article 3.1 SA

The obligation to state the reasons for taking a safeguard measure is set out in general terms in Article 3.1 of the SA:

...The competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law. Article 3.1SA

This rather sweeping language also covers, for example, the “other factors” which the domestic authorities have or should have examined when assessing serious injury or threat of serious injury [supra, section 3.4], or other information not specifically referred to in the SA but which the domestic authorities nonetheless found relevant. Likewise, if additional or different information from that originally set out in a published report is actually retained as the basis for a safeguard measure, this additional information and alternative justifications must be stated.⁸⁵

Also, if contrary facts or arguments to those retained by the domestic authorities as the basis for their decision have been brought to their attention, they are required to address these possible additional explanations and state the reasons why they are not sufficiently strong to warrant a different conclusion.⁸⁶

In addition to the general obligation set out in Article 3.1, Article 4.2(c) of the SA specifies, in respect of serious injury, that the competent authorities shall publish promptly a detailed analysis of the case under investigation as well as a demonstration of the relevance of the “factors” examined.

Failure to state reasons is relevant in two ways. First, it results in a formal defect of the measure, regardless of whether such measure is objectively justified by the facts before the domestic authorities, or which the domestic authorities should have investigated. This amounts to a violation of Article 3.1 of the SA.

Furthermore, failure by the domestic authorities to address some of the SA requirements in the reasoning of a measure or in separate published reports amounts to failure to show that these requirements were met. It therefore warrants a finding of a violation of such requirements. In other words, the reasoning in the safeguard measure and in the additional reports containing the findings of the domestic authorities also provide the benchmark to review compliance with the obligations in e.g. Article 2 or 4 of the SA.

⁸⁵ Appellate Body Report, *US - Wheat Gluten*, para. 55.

⁸⁶ Appellate Body Report, *US - Lamb*, paras. 159-161.

Not only does the foregoing apply to the conditions set out in the SA, it also applies to those in Article XIX of the GATT 1994, since that provision and the SA are to be applied together. Thus, for example, in *US - Lamb* the Appellate Body found, in respect of the requirement of “unforeseen developments”, a violation of Article XIX:1 of the GATT 1994 because the relevant investigation report did not discuss, demonstrate or even explain how such requirement was met.⁸⁷ In addition, it noted that Article 3.1 of the SA, by requiring the domestic authorities to set forth their findings and reasoned conclusions on all pertinent issues of fact and law, also requires such authorities to include a finding or reasoned conclusion on “unforeseen developments”.⁸⁸

5.3 Procedural Rights - Confidential Information

“due process rights”

The procedural rights (sometimes also referred to as “due process rights”) of the parties to a safeguard investigation are summarily set out in Article 3.1 and include:

- the right to be informed, through public notice, of the initiation of an investigation
- the right to be heard or to be provided other appropriate means to present evidence and views on the case (including the opportunity to respond to the presentations of other parties and to submit views on whether the application of a measure would be in the public interest).

Article 3.1 confers these rights on “all interested parties”. The parties most directly “interested” in an investigation are the domestic producers, foreign producers (exporters) and domestic importers, and indeed, importers and exporters are expressly referred to in Article 3.1. However, the term “interested parties” is sufficiently broad to be interpreted as covering exporting WTO Members and possibly industry associations, unions and consumer associations. Who will be considered “interested parties” in a given case is left to the domestic rules and procedures of the several WTO Members.

As for the treatment of confidential information, pursuant to Article 3.2 of the SA, the competent domestic authorities cannot disclose information which is confidential by its nature or is provided on a confidential basis without permission of the party submitting it, provided two conditions are met. On the one hand, confidential treatment must be genuinely justified. On the other hand, parties providing confidential information may be requested to provide a non-confidential summary of such information, or explanation why the information cannot be summarized.

If confidential treatment is not justified in the view of the domestic authorities and the parties supplying the relevant information refuse disclosure in a non-confidential form, the domestic authorities may disregard such information

⁸⁷ *Appellate Body Report, US - Lamb, paras. 72-73.*

⁸⁸ *Appellate Body Report, US - Lamb, para. 76.*

unless its veracity and correctness is demonstrated through sources other than the confidential one.

The provisions protecting confidential information in domestic safeguard procedures are intended to balance different interests and needs. On the one hand, both private parties primarily concerned (the complaining domestic producers and the exporters/importers) cannot risk that their business secrets or other sensitive commercial information be disclosed to their competitors as a result of their cooperating in a safeguard investigation. On the other hand, a thorough investigation of the facts of the case, which is ultimately in the interest of all players, may necessitate access to such sensitive information and some form of refutation and adversarial process in connexion with it.

Reconciling these different needs is a difficult exercise. In addition, the balance struck domestically by a WTO Member for the purpose of its domestic proceedings may be questioned if a measure adopted on the basis of confidential information is challenged in dispute settlement proceedings. In particular, the WTO Member whose measure is challenged may face the dilemma of either supplying in dispute settlement proceedings information that it treated as confidential at domestic level, or not to be able to justify its measure. In this connexion, it should be recalled that confidentiality of dispute settlement proceedings is ensured by a specific obligation imposed on the parties to the dispute by Article 13 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU"). Furthermore, under the same provision, panels can request the parties to supply information they consider relevant to their assessment of the facts, and the parties are therefore under a duty to cooperate to this end.

The Appellate Body has had a chance to criticize a Member's almost complete refusal to supply in dispute settlement proceeding information which it had treated as confidential in its domestic proceeding according to its domestic standards.⁸⁹

In that specific case, the Member concerned had refused to supply information (which it had treated as confidential in domestic procedures, in spite of the panel's offer to devise additional procedures to deal with this information, so as to render the obligation in Article 13 of the DSU more specific and stringent). The refusal to provide the information requested by the panel was held to undermine seriously the panel's ability to make an objective assessment of the facts, that is, to discharge its mandate under Article 11 of the DSU [infra, section 6.2].⁹⁰

More recently, a panel considered to be sufficient to its objective assessment of the facts the provision in indexed, aggregated or weighted average form (rather than in full) of data treated as confidential in domestic proceedings.⁹¹

⁸⁹ *Appellate Body Report, US - Wheat Gluten, para. 171.*

⁹⁰ *Appellate Body Report, US - Wheat Gluten, para. 171; Appellate Body Report, Canada - Measures Affecting the Export of Civilian Aircraft (Canada - Aircraft), WT/DS70/AB/R, adopted 20 August 1999, para. 187.*

⁹¹ *Panel Report, US - Line Pipe, paras. 7.8-7.10.*

5.4 Test Your Understanding

- 1. Assume that an investigation on safeguards is initiated in Country X, and that the authorities publish an investigation report. The report lists the factors that have been affected by the increase in imports. The report does not mention factors such as the domestic industries' productivity or capacity utilization during the investigation period. Could this be considered a violation of the SA?**
- 2. Assume that in case 1, productivity and capacity utilization are briefly mentioned but not analyzed in depth. The authorities justify this by stating that the factors do not demonstrate any injury, and they have therefore been excluded. Is this sufficient for the requirement of “state of reason”?**
- 3. Can a WTO Member request to be treated as an interested party so as to take part of the evidence in the course of the investigation?**
- 4. If a WTO Member is challenged within the DSU, is it obliged to furnish the Panel with all information, including the information, which during the domestic procedure, has been classified as confidential?**

6. THE WTO PROCEDURES

The following Sections examine two sets of procedures and procedural requirements relating to the safeguards. On the one hand, reference is made to the procedural requirements imposed by the SA in connexion with the various phases of application of its rules. On the other hand, the specific features of dispute settlement procedures when addressing safeguard measures are reviewed.

6.1 The Role of the Committee on Safeguards

Article 13 SA

Other procedures and procedural obligations in connexion with safeguard matters are set out in Article 13 of the SA. This provides for the establishment of the Committee on Safeguards, under the authority of the Council for Trade in Goods, to oversee the implementation of the Agreement. This Committee is open to representatives from all WTO Members and its main functions can be outlined as follows.

The Committee is the addressee of all the notifications (including on initiation of investigations, injury findings, provisional or definitive measures, extensions, results of consultations prior to the imposition of a measure, compensation, mid-term reviews) that WTO Members must make in accordance with the SA. Besides providing a forum for discussing such notifications, the Committee must report to the Council for Trade in Goods on them (Article 13.1(f) of the SA). To assist the Members in making such notifications, suggested formats have been drawn up (although neither are they legally binding, nor does following their suggestions guarantee that the relevant legal requirements in the SA are fulfilled).

Furthermore, at the request of a Member taking a safeguard measure, the Committee reviews whether proposals to suspend concessions or other obligations are “substantially equivalent” to those suspended through the safeguard measure, and reports as appropriate to the Council for Trade in Goods (Article 13.1(e)).

The Committee also finds, upon request of an affected Member, whether or not the procedural requirements of the SA have been complied with in connexion with a safeguard measure (also reporting its findings to the Council for Trade in Goods) (Article 13.1(b)).

The Committee also assists Members in their consultations under the provisions of this Agreement (Article 13.1(c)) - a supporting activity which may prove particularly valuable for those Members with more limited experience in the sector.

In addition, the Committee has general monitoring functions on the implementation of the Agreement on Safeguards (Article 13.1(a)). This results in the preparation of an annual report to the Council for Trade in Goods, inter alia recording the measures taken by Members.

6.2 Dispute Settlement Procedures

Article 14 SA

Pursuant to Article 14 of the SA, review of WTO Members' safeguard action through dispute settlement proceedings is based on the generally applicable provisions in Articles XXII-XXIII of the GATT 1994 (consultations and dispute settlement), and Articles 4 and 6 of the DSU. This section outlines some issues arising in dispute settlement proceedings concerning safeguard measures.

6.2.1 Standard of Review

The standard of review of safeguard measures by panels is the same as generally laid down in Article 11 of the DSU. Accordingly, panels are called upon to make “an objective assessment of the facts” submitted to their review by a Member. Unlike in the case of review of anti-dumping measures, panels are not instructed to defer to the interpretation chosen by the domestic authorities if it is amongst the permissible ones.⁹²

The issue has however arisen as to what facts and arguments panels can hear, compared to those heard and reviewed by the competent authorities in the domestic proceedings leading to the measure under review. Building on its previous pronouncements, the Appellate Body reviewed this issue extensively in *US - Lamb*, and the relevant findings can be summarized as follows:

- The applicable standard is neither “de novo” review (that is, a complete re-examination and re-evaluation of the facts), nor “total deference”, but rather the “objective assessment of the facts”.⁹³
- When review concerns compliance with Article 4 requirements (and presumably also other substantive requirements), a panel must examine whether, as required by Article 4 of the SA, the domestic authorities had considered all the relevant facts and had adequately explained how the facts supported the determinations that were made.⁹⁴
- An “objective assessment” of a claim under Article 4.2(a) of the SA has two elements, a formal one and a substantive one. The formal aspect that a panel must review is whether the competent authorities have evaluated all relevant factors. The substantive aspect that a panel must review is whether the authorities have provided a reasoned and adequate explanation of how the facts support their determination. A claim under Article 4.2(a) might

⁹² *AD Agreement, Article 17.6.*

⁹³ *Appellate Body Report, US - Lamb, para. 102.*

⁹⁴ *Appellate Body Report, US - Lamb, para. 102; Appellate Body Report, Argentina - Footwear (EC), para. 121.*

not relate at the same time to both aspects of the review envisaged here, but only to one of these aspects. For instance, the claim may be that, although the competent authorities evaluated all relevant factors, their explanation is either not reasoned or not adequate.⁹⁵

- In examining a claim under Article 4.2(a), a panel can assess whether the competent authorities' explanation for its determination is reasoned and adequate, only if the panel critically examines that explanation, in depth, and in the light of the facts before the panel. Panels must, therefore, review whether the competent authorities' explanation fully addresses the nature, and, especially, the complexities of the data, and responds to other plausible interpretations of that data. A panel must find, in particular, that an explanation is not reasoned, or is not adequate, if some alternative explanation of the facts is plausible, and if the competent authorities' explanation does not seem adequate in the light of that alternative explanation.⁹⁶

6.2.2 'New' Claims Compared to those Raised in Domestic Proceedings

This issue was addressed by the Appellate Body in *US - Lamb*, together with that of the standard of review. The Appellate Body clearly found that:

- In arguing claims in dispute settlement, a WTO Member is not confined merely to rehearsing arguments that were made to the competent authorities by the interested parties during the domestic investigation, even if the WTO Member was itself an interested party in that investigation.
- Likewise, panels are not obliged to determine, and confine themselves to, the nature and character of the arguments made by the interested parties to the competent authorities. Arguments before national competent authorities may be influenced by, and focused on, the requirements of the national laws, regulations and procedures. On the other hand, dispute settlement proceedings brought under the DSU concerning safeguard measures imposed under the Agreement on Safeguards may involve arguments that were not submitted to the competent authorities by the interested parties.⁹⁷

6.2.3 Treatment of Confidential Information

A further procedural issue which has been discussed in dispute settlement proceedings concerning safeguard measures is the disclosure of confidential

⁹⁵ Appellate Body Report, *US - Lamb*, para. 103.

⁹⁶ Appellate Body Report, *US - Lamb*, para. 106.

⁹⁷ Appellate Body Report, *US - Lamb*, para. 113.

information to panel and other WTO Members, which has been addressed above, in section 5.3.

6.3 Test Your Understanding

- 1. A Member wishes to apply safeguard measures and thereby suspend concessions. Is the Member obliged to consult the Committee on Safeguards on whether the proposed measures offers a “substantially equivalent” level of concession to the Members that would be affected by the measure?**
- 2. A Member fears it will be gravely affected by another Member's proposed safeguard measure and has limited experience in practical proceedings. Can the Member request assistance from the Committee on Safeguards in verifying that the procedural requirements have been met? What about consultation procedure?**
- 3. If a Panel is established to review a Member's safeguard measure, is it bound by the interpretation method that the domestic authorities have used in assessing the facts?**
- 4. What are the two elements a Panel can assess when reviewing a claim under Article 4.2 (a)?**
- 5. Can a Panel, when assessing a dispute, regard arguments that were not submitted to the competent authorities by the interested parties in the course of the domestic procedure?**

7. DEVELOPING COUNTRY MEMBERS

7.1 Article 9.1 of the SA

“de minimis”

Article 9.1 of the SA mandates that safeguard measures should not be applied against a product originating in a developing country Member as long as its share of imports of the product in the importing country member does not exceed three per cent, provided that developing country Members with less than three per cent import share collectively account for not more than nine per cent of total imports of the product. This is sometimes referred to as a “de minimis” rule in favour of developing countries.

7.2 Article 9.1, Panel Interpretation

In US-Line Pipe, the Panel ruled that the Article 9.1 requires the express exclusion of developing countries from the application of safeguard measures, as long as the stipulated conditions are met. The Panel concluded that, since the line pipe measure imposed by the United States applies to all developing countries in principle, the United States has failed in its obligation under Article 9.1, regardless of the fact that the line pipe measure may not have any actual impact on developing countries.

Panel Report, US - Line Pipe

Article 9.1 is clear in its mandate that a safeguard measure “shall not be applied” to imports of developing countries accounting for not more than 3 per cent of total imports ... if a measure is not to apply to certain countries, it is reasonable to expect an express exclusion of those countries from the measure.⁹⁸ ... there is a clear difference between an obligation that a measure not affect imports from certain developing countries and an obligation that a measure not be applied to imports from certain developing countries⁹⁹

The Appellate Body confirmed and strengthened this finding. Its conclusions can be summarized as follows:¹⁰⁰

- A specific list of the WTO Members, which are either included in the measure or excluded from it, is not required to comply with Article 9.1 of the SA (though it would help by providing transparency).
- Calculation of the percentages mentioned in Article 9.1 should be done on the basis of the latest available data at the time the measure takes effect.
- The WTO Member imposing the measure must take all reasonable steps it can to make certain that developing countries exporting

⁹⁸ Panel Report, US-Line Pipe, paras 7.175.

⁹⁹ Panel Report, US-Line Pipe, paras 7.181

¹⁰⁰ Appellate Body Report, US - Line Pipe, paras. 128-132.

less than the percentages indicated in Article 9.1 are excluded from the measure.

7.3 Other Rights of Developing Countries in the Application of the SA

In addition to providing for the so called “de minimis” rule, as already mentioned [supra, section 4.3], Article 9.2 allows developing country Members, as users of safeguard measures, additional flexibility.

Developing countries enjoy special rights in connexion with dispute settlement procedures, which are also relevant when safeguard measures are under review. These are the right to have a panelist selected amongst nationals of developing countries (Article 8.10 of the DSU), special deadlines for panel proceedings (Article 3.12, 12.10 of the DSU), special consideration of their interests during dispute settlement consultations (Article 4.10), legal assistance (Article 27), as well as some special rights in connexion with the implementation of reports (Article 21, paras. 2, 7, 8).

7.4 Developing Countries and the Application of the SA

Similarly to what happened for anti-dumping measures, developing countries have not been great users of safeguard measures under GATT 1947.¹⁰¹ Conversely, they appear to be primary users of the safeguard instrument under the WTO.¹⁰²

¹⁰¹ See *Analytical Index to the GATT, Vol. 1, 1995, pp. 539 ff.*, recording five measures taken by developing countries (Nigeria, Peru, Chile), out of a total of 139.

¹⁰² Based on the annual reports of the Committee on Safeguards.

DEVELOPING COUNTRIES	DEVELOPED COUNTRIES
Argentina I. Footwear (1997) II. Peaches (2001) III. Motorcycles (2001) → 3	Czech Republic IV. sugar (1999) V. isoglucose (2001) → 2
Brazil VI. Toys (1997) → 1	Republic of Korea VII. dairy products (1997) VIII. garlic (2000) → 2
Chile IX. wheat (2000) X. milk (2001) → 2	Latvia XI. swine meat (1999) → 1
Egypt XII. safety matches (1999) XIII. fluorescent lamps (2000) XIV. powdered milk (2001) → 3	Slovak Republic XV. sugar (2001) XVI. 1
India XVII. acetylene black (1998) XVIII. carbon black (1999) XIX. slabstock polyol (1998) XX. propylene glycol (1998) XXI. phenol (1999) XXII. acetone (2000) → 6	United States XXIII. brooms (1996) XXIV. wheat gluten (1998) XXV. lamb meat (1999) XXVI. steel wire rod (2000) XXVII. line pipe (2000) XXVIII. 5
Jordan XXIX. biscuits (2001) → 1	
Morocco XXX. bananas (2001) → 1	
TOTAL – 17	TOTAL – 11

7.5 Test Your Understanding

1. Assuming that for a certain good, developing countries represent 0.5 per cent, 0.75 per cent and 3.5 per cent of total

imports. If safeguard measures were to be applied, will the de minimis rule be applied to all three countries?

- 2. Does a Member imposing a safeguard measure have to expressly list the countries that are included or excluded from the measure?**
- 3. List three of the specific rights that the SA grants developing countries.**

8. CASE STUDY

Country A, a WTO Member has recently transformed its economy and opened up to international trade. Since that time, the country has increased exports within several industrial sectors. At the same time increasing imports in other sectors are gradually taking over parts of the domestic market. Country A is a large producer of porcelain and ceramics, of which 55 per cent goes for export and the rest is sold domestically. Domestic producers have traditionally held 80 per cent of the market share on the domestic market. One of the main export markets is country D, a country that is in serious economic crisis. Last year exports to country D fell and finally two of the main porcelain and ceramics producers in country A went bankrupt and closed down their production. Imports during this period have increased only marginally. However, the market share of the domestic producers fell. The remaining domestic producers are very concerned about the situation, and call for government protection.

- a) Would this situation signify “increased imports”, which could justify safeguard measures under the SA?

Assuming that the government of country A starts investigating the possibility of safeguard measures.

- b) To whom and when should the authorities notify the initiation of the investigation?
- c) Is country A entitled to impose provisional safeguard measures? Which is the specific requirement?
- d) When determining the scope of the domestic industry potentially suffering injury, could the investigation treat porcelain and ceramic products as one group, or do they have to be separated?
- e) In the assessment of injury, which factors should be examined? Could another factor than increased imports be causing the injury?

Assume that country A does impose safeguard measures.

- f) Can a developing country be excluded from the investigation and/or application of the safeguard measure and if so, under which conditions?
- g) How about a free trade partner?

9. FURTHER READING

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- **Bourrinet, J.**, L'accord relatif aux sauvegardes. La Communauté européenne et le GATT: évaluation des accords du cycle d'Uruguay, Rennes, 1995, pp. 85-93.
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9.1 Official Documents

- **Official WTO documents** can be obtained by searching for the document number on the search facility of the WTO's online document database, available at: <http://docsonline.wto.org/>

9.2 List of Relevant Panel and Appellate Body Reports

9.2.1 Appellate Body Reports

- **Appellate Body Report**, Chile - Price Band System and Safeguard Measures relating to Certain Agricultural Products, (Chile - Price Band System) WT/DS207/AB/R, issued 23 September 2002.
- **Appellate Body Report**, United States - Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea (US-Line Pipe), WT/DS202/AB/R, WT/DS178/AB/R adopted 8 March 2002
- **Appellate Body Report**, United States - Safeguard Measures on imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia (US-Lamb), WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001
- **Appellate Body Report**, United States - Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities (US-Wheat Gluten), WT/DS166/AB/R, adopted 19 January 2001
- **Appellate Body Report**, Korea - Definitive Safeguard Measures on Imports of Certain Dairy Products (Korea - Dairy), WT/DS98/AB/R, adopted 12 January 2000
- **Appellate Body Report**, Argentina - Safeguard Measures on Imports of Footwear (Argentina-Footwear (EC)), WT/DS121/AB/R, adopted 12 January 2000

9.3 Panel Reports

- **Panel Report**, Chile - Price Band System and Safeguard Measures relating to Certain Agricultural Products, (Chile - Price Band System) WT/DS207/R, as modified by the Appellate Body Report, WT/DS207/AB/R issued 23 September 2002.

- **Panel Report**, United States - Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea (US-Line Pipe), WT/DS202/R, WT/DS178/R, adopted 8 March 2002, as modified by the Appellate Body Report WT/DS202/AB/R, WT/DS178/AB/R
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- **Appellate Body Report**, Argentina - Safeguard Measures on Imports of Footwear (Argentina-Footwear (EC)), WT/DS121/R, adopted 12 January 2000, as modified by the Appellate Body Report, WT/DS121/AB/R
- **Panel Report**, Norway - Restrictions on imports of certain textile products, adopted 18 June 1980 L/4959, BISD 27S/119
- **Working Party Report**, Report on the Withdrawal by the United States of a Tariff Concession under Article XIX of the General Agreement of Tariffs and Trade, (Hatter's Fur) 27 March 1951, CP 106, adopted October 1951

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.9 SPS MEASURES



UNITED NATIONS
New York and Geneva, 2003

NOTE

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WHAT YOU WILL LEARN

The *Agreement on the Application of Sanitary and Phytosanitary Measures*, commonly referred to as the *SPS Agreement*, is one of the WTO agreements which resulted from the Uruguay Round of Multilateral Trade Negotiations, held from 1986 to 1993 under the auspices of the GATT. The *SPS Agreement* is contained in Annex 1 A of the 1994 *Marrakesh Agreement Establishing the World Trade Organization* and came into force on 1 January 1995. This Agreement was negotiated in tandem with the *Agreement on Agriculture*, as negotiators wanted to ensure that the hard-won liberalization in the agricultural sector achieved by the *Agreement on Agriculture* would not be undermined by the misuse of health regulations for protectionist purposes. Thus, the *SPS Agreement* creates disciplines applicable to measures for the protection of human and animal life or health (sanitary measures) and of plant life or health (phytosanitary measures) from certain, defined risks. It aims to balance the right of Members to take measures to protect health in their territories from risks contained in traded food and agricultural products, with the goal of trade liberalization in the food and agricultural sector. Generally speaking, the *SPS Agreement* thus aims to reconcile free trade with legitimate concerns for the life and health of humans, animals and plants. The *SPS Agreement* is of particular importance for developing countries, many of whom are primary agricultural exporters and depend on access to foreign markets for their agricultural products for much of their foreign revenue.

This Module provides an overview of the substantive and procedural disciplines contained in the *SPS Agreement*, and sets out the jurisprudence of the panels and Appellate Body of the WTO in respect of this Agreement. It also pays particular attention to the position of developing countries under the *SPS Agreement*.

The first Section of this Module deals with the scope of application of the *SPS Agreement* and describes its relationship to other relevant WTO agreements. This will enable the trainee to identify when the *SPS Agreement* is applicable to a particular factual situation. The second Section lays out the basic principles of the *SPS Agreement*, namely the right of Members to take SPS measures and the basic disciplines surrounding the exercise of this right, as well as the underlying goal of harmonization of SPS measures. The third examines the risk analysis obligations that Members must comply with when imposing SPS measures. This section encompasses both risk assessment obligations and risk management disciplines and devotes some attention to the use of provisional measures in cases of scientific uncertainty. The fourth Section deals with the remaining substantive provisions of the *SPS Agreement*, namely the rules on the recognition of equivalence and adaptation to regional conditions. The fifth is devoted to the institutional and procedural rules contained in the *SPS Agreement*, including those on the role of the SPS Committee and those governing dispute settlement under the *SPS Agreement*, to the extent that these differ from the general dispute settlement rules addressed in Modules

3.1 to 3.4. The sixth Section specifically addresses the special provisions for developing countries in the *SPS Agreement*. This Module concludes with a set of hypothetical case studies, designed to test the reader's knowledge and illustrate the practical application of the theory learnt. Finally, some recommendations are made for further reading.

1. SCOPE OF APPLICATION OF THE SPS AGREEMENT

On completion of this section the reader will be able:

- to identify the circumstances in which the *Agreement on the Application of Sanitary and Phytosanitary Measures*, or the *SPS Agreement*, applies to a factual situation.
- to explain what is meant by a “sanitary or phytosanitary measure” under this Agreement and be able to determine whether the Agreement applies to a particular dispute.
- to understand the relationship between the *SPS Agreement* and other WTO Agreements relevant in this area.

1.1 Substantive Scope of Application

Article 1.1 SPS

Article 1.1 of the *SPS Agreement* defines the scope of application of the Agreement. It provides:

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

Thus, as stated by the Panel in *EC - Hormones*, there are two requirements for the *SPS Agreement* to apply, namely that the measure in dispute is an SPS measure and that the measure, directly or indirectly, affects international trade.¹

1.1.1 Definition of an SPS Measure

Article 1.2 and Annex A.1 SPS

Not all measures aimed at public health protection are SPS measures for purposes of the *SPS Agreement*. Article 1.2 points to Annex A of the *SPS Agreement* for the definitions of the terms used in the Agreement. Paragraph 1 of Annex A, defines SPS measures as follows:

Any measure applied:

- (a) to protect animal or plant life or health within the territory of the Member from risks arising from the entry, establishment or spread of pests, diseases, disease-carrying organisms or disease-causing organisms;
- (b) to protect human or animal life or health within the territory of the Member from risks arising from additives, contaminants, toxins or disease-causing organisms in foods, beverages or feedstuffs;

¹ Panel Report, *EC Measures Concerning Meat and Meat Products (Hormones)* (“*EC – Hormones (US)*”), complaint by the United States, WT/DS26/R/USA, DSR 1998:III, 699, para. 8.38; and Panel Report, *EC Measures Concerning Meat and Meat Products (Hormones)* (“*EC – Hormones (Canada)*”), by Canada, WT/DS48/R/CAN, DSR 1998:II, 235, para. 8.39.

(c) to protect human life or health within the territory of the Member from risks arising from diseases carried by animals, plants or products thereof, or from the entry, establishment or spread of pests; or

(d) to prevent or limit other damage within the territory of the Member from the entry, establishment or spread of pests. Sanitary or phytosanitary measures include all relevant laws, decrees, regulations, requirements and procedures including, inter alia, end product criteria; processes and production methods; testing, inspection, certification and approval procedures; quarantine treatments including relevant requirements associated with the transport of animals or plants, or with the materials necessary for their survival during transport; provisions on relevant statistical methods, sampling procedures and methods of risk assessment; and packaging and labelling requirements directly related to food safety.

It is clear from the above definition that the question whether a measure falls there under depends on its *purpose or goal*. Broadly speaking, the definition covers measures aimed at protecting humans and animals from food-borne health risks and protecting humans, animals and plants from risks from pests or diseases. Measures addressing other health risks relevant for international trade (such as a ban on asbestos-containing products) and measures not directly aimed at health protection, but rather at consumer information (such as a labelling requirement for biologically grown vegetables), do not fall under this definition. Such measures would thus not be subject to the disciplines of the *SPS Agreement* but be dealt with under other WTO rules.

While this has not yet been subject to dispute settlement, it would appear that the *purpose or goal* of a measure would be determined objectively (for example by examining the formulation of the measure, its structure or design, and its effect), rather than by trying to determine the subjective aim of the Member imposing it. The latter would have the clearly unintended result of enabling a Member to evade the disciplines of the *SPS Agreement* by denying that the purpose of its measure is one of those falling within the Annex A.1 definition.

If the measure at issue is aimed at one of the goals mentioned in points (a) to (d) of the Annex A.1 definition, it is an SPS measure for the purposes of the *SPS Agreement*, regardless of the specific form it takes. This appears from the second part of the definition, which contains a broad, illustrative, non-exhaustive list of various types of government measures which could be classified as SPS measures, ranging from end-product criteria and quarantine requirements to certification and sampling procedures.

It is important to note that the Annex A.1 definition expressly refers to the protection of human, plant or animal life or health *within the territory of the Member*. Thus, measures aiming at the extra-territorial application of domestic health standards are excluded from the application of the *SPS Agreement*.

1.1.2 Discriminatory and Non-discriminatory Measures

The scope of application of the *SPS Agreement* is not limited to discriminatory SPS measures. When negotiating the *SPS Agreement*, Members realized that a test based on discrimination is not sufficient to separate legitimate SPS measures from those used for protectionist purposes. It is possible for a measure that neither on its face nor in practice discriminates between domestic and imported products to have a negative impact on international trade and thus serve to protect the domestic producers from foreign competition. For this reason, the disciplines of the *SPS Agreement* catch both discriminatory and non-discriminatory SPS measures that affect international trade. It is therefore possible for a measure that is non-discriminatory and thus in conformity with the GATT 1994, to violate the *SPS Agreement*.

1.1.3 Effect on International Trade

Article 1.1 SPS

The second requirement laid down in Article 1.1 for the application of the *SPS Agreement* is that the measure at issue must directly or indirectly affect international trade. Empirical proof of a reduction in trade flows is not required, but it suffices to show that the measure is applied to imports and therefore can be presumed to have an impact on international trade. The requirement of an effect on international trade should thus be easy to fulfil and has in fact not been in dispute in any SPS case thus far.

1.2 Temporal Scope of Application

The *SPS Agreement* came into force on 1 January 1995. The question thus arises whether SPS measures in existence before this date are subject to its provisions. In *EC - Hormones* the EC argued that as its ban on hormone-treated beef predated the entry into force of the *SPS Agreement*, this ban was not subject to the disciplines of the *SPS Agreement*. Upholding the Panel's finding rejecting this argument, the Appellate Body held:

If the negotiators had wanted to exempt the very large group of SPS measures in existence on 1 January 1995 from the disciplines of provisions as important as Articles 5.1 and 5.5, it appears reasonable to us to expect that they would have said so explicitly. Articles 5.1 and 5.5 do not distinguish between SPS measures adopted before 1 January 1995 and measures adopted since; the relevant implication is that they are intended to be applicable to both.²

Furthermore the Appellate Body pointed to Article XVI:4 of the *WTO Agreement* which obliges Members to ensure the conformity of their laws, regulations and procedures with their obligations under the annexed

² Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* ("EC – Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, DSR 1998:1, 135, para. 128.

Agreements.³ It is thus apparent that Members have to review their existing SPS measures in the light of the new disciplines of the *SPS Agreement*.

1.3 Application to Bodies Other than Central Government

Article 13 SPS

The disciplines contained in the *SPS Agreement* are not only applicable to measures by central governments. According to Article 13 of the *SPS Agreement*, Members are fully responsible for the observance of the *SPS Agreement* and are obliged to take positive measures to ensure the compliance with its provisions by other than central government bodies. In addition, Members must take reasonable measures to ensure that non-governmental bodies in their territories and regional bodies, in which relevant entities in their territories are members, comply with the rules of the *SPS Agreement*. Members may only rely on the services of non-governmental bodies for the implementation of SPS measures if these bodies comply with the provisions of the *SPS Agreement*. Further, Members may not require or encourage regional, non-governmental or local government bodies to act in a way contrary to the Agreement.⁴

1.4 Relationship with Other WTO Agreements

1.4.1 TBT Agreement

Article 1.4 SPS and Article 1.5 TBT

During the Tokyo Round trade negotiations, the first steps were taken towards addressing the problem of non-tariff barriers to trade, in the form of technical regulations, by the conclusion of the *Agreement on Technical Barriers to Trade*, commonly known as the *Standards Code*. This agreement was not very effective and was, as a result of the Uruguay Round negotiations, replaced by the new *WTO Agreement on Technical Barriers to Trade* (the *TBT Agreement*) which tightens the disciplines of the *Standards Code*. The *TBT Agreement* is broadly applicable to technical regulations and standards, including those aimed at the protection of health. However, in the Uruguay Round negotiations, negotiators saw SPS measures as meriting special rules, apart from those applicable to the broader category of technical regulations and standards. Thus a separate Agreement, the *SPS Agreement* was concluded to deal specifically with SPS measures.

The importance of determining which of these two agreements applies to a particular measure lies in the fact that their respective rules differ, those of the *TBT Agreement* being less strict than those of the *SPS Agreement*. In order to establish which of the two Agreements applies to a particular measure, recourse must be had to Article 1.5 of the *TBT Agreement* which states:

³ *Ibid.*

⁴ This provision was applied in *Compliance Panel Report, Australia – Measures Affecting Importation of Salmon - Recourse to Article 21.5 of the DSU by Canada*, (“*Australian – Salmon*”), *WT/DS18/RW para. 7.13*, with respect to a measure by the provincial government of Tasmania.

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

In addition, Article 1.4 of the *SPS Agreement* provides that nothing in that Agreement shall affect the rights of Members under the *TBT Agreement* with regard to measures not falling within the scope of the *SPS Agreement*. Clearly, therefore, the *SPS Agreement* and the *TBT Agreement* are mutually exclusive.

Once a measure falls within the definition of an SPS measure in the *SPS Agreement*, it is subject to the rules of this Agreement to the exclusion of the *TBT Agreement*, even if the measure is also a technical regulation or standard within the meaning of the *TBT Agreement*. On the other hand, if a measure qualifies as a technical regulation or standard and is *not* an SPS measure, the *TBT Agreement* applies.

The first step in determining the applicable agreement will therefore always be to establish whether the measure at issue is an SPS measure. If so, it is no longer necessary to examine whether it is a technical regulation or standard for purposes of the *TBT Agreement* as the measure falls outside its scope of application.

1.4.2 GATT 1994

Article XX(b) GATT

The *General Agreement on Tariffs and Trade* (the GATT), unlike the *SPS Agreement* and the *TBT Agreement*, does not only apply to a circumscribed category of measures, but covers all measures relating to trade in goods. In this sense, it is broader in its application than the *SPS Agreement*, which applies only to SPS measures. On the other hand, only health measures that are discriminatory will be GATT-inconsistent and fall to be examined under Article XX(b) of the GATT, whereas the *SPS Agreement* catches all SPS measures, whether they are discriminatory or non-discriminatory. In this sense, the GATT is narrower in its application than the *SPS Agreement*.

Before the entry into force of the *SPS Agreement*, Members could impose and maintain GATT-inconsistent measures necessary for the protection of human, animal and plant life or health under the exception provided in Article XX(b) of the GATT 1947. The inadequacy of this provision in dealing with the complexities of SPS measures, led Members to negotiate the *SPS Agreement* in the Uruguay Round, in an attempt to flesh out Article XX(b) and set clear limits to the use of SPS measures in ways that could adversely affect international trade. However, the resultant *SPS Agreement* goes further than a mere elaboration of Article XX(b) of the GATT, and establishes a new, comprehensive set of norms for the adoption and maintenance of SPS measures.

The question arises whether, as is the case with Article XX(b), a violation of the GATT must be shown before the *SPS Agreement* can be applicable. This

question arose in *EC - Hormones* and the Panel in that case found that the only two requirements for the applicability of the *SPS Agreement* are those contained in Article 1.1, namely the existence of an SPS measure and a direct or indirect effect on international trade and that there is no further express requirement of a violation of the GATT.⁵ In addition, the Panel went on to state:

Moreover, we find the EC claim that the SPS Agreement does not impose “substantive” obligations additional to those already contained in Article XX(b) of GATT not to be persuasive. It is clear that some provisions of the SPS Agreement elaborate on provisions already contained in GATT, in particular Article XX(b). The final preambular paragraph of the SPS Agreement provides, indeed, that the Members desired “to elaborate rules for the application of the provisions of GATT 1994 which relate to the use of sanitary or phytosanitary measures, in particular the provisions of Article XX(b)”. Examples of such rules are, arguably, some of the obligations contained in Article 2 of the SPS Agreement. However, on this basis alone we cannot conclude that the SPS Agreement only applies, as Article XX(b) of GATT does, if, and only if, a prior violation of a GATT provision has been established. Many provisions of the SPS Agreement impose “substantive” obligations which go significantly beyond and are additional to the requirements for invocation of Article XX(b). These obligations are, inter alia, imposed to “further the use of harmonized sanitary and phytosanitary measures between Members” and to “improve the human health, animal health and phytosanitary situation in all Members”. They are not imposed, as is the case of the obligations imposed by Article XX(b) of GATT, to justify a violation of another GATT obligation (such as a violation of the non-discrimination obligations of Articles I or III).⁶

Interpretative Note to Annex 1A and Article 2.4 SPS

The *SPS Agreement* did not, however replace the provisions of the GATT 1947 (now incorporated by reference into the GATT 1994), relevant to health measures. Nor is the *SPS Agreement* subordinate to the GATT. Instead the two Agreements now operate in complement to each other, and to the *TBT Agreement*. Where a measure for the protection of health is at issue, it could therefore be caught by any of the three Agreements depending on the nature and content of the measure. The current position of health measures is consequently determined by the disciplines of these three Agreements within their respective spheres of application.

Unlike the situation with the *TBT Agreement*, there is no provision making the *SPS Agreement* and the GATT mutually exclusive. Thus a measure which falls within the definition of an SPS measure may also be subject to GATT rules.

The relationship between the GATT 1994 and the other Annex 1A Agreements (i.e. those agreements dealing with trade in goods), one of which is the *SPS Agreement*, is governed by the *Interpretative Note to Annex 1A*. The

⁵ Panel Report, *EC – Hormones (US)*, para. 8.36 and Panel Report, *EC – Hormones (Canada)*, para. 8.39.

⁶ Panel Report, *EC - Hormones (US)* para. 8.38 and 8.40.

Interpretative Note provides that in the event of a conflict between a provision of the GATT 1994 and a provision in another Annex 1A Agreement, the latter prevails to the extent of the conflict. Thus the provisions of the *SPS Agreement* would have precedence over any conflicting GATT rule.

However the likelihood that there would be a conflict between the relevant GATT rules and the disciplines of the *SPS Agreement* is negligible, as the *SPS Agreement* takes on board the GATT disciplines relevant to health measures and elaborates on them. This fact is recognized in Article 2.4 of the *SPS Agreement* by means of a presumption of consistency with the relevant provisions of the GATT 1994 (and in particular Article XX(b)) for SPS measures conforming to the provisions of the *SPS Agreement*. This means that once a measure has been found to comply with the *SPS Agreement*, its compliance with the GATT 1994 is presumed.

When an SPS measure is at issue, it is therefore logical to examine it under the *SPS Agreement* first, before turning to its conformity with GATT rules. This argument is borne out by the finding of the Panel in *EC - Hormones* in addressing the question of which of these two Agreements it should examine first. It held:

Having reached the conclusion that we are not per se required to address GATT claims prior to those raised under the SPS Agreement, we must then decide which of the two agreements we should examine first in this particular dispute. The SPS Agreement specifically addresses the type of measure in dispute. If we were to examine GATT first, we would in any event need to revert to the SPS Agreement: if a violation of GATT were found, we would need to consider whether Article XX(b) could be invoked and would then necessarily need to examine the SPS Agreement; if, on the other hand, no GATT violation were found, we would still need to examine the consistency of the measure with the SPS Agreement since nowhere is consistency with GATT presumed to be consistency with the SPS Agreement. For these reasons, and in order to conduct our consideration of this dispute in the most efficient manner, we shall first examine the claims raised under the SPS Agreement.⁷

1.5 Test Your Understanding

- 1. What requirements must be met for the SPS Agreement to apply to a particular measure?**
- 2. Can SPS standards issued by a non-governmental body be challenged under the *SPS Agreement*? If so, against whom would the dispute be initiated?**
- 3. Would a measure banning the use of toxic plastics in toys for children be regarded as an SPS measure? Why?**

⁷ Panel Report, *EC-Hormones (US)*, para. 8.42.

- 4. Why can one say that the *SPS Agreement* is both wider and narrower than the GATT 1994 in its scope of application?**
- 5. If an SPS measure is found to be in conformity with the *SPS Agreement*, is it then necessary to test its conformity with the *TBT Agreement* and/or the GATT? If an SPS measure were found to be in conformity with the GATT, would it still be necessary to test its conformity with the *SPS Agreement*?**

2. BASIC PRINCIPLES OF THE SPS AGREEMENT

On completion of this section the reader will be able:

- to discuss the basic principles of the *SPS Agreement* and their application in dispute settlement.
- to explain the way in which the *SPS Agreement* seeks to balance the right of governments to enact health measures with free trade, in particular, what the limits on the exercise of this right are.
- to identify the basic scientific disciplines introduced by the *SPS Agreement* as well as the existing GATT disciplines taken on board by the *SPS Agreement*.
- to describe how these basic rules are applied in the case law and what their effect is on the burden of proof.
- to demonstrate how the *SPS Agreement* encourages, without obliging, Members to harmonize their SPS measures around international standards, and to assess the implications thereof for developing countries.

2.1 Basic Rights and Obligations

Article 2 SPS

Article 2 of the *SPS Agreement* sets out the basic rights and obligations under the Agreement, which are then further elaborated on in subsequent articles. Article 2 reflects the underlying aim of the *SPS Agreement* of balancing the recognized right of sovereign governments to take measures for the protection of health, with the need to promote free trade and prevent protectionism.

2.2 Right to Take SPS Measures

Article 2.1 SPS

Article 2.1 expressly recognises the *right* of Members to take SPS measures necessary for the protection of human, animal or plant life or health, provided that they conform to the disciplines of the *SPS Agreement*. This is an important provision, as it represents a movement away from the position under the GATT, where in principle discriminatory health measures are prohibited unless they can be justified under the exception in Article XX(b). Thus, under GATT rules the burden of proof rests on the Member imposing the health measure to justify its measure. On the contrary, Article 2.1 of the *SPS Agreement* makes clear that SPS measures are, in principle, allowed and it is for the complaining Member to prove that the measure does not comply with the disciplines of the *SPS Agreement*.

2.3 Limits to the Right to Take SPS Measures

Article 2.2 SPS

The undisputed right of Members to take SPS measures is not unlimited but its exercise is subject to the disciplines set out in the rest of the *SPS Agreement*.

Some of these disciplines contain new scientific justification requirements for SPS measures, whereas others embody familiar GATT rules. These disciplines find their first reflection in Articles 2.2 and 2.3 of the *SPS Agreement* and are further fleshed out in later provisions. Article 2.2 provides:

Members shall ensure that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant life or health, is based on scientific principles and is not maintained without sufficient scientific evidence, except as provided for in paragraph 7 of Article 5

Article 2.2 lays down two basic requirements for SPS measures, namely that: (1) they be applied only to the extent *necessary* to protect human, animal or plant life or health; and (2) they have a basis in *scientific evidence*, except as provided in Article 5.7.

2.3.1 Necessity Test

The obligation on Members, contained in Article 2.2 of the *SPS Agreement*, to ensure that their SPS measures are applied only to the extent necessary to protect human, animal or plant life or health, reflects the familiar GATT necessity test contained in Article XX(b). As mentioned before, Article XX(b) of the GATT represents an exception to the normal GATT disciplines and thus the burden of proof to show that its requirements are met rests on the Member imposing the health measure. On the contrary, this rule-exception relationship is absent in Article 2.2 of the *SPS Agreement* and it is therefore for the complaining Member to prove that the necessity test is not met.

The necessity test in Article 2.2 has not yet been subject to dispute settlement as complaining parties who bring disputes under the *SPS Agreement* seem to accept readily that the measures in dispute comply with this requirement, or address their challenges to later more specific provisions of the *SPS Agreement*, which could be regarded as further specifications of the necessity test.

2.3.2 Scientific Basis/Evidence

Article 2.2 introduces the first mention of *scientific* disciplines on SPS measures into the *SPS Agreement* and establishes science as the touchstone against which SPS measures will be judged. It requires that SPS measures be based on scientific principles and not be maintained without sufficient scientific evidence, except as provided for in Article 5.7 (which deals with cases where there is insufficient scientific evidence).⁸ This scientific requirement is further elaborated on in Article 5.1, which requires that SPS measures be based on a risk assessment.

⁸ Article 5.7 is dealt with in detail in section 3 below.

The importance of these scientific disciplines in mediating between the competing goals of trade liberalization and health protection was made explicit by the Appellate Body in *EC - Hormones* where it stated:

...The requirements of a risk assessment under Article 5.1, as well as of 'sufficient scientific evidence' under Article 2.2, are essential for the maintenance of the delicate and carefully negotiated balance in the SPS Agreement between the shared, but sometimes competing interests of promoting international trade and of protecting the life and health of humans...⁹

The crux of the scientific discipline in Article 2.2 is the requirement of “sufficient scientific evidence” for SPS measures. The issue of the meaning of this requirement was raised in *EC - Hormones* but not decided on for reasons of judicial economy. It arose again in *Japan - Agricultural Products*, where the Appellate Body pointed out that “sufficiency” is a relational concept, requiring the existence of an adequate relationship between two elements, in this case the SPS measure and the scientific evidence.¹⁰ It went on to conclude:

...we agree with the Panel that the obligation in Article 2.2 that an SPS measure not be maintained without sufficient scientific evidence requires that there be a rational or objective relationship between the SPS measure and the scientific evidence. Whether there is a rational relationship between an SPS measure and the scientific evidence is to be determined on a case-by-case basis and will depend upon the particular circumstances of the case, including the characteristics of the measure at issue and the quality and quantity of the scientific evidence.¹¹

Therefore, it is clear that panels have some discretion in determining whether a “rational relationship” exists between the SPS measure and scientific evidence, according to the circumstances of the particular case. Panels may examine the quantity and quality of scientific evidence as well as the nature of the SPS measure imposed in coming to their decision. Where there is reputable scientific support for a measure, it would appear that the requirement of a rational relationship between the measure and the scientific evidence is met and thus that there is “sufficient scientific evidence” for the measure.

The burden of proof rests with the complaining party to raise a *prima facie* case that there is no “sufficient scientific evidence” for the measure. In *Japan - Agricultural Products*, the United States claimed that the Panel had imposed an impossible burden of proof on it under Article 2.2 by requiring it to prove a negative, namely that no relevant studies or reports existed to support Japan’s SPS measure (in respect of four of the eight products at issue).¹² The Appellate

⁹ Appellate Body Report, *EC-Hormones* para. 177.

¹⁰ Appellate Body Report, *Japan - Measures Affecting Agricultural Products* (“*Japan – Agricultural Products II*”), WT/DS76/AB/R, adopted 19 March 1999, para. 73.

¹¹ Appellate Body Report, *Japan - Agricultural Products II*, para. 84.

¹² Appellate Body Report, *Japan - Agricultural Products II*, para.38.

Body rejected the argument of the United States, and held:

...In our view, it would have been sufficient for the United States to raise a presumption that there are no relevant studies or reports. Raising a presumption that there are no relevant studies or reports is not an impossible burden. The United States could have requested Japan, pursuant to Article 5.8 of the SPS Agreement, to provide 'an explanation of the reasons' for its varietal testing requirement, in particular, as it applies to apricots, pears, plums and quince. Japan would, in that case, be obliged to provide such explanation. The failure of Japan to bring forward scientific studies or reports in support of its varietal testing requirement as it applies to apricots, pears, plums and quince, would have been a strong indication that there are no such studies or reports. The United States could also have asked the Panel's experts specific questions as to the existence of relevant scientific studies or reports or it could have submitted to the Panel the opinion of experts consulted by it on this issue.¹³

In *EC - Hormones* the Appellate Body mentioned that in determining whether there is “sufficient scientific evidence” panels should bear in mind that responsible governments act with prudence and precaution when faced with serious risks to human health. It seems from this finding that the more serious the risks, the easier it will be to prove “sufficient scientific evidence”.

***Relationship
between Articles
2.2 and 5.7 SPS***

It must be borne in mind that Article 2.2 does take into account the fact that governments sometimes need to act in the face of scientific uncertainty by making express reference to Article 5.7 as an exception to the requirement of “sufficient scientific evidence”. Article 5.7¹⁴ has been recognized by the Appellate Body as reflecting the precautionary principle.¹⁵ In *Japan - Agricultural Products* the Appellate Body discussed the relationship between Article 2.2 and Article 5.7, holding that:

...it is clear that Article 5.7 of the SPS Agreement, to which Article 2.2 explicitly refers, is part of the context of the latter provision and should be considered in the interpretation of the obligation not to maintain an SPS measure without sufficient scientific evidence. Article 5.7 allows Members to adopt provisional SPS measures 'in cases where relevant scientific evidence is insufficient' and certain other requirements are fulfilled. Article 5.7 operates as a qualified exemption from the obligation under Article 2.2 not to maintain SPS measures without sufficient scientific evidence. An overly broad and flexible interpretation of that obligation would render Article 5.7 meaningless.¹⁶

2.3.3 No Arbitrary or Unjustifiable Discrimination or Disguised Restriction on Trade

¹³ Appellate Body Report, *Japan - Agricultural Products II*, para. 137.

¹⁴ The requirements of Article 5.7 will be discussed in section 3 below.

¹⁵ Appellate Body Report, *EC-Hormones*, para. 124.

¹⁶ Appellate Body Report, *Japan - Agricultural Products II*, para. 80.

Article 2.3 SPS

The third basic limitation on the exercise of the right to impose SPS measures is found in Article 2.3 of the *SPS Agreement*. This article embodies certain familiar GATT trade disciplines, which are the non-discrimination provisions of Article I:1 and III:4 of the GATT as well the *chapeau* of Article XX¹⁷ which prevents the application of measures falling within the Article XX exceptions in ways which would “constitute a means of arbitrary or unjustifiable discrimination between countries where the same provisions prevail, or a disguised restriction on international trade.” Article 2.3 provides:

Members shall ensure that their sanitary and phytosanitary measures do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail, including between their own territory and that of other Members. Sanitary and phytosanitary measures shall not be applied in a manner which would constitute a disguised restriction on international trade.

Article 2.3 was at issue before the Compliance Panel in *Australia - Salmon* as Canada claimed that Australia had imposed import requirements for salmonids from Canada, but had no internal control measures regarding the movement of dead Australian fish. According to Canada, this constituted arbitrary or unjustifiable discrimination under Article 2.3. The Compliance Panel identified three cumulative requirements for proof of violation of Article 2.3, namely that:

- (1) the measure discriminates either between the territories of Members other than the Member imposing the measure, or between the territory of the Member imposing the measure and another Member;
- (2) the discrimination is arbitrary or unjustifiable; and
- (3) identical or similar conditions prevail in the territories of the Members compared.¹⁸

The first element which must be proved is therefore the existence of discrimination. In *Australia - Salmon* the Compliance Panel held that discrimination under Article 2.3 includes not only discrimination between like products but also discrimination between *different* products (in this case between salmonids from Canada and other dead fish from Australia).¹⁹ This deviates significantly from the non-discrimination rules in the GATT 1994, which only prohibit discrimination between “like”²⁰ or “directly competitive or substitutable”²¹ products. The broader prohibition in Article 2.3 takes into account the fact that different products may pose the same or similar health risks and should therefore be treated in the same way. There could be a possibility for example, that different fruits may be vectors for the same pest or various animals can be carriers of Foot and Mouth Disease.

¹⁷ This fact was expressly stated in Appellate Body Report, *Australia – Measures Affecting Importation of Salmon* (“*Australia – Salmon*”), WT/DS18/AB/R, para. 251.

¹⁸ Compliance Panel Report, *Australia - Salmon*, para. 7.111.

¹⁹ Compliance Panel Report, *Australia - Salmon*, para. 7.112.

²⁰ Article I:1 (Most Favoured Nation Treatment obligation) and Article III:4 (National Treatment obligation) of the GATT 1994.

²¹ Article III:2 of the GATT 1994 (in respect of internal taxes) as explained in the Ad Note thereto.

The breadth of this prohibition on discriminatory treatment is tempered by the other two requirements that must be met before Article 2.3 can be proved to be violated. Namely, the difference in treatment must be arbitrary or unjustifiable *and* identical or similar conditions must prevail in the territories of the Members subject to the different treatment. If the difference in treatment can be justified (for example because the two products compared do not carry the risk of the spread of the same pest or disease) or the conditions in the territories of the Members involved differ, Article 2.3 is not violated.

***Relationship
between Articles
2.3 and 5.5 SPS***

As stated above, the basic disciplines in Article 2 are elaborated on in later articles. In this way, the rule contained in Article 2.3 finds reflection in Article 5.5, which prohibits arbitrary or unjustifiable distinctions in the levels of protection deemed appropriate by a Member in different but comparable situations.

In *EC - Hormones* the Appellate Body noted that Article 5.5 must be read together with Article 2.3 which forms part of its context.²² However, this does not mean that the discipline in Article 2.3 is subsumed into Article 5.5. While a violation of Article 5.5 necessarily implies a violation of Article 2.3, the converse is not true. Article 2.3 contains independent obligations beyond those of Article 5.5. Thus, a violation of Article 2.3 can be found without any examination under Article 5.5.²³

2.4 The Goal of Harmonization

SPS measures vary widely across countries due to the differences in factors which national regulatory authorities take into account in creating SPS measures, such as the interests of domestic industries, consumers' tolerance of risk, climatic and geographical conditions, level of technological development and the economic resources available. However, the resulting diversity of SPS measures has a negative impact on trade as exporters must meet a plethora of standards to gain entry to export markets. This is of particular significance for developing countries which often lack the resources and technical capacity to implement these diverse standards.

The *SPS Agreement* aims to address this problem. In its preamble, one of the primary aims expressed is the promotion of the use of harmonized SPS measures by Members, based on international standards developed by the relevant international organizations, without requiring Members to change what they consider to be an appropriate level of protection.²⁴

Article 3 of the *SPS Agreement* therefore attempts to balance the aim of increasing free trade through harmonizing SPS measures and thus reducing the trade barriers caused by differing standards, with respect for the right of

²² Appellate Body Report, *EC - Hormones*, para. 212.

²³ Compliance Panel Report, *Australia - Salmon*, para. 8.160 and Appellate Body Report, *Australia - Salmon*, para. 252.

²⁴ This aim is expressed in the sixth paragraph of the Preamble to the *SPS Agreement*.

Members to choose their own level of protection. This aim was expressly stated by the Appellate Body in *EC - Hormones* where it held:

In generalized terms, the object and purpose of Article 3 is to promote the harmonization of the SPS measures of Members on as wide a basis as possible, while recognizing and safeguarding, at the same time, the right and duty of Members to protect the life and health of their people. The ultimate goal of the harmonization of SPS measures is to prevent the use of such measures for arbitrary or unjustifiable discrimination between Members or as a disguised restriction on international trade, without preventing Members from adopting or enforcing measures which are both 'necessary to protect' human life or health and 'based on scientific principles', and without requiring them to change their appropriate level of protection.²⁵

Harmonization around international standards is encouraged in the *SPS Agreement* by means of a presumption of consistency of measures conforming to international standards with the GATT 1994 and the *SPS Agreement*. However, the adoption of harmonized standards is not actually mandated even though global standards would be most trade efficient. This is in line with the fact that the choice of a level of protection is viewed as a sovereign decision and accorded substantial deference in the *SPS Agreement*. Thus a government is not obliged to adopt an international standard that leads to a level of health protection lower than that which it deems to be appropriate. This strategy is embodied in Article 3 of the *SPS Agreement*.

Under Article 3, Members are given three autonomous options with regard to international harmonised standards, each with its own consequences. Broadly speaking, Members may either (1) base their SPS measures on international standards under Article 3.1; (2) conform their SPS measures to international standards under Article 3.2; or (3) deviate from international standards under Article 3.3. It is important to note that these are equally available alternatives and that there is no rule-exception relationship between them.²⁶ As a result, the burden of proof remains on the complaining Member to show that the requirements under any of the three options are not met.

These three options are examined in more detail below.

2.4.1 Measures Based on International Standards

Article 3.1 SPS

Article 3.1 expresses the aim of harmonizing SPS measures on as wide a basis as possible, and states the obligation of Members to “base” their SPS measures on international standards, guidelines or recommendations, where they exist, except as provided for in Article 3.3.²⁷

²⁵ Appellate Body, *EC – Hormones*, para.177.

²⁶ In *EC-Hormones* the Appellate Body rejected the Panel’s approach of seeing Articles 3.1 and 3.2 as the general rule and Article 3.3 as the exception (Appellate Body Report, *EC – Hormones*, para. 104).

²⁷ Once again, it should be remembered that this last phrase does not mean that Article 3.3 is an exception to the obligation set out in Article 3.1, but that it only serves to exclude from its scope of application measures falling under Article 3.3 (Appellate Body Report, *EC - Hormones*, para. 104).

Annex A.3 SPS

It is necessary to identify what is meant by “international standards, guidelines or recommendations”. The WTO is not a regulatory body with norm-setting capacity. Therefore it cannot set harmonized standards itself, but relies on those set by international standard-setting organizations active in the field of human, animal or plant health. These organizations are identified in Annex A.3 of the *SPS Agreement*, which defines “international standards, guidelines and recommendations” as those set by: (1) the Codex Alimentarius Commission in the area of food safety; (2) the International Office of Epizootics in the area of animal health; (3) the International Plant Protection Convention in the area of plant health; and (4) other relevant international organizations open for membership to all WTO Members, as identified by the SPS Committee, for matters not covered by the three mentioned organizations.

Each of the standard-setting organizations has its own structure and standard-setting procedure. These are dictated by their own statutes and not by the WTO. In general, their activities may be characterised as taking risk management decisions (such as laying down guidelines or setting standards, which embody a certain level of protection) on the basis of scientific information from risk assessments.²⁸ However, the way in which they do this varies considerably. Due to the increased importance of the standards set by these organizations since the coming into force of the *SPS Agreement*, there has been a growing interest in the standard-setting work of these organizations.

“Based on”

Where a relevant international standard, guideline or recommendation exists, Article 3.1 requires that Members “base” their SPS measures on that standard. In *EC - Hormones* the meaning of “based on” was addressed. The Appellate Body stated:

...To read Article 3.1 as requiring Members to harmonize their SPS measures by conforming those measures with international standards, guidelines and recommendations, in the here and now, is, in effect, to vest such international standards, guidelines and recommendations (which are by the terms of the Codex recommendatory in form and nature) with obligatory force and effect. The Panel’s interpretation of Article 3.1 would, in other words, transform those standards, guidelines and recommendations into binding norms. But, as already noted, the SPS Agreement itself sets out no indication of any intent on the part of the Members to do so. We cannot lightly assume that sovereign states intended to impose upon themselves the more onerous, rather than the less burdensome, obligation by mandating conformity or compliance with such standards, guidelines and recommendations. To sustain such an assumption and to warrant such a far-reaching interpretation, treaty language far more specific and compelling than that found in Article 3 of the SPS Agreement would be necessary.²⁹

The Appellate Body thus made it clear that the voluntary standards set by the

²⁸ The distinction between risk assessment and risk management is discussed in Section 3 below.

²⁹ Appellate Body, *EC-Hormones*, para. 165.

relevant international organizations do not become mandatory through the operation of the *SPS Agreement*.

With regard to the meaning of “based on”, the Appellate Body stated that one thing is commonly said to be based on another if the former stands or is founded or built upon or supported by the latter. Further, it stated that a measure based on a standard does not necessarily conform to that standard, such as where only some but not all the elements of the standard are incorporated into the measure.³⁰

For developing countries, the advantage of basing their SPS measures on international standards comes from the fact that they are often unable to undertake the scientific studies necessary to support their own SPS measures, due to resource constraints. International standards are necessarily based on scientific risk assessments. Therefore, developing country measures that are based thereon, even if they do not conform completely and do not adopt the same measure as the international standard, are based on a risk assessment. If challenged under Article 5.1, which requires that SPS measures be based on a risk assessment, developing countries can then point to the risk assessment that forms the basis for the international standard, and must then only show that their own measure is “based on” this risk assessment.³¹ For this reason, it is to the advantage of developing countries that as many international standards as possible are developed in areas of interest to them.

2.4.2 Measures Conforming to International Standards

Article 3.2 SPS

The second option open to Members, set out in Article 3.2, is to choose to establish an SPS measure which conforms to the relevant international standard, guideline or recommendation. In *EC - Hormones* the Appellate Body explained what is required for a measure to “conform to” an international standard, stating:

“conform to”

*Such a measure would embody the international standard completely and, for practical purposes, convert it into a municipal standard.*³²

It thus appears that the national measure must be identical to the international standard, both as regards its structure and the level of protection it embodies.

Presumption of consistency

Article 3.2 encourages harmonization by creating a presumption of consistency with the GATT 1994 and the *SPS Agreement* for such conforming measures. This presumption was held to be rebuttable.³³ The Appellate Body in *EC - Hormones* addressed the implications of the presumption of consistency. It stated that the presumption is an *incentive* for Members to conform their SPS

³⁰ Appellate Body Report, *EC – Hormones*, para.163.

³¹ The requirement that an SPS measure be “based on” a risk assessment will be discussed in Section 3 below.

³² Appellate Body, *EC - Hormones*, para. 170.

³³ Appellate Body Report, *EC - Hormones*, para. 170.

measures with international standards, but that Members who decide not to conform their measure to international standards may not be *penalized* by the imposition of a special or generalized burden of proof.³⁴ It is therefore clear that the burden of proof remains on the complaining party to prove a violation of the *SPS Agreement* in either case, but the burden is heavier in respect of conforming SPS measures as the complaining party has to overcome the presumption of consistency contained in Article 3.2.

The presumption of consistency in Article 3.2 holds definite benefits for developing countries. Often developing countries lack the resources to comply with all the disciplines of the *SPS Agreement* when imposing SPS measures. They are thus vulnerable to challenges under the *SPS Agreement*. When their SPS measures conform to international standards, the likelihood that they will be challenged is greatly reduced due to the difficulties involved in overcoming the presumption of consistency contained in Article 3.2. It should be noted that the presumption of consistency extends not only to the scientific disciplines of the *SPS Agreement*, but that the conforming measures will be presumed consistent with the entire *SPS Agreement* as well as the GATT 1994.

2.4.3 Measures Resulting in a Higher Level of Protection

Article 3.3 SPS

The third option open to Members is contained in Article 3.3. Article 3.3 recognizes the right of Members to use SPS measures which result in a higher level of protection than would be achieved by measures “based on” the relevant international standards and sets certain requirements for this. This option is significant in that it recognizes Members’ right to choose their own level of SPS protection, an important principle in the *SPS Agreement*. In *EC - Hormones* the Appellate Body held that:

The right of a Member to establish its own level of sanitary protection under Article 3.3 of the SPS Agreement is an autonomous right and not an ‘exception’ from a ‘general obligation’ under Article 3.1.³⁵

The right to choose measures providing a higher level of protection than international standards is not an “absolute or unqualified right”, as recognized by the Appellate Body in *EC - Hormones*.³⁶ Instead, it is subject to the requirements laid down in Article 3.3, namely that there either be a scientific justification for the measure or that the measure be the result of the higher level of protection chosen by the Member in accordance with Articles 5.1-5.8. In both cases, the measure must be consistent with all other provisions of the *SPS Agreement*.

Although the use of the word “or” would seem to indicate that two different situations are envisaged by Article 3.3 where deviation from international

³⁴ Appellate Body Report, *EC - Hormones*, para. 102.

³⁵ Appellate Body, *EC-Hormones*, para. 172

³⁶ Appellate Body Report, *EC - Hormones*, para.172.

standards is possible, the Appellate Body has recognized that this article is “not a model of clarity in drafting”.³⁷ According to the Appellate Body, the distinction made in Article 3.3 between two situations “may have very limited effects and may, to that extent, be more apparent than real.”³⁸ This is because, on proper interpretation of this provision, a Member that deviates from an existing international standard is *always* obliged to justify its measures by means of a risk assessment.³⁹ In other words, a Member who claims scientific justification for its deviation from an international standard, must base its claim on a proper risk assessment in the same way as must a Member who justifies its deviation on the grounds that it has chosen a different level of protection than that achieved by the international standard. According to the Appellate Body, the requirement of a risk assessment is “intended as a countervailing factor in respect of the right of Members to set their appropriate level of protection.”⁴⁰

2.4.4 *Developing Country Participation in International Standard Setting*

Articles 3.4 and 10.4 SPS

Members are obliged, under Article 3.4, to participate in the work of the international standard-setting organizations, to the extent that their resources permit, and to promote the development and periodic review of the SPS standards set in these organizations. However, this provision itself recognizes that resources are a limiting factor regarding the participation of Members in international standard-setting organizations.

In fact, much critical attention has been focused on the standard-setting process in these organizations and the problems that developing countries face with regard to effective participation therein.⁴¹ The recognition of this situation is reflected in Article 10.4, which states that Members should encourage and facilitate the active participation of developing country Members in the relevant international standard-setting organizations. There have been initiatives in this regard, but concerns still remain regarding the commitment of developed countries to implementing Article 10.4, which does not impose real obligations on Members but states only that they “should” provide assistance to developing countries in this regard.

In recent years, due to their awareness of the increased importance of international standards under the *SPS Agreement*, the participation of developing countries in the standard-setting organizations has been increasingly active. Their level of attendance has improved and they have become more vocal in ensuring their viewpoints are taken into account in plenary sessions

³⁷ Appellate Body Report, *EC - Hormones*, para.175.

³⁸ Appellate Body Report, *EC - Hormones*, para. 176.

³⁹ In a footnote to Article 3.3, “scientific justification” is defined in a way that indicates that a risk assessment is required (Appellate Body Report, *EC - Hormones*, para. 175).

⁴⁰ Appellate Body Report, *EC - Hormones*, para. 177.

⁴¹ The issue of effective participation should be distinguished from that of Membership in the international standard-setting organizations. In fact, a large majority of WTO Members, including most developing countries, are members of Codex, the OIE and the IPPC. The WTO secretariat has compiled a list in this regard (see G/SPS/GEN/49/Rev.4, dated 30 April 2002).

where standards are decided upon. However, their participation in technical committees where scientific evidence is discussed and standards are prepared often leaves much to be desired. This is often due to the lack of human and financial resources necessary to ensure attendance of the plethora of committee meetings by well-prepared specialists in the areas in which standards are set. In addition, the lack of effective national infrastructures for the evaluation of draft standards and the formulation of positions has been identified as a problem.⁴²

Increasingly there have been concerted efforts to address the problems that developing countries face with regard to effective participation in standard-setting organizations.⁴³ The Directors-General of the FAO, WHO, OIE, WTO and the President of the World Bank issued a statement at the Doha Ministerial Conference in which they affirmed their commitment to strengthening the capacity of developing countries to participate fully in international standard-setting.⁴⁴ However, it is clear that there is still much to be done in this regard.⁴⁵

2.5 Test Your Understanding

1. **Explain the effect of Article 2.1 of the SPS Agreement on the burden of proof in dispute settlement regarding an SPS measure and compare this to the situation of health measures under the GATT 1994.**
2. **What does the requirement of “sufficient scientific evidence” entail?**
3. **WTO Members are not required to adopt internationally agreed SPS standards, guidelines or recommendations. They have in fact three options. Describe these three options and their consequences. Which of these options is often most beneficial to developing country Members?**
4. **Describe the current situation with regard to developing country participation in international standard-setting organizations.**

⁴² G/SPS/GEN/236, dated 9 March 2001.

⁴³ See for example the initiatives described in: G/SPS/GEN/250, dated 14 May 2001.

⁴⁴ WT/MIN(01)/ST/97, dated 11 November 2001.

⁴⁵ In this respect it should be noted that a review of the Codex (and other FAO and WHO work on food standards) has been launched to provide input into decision making on future policies and management. This review will include an evaluation of the particular interests of developing countries as regards their participation in the standard-setting process (see World Health Organization and Food and Agriculture Organization, Joint FAO/WHO Evaluation of the Codex Alimentarius and other FAO and WHO Work on Food Standards 16 April 2002, WHO/FAO: Rome/Geneva para. 8(iv)). See also Steve Suppan and Rod Leonard, Comments Submitted to the Independent Evaluation of the Codex Alimentarius and Other FAO-WHO Work on Food Standards, WTO Watch (2002), available at: www.wtwatch.org/library/admin/uploadedfiles/showfile.cfm?FileName=Comments_Submitted_to_the_Independent_Evaluation.htm.

3. RISK ANALYSIS OBLIGATIONS

On completion of this section the reader will be able:

- to identify and discuss the obligations in the *SPS Agreement* that relate to risk analysis and the regulatory process.
- to distinguish between risk assessment and risk management and explain how the disciplines relevant to each are applied in practice.
- to assess the role of the precautionary principle in the *SPS Agreement* as reflected in Article 5.7.

3.1 Aspects of the Regulatory Process

A distinction has been drawn between two aspects of the regulatory process that deal with risk analysis: risk assessment and risk management. Risk assessment can be defined as the science-based process of determining the existence of a risk and the likelihood of it occurring. Risk management, on the other hand, entails a policy-based choice of the level of health protection that a state wants to secure in its territory, and the choice SPS measure to achieve this level of protection. Risk management decisions are based not only on the scientific results of the risk assessment but also on various societal value judgements such as the citizens' tolerance of risk. The distinction between the two aspects of the regulatory process is not absolute, however, and non-scientific elements do play a role in risk assessment. The distinction is only a useful tool to enhance understanding of the regulatory process.

Article 5 SPS

The rules of the *SPS Agreement* relating to the regulatory process, contained in Article 5, have been fashioned in a way that *implicitly* takes this distinction into account when judging the validity of national SPS measures. Strict disciplines are applied to the risk assessment process, whereas a Member's choice of an appropriate level of protection is, to a large extent, respected. However, as noted by the Appellate Body in *EC - Hormones*, there is no express mention of the term "risk management" in the *SPS Agreement* and this conceptual distinction should not be used in a way that is not supported by the actual text of the *SPS Agreement*.⁴⁶

3.2 Risk Assessment

The *SPS Agreement* contains certain disciplines applicable to the risk assessment phase of the regulatory process, which aim to ensure that SPS measures are scientifically justified and take the relevant factors into account. Fundamental to these disciplines is the requirement that Members ensure that their SPS measures are based on a risk assessment.

⁴⁶Appellate Body Report, *EC - Hormones*, para. 181.

3.2.1 Concept of Risk Assessment

Annex A.4 SPS

In order to establish if an SPS measure is based on a risk assessment as required by Article 5.1, it is first necessary to determine what is meant by a risk assessment. Annex A.4 of the *SPS Agreement* defines two types of risk assessments, which correspond to the two broad goals of SPS measures as defined in Annex A.1, namely protection from risks from pests or diseases and protection from food-borne risks.⁴⁷ It is important to determine what type of risk assessment is required in a particular case as the requirements for each type differ.

The first type of risk assessment requires the “evaluation of the likelihood of entry, establishment or spread of a pest or disease within the territory of an importing Member according to the sanitary or phytosanitary measure which might be applied, and of the associated potential biological and economic consequences”. The second requires the “evaluation of the potential for adverse effects on human or animal health arising from the presence of additives, contaminants, toxins or disease-causing organisms in food, beverages or feedstuffs.” Which definition of risk assessment applies in a given case will depend on what type of SPS measure (defined according to its *goal or purpose*) is at issue.

Risk assessment for food-borne risks

In *EC - Hormones* the SPS measure (the EC’s ban on hormone-treated beef) was aimed at food-borne risks. Thus the second definition of risk assessment was at stake. The Panel had held that there were two requirements for this kind of risk assessment (in this case), namely it should:

- (i) *identify* the *adverse effects* on human health (if any) arising from the presence of the hormones at issue when used as growth promoters *in meat or meat products*; and
- (ii) if any such adverse effects exist, *evaluate* the *potential* or probability of occurrence of these effects.⁴⁸

The Appellate Body did not take issue with the two-step test, but disagreed with the Panel’s use of “probability” as an alternative for “potential” as the word seems to introduce a quantitative element to the notion of risk.⁴⁹ The Appellate Body agreed with the Panel⁵⁰ that there must be an “identifiable risk”, not just a theoretical uncertainty (which always remains since science can *never* provide *absolute* certainty that a given substance will not *ever* have adverse health effects). However, to the extent that the Panel seemed to require a risk assessment to establish a minimum magnitude of risk, the Appellate Body noted that there is no basis in the *SPS Agreement* for such a quantitative requirement.⁵¹ Thus, although a risk assessment must identify a real risk, this risk need not be quantified but can be expressed qualitatively.

⁴⁷ The definition of SPS measures in Annex A.1 is discussed in Section 1 above.

⁴⁸ Panel Report, *EC – Hormones (Canada)* para. 8.101 and Panel Report, *EC – Hormones (US)*, para. 8.98.

⁴⁹ Appellate Body Report, *EC - Hormones*, paras.184-186.

⁵⁰ Panel Report, *EC – Hormones (Canada)* para. 8.155-156 and Panel Report, *EC – Hormones (US)*, para. 8.152-153.

⁵¹ Appellate Body Report, *EC - Hormones*, para. 186.

Risk assessment for risks from pests or diseases

In *Australia - Salmon* the SPS measure at issue (Australia's ban on fresh, chilled or frozen salmon from Canada) was aimed at preventing the entry, establishment or spread of fish diseases. Thus the first definition of risk assessment was applicable. The Panel held that this type of risk assessment must:

- (1) assess the risk of entry, establishment or spread of a disease; and
- (2) assess the risk of the 'associated potential biological and economic consequences'.⁵²

This differs from the second definition of a risk assessment for food-borne risks as the latter does not involve an evaluation of biological and economic consequences. This is because in cases where human health is at risk, Members cannot be required to weigh up economic considerations.

In order to assess these two elements of risk under the first definition, a three-pronged test must be met.⁵³ Namely, the risk assessment must:

- (1) *identify* the pests or diseases whose entry, establishment or spread a Member wants to prevent within its territory, as well as the potential biological and economic consequences associated with the entry, establishment or spread of these diseases;
- (2) *evaluate the likelihood* of entry, establishment or spread of these pests or diseases, as well as the associated potential biological and economic consequences; and
- (3) *evaluate the likelihood* of entry, establishment or spread of these diseases *according to the SPS measures which might be applied*.⁵⁴

The Appellate Body in *Australia - Salmon*⁵⁵ pointed to the different language used in the first and second definitions of risk assessment in Annex A. While the second calls for an evaluation of the "potential" for adverse effects, the first requires the evaluation of the "likelihood" of entry, establishment or spread of pests or diseases. The Appellate Body held that "likelihood" means "probability". Thus under this definition of risk assessment it is not sufficient to show a *possibility* of entry, establishment or spread of diseases and associated biological and economic consequences. Instead, the risk assessment must evaluate the "likelihood", i.e., the *probability*, of entry, establishment or spread of diseases and associated biological and economic consequences as well as the "likelihood", i.e., *probability*, of entry, establishment or spread of diseases according to the SPS measures which might be applied.⁵⁶

The Appellate Body disagreed with the Panel that *some* evaluation of the

⁵² Panel Report, *Australia – Measures Affecting Importation of Salmon* ("Australia – Salmon"), WT/DS18/R and Corr.1, para. 8.72.

⁵³ Appellate Body Report, *Australia - Salmon*, para. 121.

⁵⁴ Appellate Body Report, *Australia - Salmon*, para. 121. This test was endorsed by the Appellate Body in *Japan-Agricultural Products* as well as by the Compliance Panel in *Australia-Salmon* (Appellate Body Report, *Japan - Agricultural Products*, para.112; Compliance Panel Report, *Australia - Salmon*, para. 7.41).

⁵⁵ Appellate Body Report, *Australia – Salmon*, para. 123.

⁵⁶ The first definition was also at issue in *Japan-Agricultural Products* (Appellate Body Report, *Japan - Agricultural Products*, para.113-114).

likelihood or probability is sufficient, but agreed that the probability may be expressed either quantitatively or qualitatively and that there is no requirement for the risk assessment to establish a certain magnitude or threshold level of degree of risk.⁵⁷

It seems likely that the different terminology in the two definitions of risk assessment was intended to set less stringent requirements in cases where human health is more likely to be at risk, namely where food safety is at issue, than in cases where the risk applies to pests or diseases, which are more likely to affect plants or animals. However, in neither case is a quantified assessment of risk required or does a minimum threshold of risk have to be proved.

Specificity

Aside from the findings regarding the specific requirements of each of the two definitions of risk assessment, the decisions in these cases also address common issues relating to risk assessment in general. One of these issues is the requirement of specificity in the analysis of risk. It is not sufficient for a risk assessment to show a general risk of harm, but the specific kind of risk at stake in the dispute must be shown.⁵⁸

Comprehensive-ness

Further a risk assessment must be comprehensive i.e. it must cover each of the substances at issue.⁵⁹

Relevance of risk assessments for other product categories

It is possible that studies or risk assessments exist in product categories other than the one at issue, which may have relevance to the case at hand. For example, the two product categories could face risks from the same disease agent. However, although a completely new risk assessment may not be necessary for each product category, a risk assessment for one product cannot be regarded as constituting a risk assessment for related product categories.⁶⁰

As appropriate to the circumstances

The requirement that SPS measures be based on a risk assessment is qualified by the phrase “as appropriate to the circumstances.” It has been held that this qualification does not annul or supersede the obligation to base SPS measures on a risk assessment. Instead, it was held to relate to the *manner* in which such risk assessment has to be carried out.⁶¹ This may differ, depending on the source of the risk (e.g. chemical or pathogen), subject of the risk (human, plant or animal), product involved, and country-specific situations regarding the country of origin or destination of the product. What the appropriate manner

⁵⁷ Appellate Body Report, *Australia - Salmon*, paras 123-124.

⁵⁸ In *EC-Hormones* the Appellate Body found that the risk assessments provided by the EC did not focus on or address the particular kind of risk at stake in that case, namely the carcinogenic or genotoxic potential of the residues of those hormones found in meat derived from cattle to which the hormones had been administered for growth promotion purposes. Thus the studies were not sufficiently specific to the case at hand and did not meet the requirements for a risk assessment (Appellate Body Report, *EC - Hormones*, para. 200).

⁵⁹ In *EC-Hormones* there was an almost complete lack of evidence regarding one of the hormones at issue, MGA. The Panel noted that one of the basic principles of a risk assessment is that it needs to be carried out for each individual substance at issue (Panel Report, *EC – Hormones (Canada)*, para. 8.258 and Panel Report, *EC – Hormones (US)*, para. 8.255). Similarly, the Panel in *Australia – Salmon* had emphasized that a risk assessment must identify and evaluate the risk for any given disease of concern separately, not simply address the overall risk related to the combination of all diseases of concern (Panel Report, *Australia – Salmon*, para.8.74).

⁶⁰ Panel Report, *Australia – Salmon*, para.8.58.

⁶¹ Panel Report, *Australia – Salmon*, para. 8.57.

of conducting a risk assessment is in a specific case, is determined with reference to the opinions of scientific experts and risk assessment techniques established by international standard-setting organizations in the area at issue.⁶² This flexibility in the manner of conducting a risk assessment could be particularly useful to developing countries.

3.2.2 *Factors to be taken into Account*

Article 5.2 SPS

Although the *SPS Agreement* does not specify a methodology to be used in conducting a risk assessment, aside from requiring Members to take into account the techniques developed by international organizations,⁶³ Article 5 does list certain factors that Members must take into account when making a risk assessment. Article 5.2 lists the relevant scientific and technical considerations, namely: “available scientific evidence; relevant processes and production methods; relevant inspection, sampling and testing methods; prevalence of specific diseases or pests; existence of pest- or disease-free areas; relevant ecological and environmental conditions; and quarantine or other treatment.” From this list it is clear that a risk assessment, for the purposes of the *SPS Agreement*, is not purely scientific (in the sense of laboratory science), but involves consideration of real-world factors that affect risk, such as climatic factors that could contribute to the proliferation of a pest; the vulnerability of an ecology such as that on an island state; the effectiveness of control mechanisms etc.

In *EC - Hormones* the Appellate Body clarified that Article 5.2 is not a closed list, and therefore risks related to detection and control of failure to observe good veterinary practice could also be taken into account as part of the risk assessment. It therefore overruled the Panel’s finding that such considerations were non-scientific and therefore belonged under risk management rather than risk assessment. In this regard, the Appellate Body noted:

It is essential to bear in mind that the risk that is to be evaluated in a risk assessment under Article 5.1 is not only risk ascertainable in a science laboratory operating under strictly controlled conditions, but also risk in human societies as they actually exist, in other words, the actual potential for adverse effects on human health in the real world where people live and work and die.⁶⁴

Article 5.3 SPS

Article 5.3 lists certain *economic* factors which Members must take into account when assessing risks to animal or plant (not human) life or health, or when choosing the SPS measure to be applied to achieve their chosen level of

⁶² Panel Report, *Australia – Salmon*, para.8.71.

⁶³ The relevant international standard setting organizations have established guidelines on risk assessment techniques. See for example the *Codex Principles and Guidelines for the Conduct of Microbiological Risk Assessment CAC/GL30*, (1999); the *IPPC Guidelines for Pest Risk Analysis. Chapter 2: Pest Risk Assessment, ISPM 2* (1996); and the *OIE International Animal Health Code, Guidelines for Risk Analysis, Chapter 1.3.2*.(2001) and *International Aquatic Animal Health Code, Guidelines for Risk Assessment, Chapter 1.4.2* (2002).

⁶⁴ Appellate Body, *EC-Hormones*, para. 187.

protection. These economic factors are: “the potential damage in terms of loss of production or sales in the event of entry, establishment or spread of a pest or disease; the costs of control or eradication in the territory of the importing Member; and the relative cost-effectiveness of alternative approaches to limiting risks.” It is significant to note that Members are not obliged to take these factors into account when regulating risks to human life or health as it is recognized that human health has priority above economic considerations.

3.2.3 Requirement that Measures be “based on” a Risk Assessment

Article 5.1 SPS

Article 5.1 sets the requirement that SPS measures be “based on” an assessment of the risks to human, animal or plant life or health, as appropriate to the circumstances and taking into account risk assessment techniques developed by the relevant international organizations.

The meaning of “based on” was discussed in *EC - Hormones*. The Appellate Body found that ‘based on’ refers to a certain *objective relationship* between two elements, namely between the SPS measure and the risk assessment.⁶⁵

The Appellate Body went on to hold that the requirement that an SPS measure be “based on” a risk assessment is a substantive requirement. Article 5.1, read together with Article 2.2, requires that the results of the risk assessment must “sufficiently warrant” or “reasonably support” the relevant SPS measure, and thus that there be a *rational relationship* between the measure and the risk assessment.⁶⁶

Conflicting scientific conclusions

In practice, the situation sometimes arises that risk assessments come to conflicting conclusions. The Appellate Body in *EC - Hormones* addressed this situation and found that a risk assessment need not come to a monolithic conclusion, but can set out both mainstream and diverging scientific opinions.⁶⁷ It further held:

*... In most cases, responsible and representative governments tend to base their legislative and administrative measures on ‘mainstream’ scientific opinion. In other cases, equally responsible and representative governments may act in good faith on the basis of what, at a given time, may be a divergent opinion coming from qualified and respected sources. By itself, this does not necessarily signal the absence of a reasonable relationship between the SPS measure and the risk assessment, especially where the risk involved is life-threatening in character and is perceived to constitute a clear and imminent threat to public health and safety. Determination of the presence or absence of that relationship can only be done on a case-to-case basis, after account is taken of all considerations rationally bearing upon the issue of potential adverse health effects.*⁶⁸

⁶⁵ Appellate Body Report, *EC - Hormones*, para. 189.

⁶⁶ Appellate Body Report, *EC - Hormones*, para. 193.

⁶⁷ Appellate Body Report, *EC - Hormones*, para. 193.

⁶⁸ Appellate Body, *EC-Hormones*, para. 194.

Borrowed risk assessments

The Appellate Body further noted that 5.1 does not require a Member to conduct its own risk assessment. Instead Members may base their measures on other relevant assessments, such as those carried out by another Member, or an international organization, “as appropriate to the circumstances”.⁶⁹ This finding means that developing countries, many of whom experience problems in conducting their own risk assessments due to resource constraints, may base their measures on risk assessments of other Members or international organizations. However, it should be noted that these borrowed risk assessments should address the risk situation actually faced by the Member imposing the measure (i.e. the relevant environmental conditions, inspection methods, potential damage etc.) in order to meet the requirements of Articles 5.2 and 5.3.

Measures preceding risk assessments

It is also important to determine *when* the risk assessment needs to have been made in order for a measure to be “based” thereon. Obviously there is a multitude of SPS measures that were in existence long before the coming into force of the *SPS Agreement*. It is possible that many of these were not based on a risk assessment, particularly in Members whose resources are too scarce to permit them to undertake thorough risk assessments before enacting SPS measures. The Panel in *EC - Hormones* noted it is possible for an SPS measure enacted before the entry into force of the *SPS Agreement* to be based on a risk assessment carried out after this date. However, this does not excuse a Member from the obligation to base its measure on a risk assessment.⁷⁰ The Appellate Body in that case confirmed this finding.⁷¹

3.3 Risk Management

As discussed above, the *SPS Agreement* gives national regulators broad latitude to take risk management decisions, such as determining the appropriate level of protection they will aim at and choosing the SPS measures they will impose to achieve this level of protection. However, there are certain, non-scientific disciplines that apply to the exercise of these choices.

3.3.1 Right to Determine the Appropriate Level of Protection

Annex A.5 SPS

The concept of “appropriate level of protection” is defined in Annex A paragraph 5 as the level of protection *deemed appropriate by the Member* imposing the measure. It is therefore clear that it is the prerogative of a Member to decide what level of protection of human, animal and plant life or health it will aim at in its territory. This choice is usually made on the basis of scientific information as well as other considerations such as producer and consumer preferences. The *SPS Agreement* does not compel a Member to accept a level

⁶⁹ Appellate Body Report, *EC - Hormones*, para. 190. However, the Appellate Body did require that proof that a risk assessment supporting the measure does exist, be produced at dispute-settlement proceedings.

⁷⁰ Panel Report, *EC – Hormones (Canada)*, para. 8.102 and Panel Report, *EC – Hormones (US)*, para. 8.99.

⁷¹ Appellate Body Report, *EC - Hormones*, para. 129.

of protection lower than the one it has chosen, even if this would be more trade efficient.

It is important to distinguish carefully between the risk assessed in a risk assessment and the appropriate level of protection aimed at. This fact was noted by the Appellate Body in *Australia - Salmon*, where it rejected the Panel's finding that Members may not aim at "zero risk".⁷² The Appellate Body distinguished the "risk" evaluated in a risk assessment, which must be an identifiable risk and not just a theoretical uncertainty (as discussed above), and the "appropriate level of protection" chosen, which may be a zero-risk level.⁷³ Clearly, once it is established that there is scientific evidence of risk, Members are free to choose their own appropriate level of protection.

3.3.2 *Minimizing Negative Trade Effects*

Article 5.4 SPS

Article 5.4 provides that Members *should* take into account the objective of minimizing negative trade effects, when choosing their appropriate level of protection. The use of the word "should" rather than "shall" indicates that it is a purely hortative provision, containing no binding obligation on Members but merely encouraging them to consider the trade effects of their choice of level of protection.⁷⁴ Clearly, obliging Members to choose the least trade restrictive level of protection would go against the underlying principle of the *SPS Agreement* that recognizes the right of Members to determine the level of protection they want to secure within their territories.

3.3.3 *Avoidance of Arbitrary or Unjustifiable Distinctions leading to Discrimination/Disguised Restrictions on Trade*

Article 5.5 SPS

Unlike Article 5.4, Article 5.5 of the *SPS Agreement* contains a binding obligation, which disciplines Members' choice of appropriate level of protection. Article 5.5 provides:

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

⁷² Panel Report, *Australia - Salmon*, para. 8.81.

⁷³ Appellate Body Report, *Australia - Salmon*, para. 125.

⁷⁴ This was recognized by the Panel in *EC-Hormones* (Panel Report, *EC - Hormones (Canada)*, para. 8.169 and Panel Report, *EC - Hormones (US)*, para. 8.166).

It is necessary to determine what precisely the discipline embodied in Article 5.5 entails. Two elements of Article 5.5 can be distinguished, namely:

- (1) the *goal* of achieving consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection; and
- (2) the *legal obligation* to avoid arbitrary or unjustifiable distinctions in the levels of protection considered to be appropriate in different situations, if these distinctions result in discrimination or disguised trade restrictions.

Regarding the first element, the Appellate Body in *EC - Hormones* noted that it sets a goal to be achieved in the *future* and does not establish a *legal obligation* of consistency of appropriate levels of protection. Further, it recognized that governments often establish their appropriate levels of protection on a case-by-case basis over time as risks arise, thus the goal is not absolute or perfect consistency, but only the avoidance of arbitrary or unjustifiable inconsistencies.⁷⁵

Regarding the second element, which does create an immediate obligation on Members, the Appellate Body in *EC - Hormones*⁷⁶ set out the requirements required for a violation to be shown. These are that:

- (1) the Member has set its own level of protection in different situations;
- (2) the levels of protection show arbitrary or unjustifiable differences in their treatment of different situations; and
- (3) these arbitrary or unjustifiable differences lead to discrimination or a disguised restriction on trade (referring to the effect of the measure used to reflect the particular level of protection).⁷⁷

These requirements were found to be *cumulative*, thus proof of different treatment of different situations is not sufficient, though it might serve as a warning signal that the measure might be discriminatory or a disguised restriction on trade.

Different situations

It is obvious that not all health risks can or should be treated the same. Thus, with regard to the first requirement for proving a violation of Article 5.5, the Appellate Body in *EC - Hormones* found that to compare the different levels of protection deemed appropriate by a Member, the different situations dealt with must be *comparable*, that is, have some common element or elements.⁷⁸ In *Australia - Salmon*, the Appellate Body noted that situations involving a risk of entry, establishment or spread of the same or a similar disease or a risk of the same or similar associated potential biological and economic consequences are *comparable* under Article 5.5.⁷⁹

⁷⁵ Appellate Body Report, *EC - Hormones*, para. 213.

⁷⁶ Appellate Body Report, *EC - Hormones*, paras 214-215.

⁷⁷ These elements were reiterated in Appellate Body Report, *Australia - Salmon*, para. 140.

⁷⁸ Appellate Body Report, *EC - Hormones*, para. 217.

⁷⁹ In *EC-Hormones* the Panel addressed the comparability of different situations (Panel Report, *EC - Hormones (Canada)*, paras 8.190, 8.215 and 8.224 and Panel Report, *EC - Hormones (US)*, paras 8.186, 8.212 and 8.221). The Appellate Body did not decide on the comparability of the situations identified by the Panel. In *Australia-Salmon* the Appellate Body found two situations where different levels of protection had been adopted comparable (Appellate Body Report, *Australia - Salmon*, para. 153).

To establish if the first requirement has been met, it is further necessary to determine whether Member has imposed *different* levels of protection in different (but comparable) situations. In *Australia – Salmon*, the Panel held that the level of protection is normally reflected in the SPS measure imposed and assumed that if there is a difference in the sanitary *measures* imposed for the different situations compared under Article 5.5, this difference reflects a distinction in *levels of protection*.⁸⁰ However, in dealing with the determination of the appropriate level of protection under Article 5.6, the Appellate Body in *Australia - Salmon* noted that nothing in the *SPS Agreement* or the DSU permits a panel or the Appellate Body to imply the Member's appropriate level of protection from the measure it applies to attain that level of protection.⁸¹ Only if a Member does not express its chosen level of protection or does so insufficiently clearly to enable the application of the relevant provisions of the *SPS Agreement*, may its level of protection be implied from the measures it imposes.

Arbitrary or unjustifiable differences

Regarding the second requirement, namely that of arbitrary or unjustifiable differences in the levels of protection, the panels and the Appellate Body examine whether there are reasons to justify the differences in levels of protection. For example, they may examine whether the two situations compared involve different levels of risk,⁸² whether the difficulty of controlling the risk differs in each case⁸³ or whether the degree of government intervention necessary to achieve the same level of protection in each case differs.⁸⁴

Discrimination or disguised restriction on trade

The third and “most important”⁸⁵ requirement to show a violation of Article 5.5 is that the arbitrary or unjustifiable distinctions in levels of protection result in discrimination or a disguised restriction on trade. From the case law, it is possible to identify certain “warning signals” which are not conclusive in their own right, but that taken *cumulatively* and with other factors *may* support the finding that the third requirement of Article 5.5 was met.⁸⁶ However, this depends on the circumstances of each case.

The three warning signals identified by the Panel in *Australia - Salmon*, and which the Appellate Body in that case agreed with,⁸⁷ were:

- (1) the arbitrary character of the differences in levels of protection (i.e. that the second requirement of Article 5.5 is met);⁸⁸

⁸⁰ Panel Report, *Australia – Salmon*, paras. 8.123-8.124.

⁸¹ Appellate Body Report, *Australia - Salmon*, paras 199-200. This issue is dealt with further later in this section.

⁸² In *Australia-Salmon* the differences in risk involved were examined (Panel Report, *Australia - Salmon*, para. 8.137-141 and Appellate Body Report, *Australia – Salmon*, para. 158).

⁸³ Appellate Body Report, *EC - Hormones*, paras 221-225.

⁸⁴ Appellate Body Report, *EC - Hormones*, para. 221.

⁸⁵ Appellate Body Report, *EC - Hormones*, para. 240.

⁸⁶ In *Australia – Salmon*, the Panel had found a violation of the third requirement of Article 5.5 on the basis of these three “warning signals” and three “other factors more substantial in nature” taken cumulatively (Panel Report, *Australia – Salmon*, paras 8.149-8.159.). The first two warning signals were also relied upon in *EC-Hormones* (Appellate Body Report, *EC - Hormones*, paras.215 and 240).

⁸⁷ Appellate Body Report, *Australia – Salmon*, para.162-166.

⁸⁸ Panel Report, *Australia – Salmon*, para.8.149; also mentioned in Appellate Body Report, *EC - Hormones*, para. 215.

- (2) rather substantial difference in levels of protection;⁸⁹ and
- (3) the absence of scientific justification (based on earlier findings of inconsistency with Articles 5.1 and 2.2) which indicates that the measure at issue constitutes a restriction on international trade, disguised as a sanitary measure.⁹⁰

In *EC - Hormones* the *objectives* of the measure were also examined by the Panel and the Appellate Body, in order to determine whether there was discrimination or a disguised restriction on trade and they came to different conclusions on this point.⁹¹

Relationship with Article 2.3 SPS

The Panel and Appellate Body in *EC - Hormones* found that Article 5.5 must be read together with the basic obligation of Members to avoid discrimination and disguised restrictions on trade in Article 2.3.⁹²

Guidelines for implementation of Article 5.5 SPS

After five years of deliberation, at its meeting of 21-22 June 2000, the SPS Committee adopted guidelines for the implementation of Article 5.5.⁹³ The clarifications resulting from the case law on this point are reflected in the guidelines. In particular, the cumulative presence of the three above-mentioned “warning signals” is stated to be a possible indication of a violation of Article 5.5.

The guidelines are not legally binding but are intended as aids to assist officials in applying Article 5.5 when deciding on appropriate levels of protection or adopting and implementing SPS measures. The guidelines will be reviewed periodically, the first review to be undertaken within 36 months of their adoption.

3.3.4 Least Trade-Restrictive Measure

Article 5.6 SPS

Risk management decisions taken by governments involve not only the choice of an appropriate level of protection, but also the choice of an SPS measure to achieve this level of protection. Article 5.6 disciplines the choice of SPS measure. It obliges Members to ensure that their SPS measures are not more trade restrictive than required to achieve their appropriate level of protection, taking into account technical and economic feasibility. This amounts to a discipline on the choice of measure rather than on the selection of an appropriate level of protection.

In a footnote to this article, the concept of “a measure not more trade restrictive than required” is defined. In *Australia - Salmon* the Appellate Body agreed

⁸⁹ Panel Report, *Australia – Salmon*, para.8.150; also mentioned in Appellate Body Report, *EC - Hormones*, para. 240.

⁹⁰ Panel Report, *Australia – Salmon*, para.8.151; also mentioned in Panel Report, *EC – Hormones (Canada)*, para. 8.244 and Panel Report, *EC – Hormones (US)*, para. 8.241.

⁹¹ Panel Report, *EC – Hormones (Canada)*, para. 8.245 and Panel Report, *EC – Hormones (US)*, para. 8.242. Contra Appellate Body Report, *EC - Hormones*, para. 245.

⁹² Appellate Body Report, *EC - Hormones*, para. 212. This point is discussed further in section 2 above.

⁹³ G/SPS/15, dated 18 July 2000.

with the Panel⁹⁴ that this footnote contains a three-pronged test.⁹⁵ Namely, a measure is more trade restrictive than required only if there is another SPS measure which:

- (a) is reasonably available taking into account technical and economic feasibility;
- (b) achieves the Member's appropriate level of sanitary protection; and
- (c) is significantly less trade restrictive than the contested measure.

The Appellate Body noted that the three elements are *cumulative* in the sense that, to establish inconsistency with Article 5.6, all of them have to be met.⁹⁶

Reasonably available

To show a violation of Article 5.6, the complaining party must prove that an alternative measure exists that is "reasonably available taking into account technical and economic feasibility". This recognition of the fact that a less trade restrictive measure could have high regulatory or compliance costs or could be impractical to implement is particularly significant for developing countries. They will thus not be required to adopt less trade restrictive measures in cases where they do not have the resources or technical capacity to do so.

Achieves appropriate level of protection

In order to show a violation of Article 5.6, a Member must prove that the alternative measures achieve the importing Member's appropriate level of protection. This is important as the *SPS Agreement* recognizes that Members have the prerogative to set their own level of protection and cannot be required to lower it even if less trade restrictive alternatives exist.

It is thus necessary to determine what the appropriate level of protection is in order to be able to apply this provision. The choice of level of protection is the sole prerogative of national decision-makers. Thus alternative measures must always be judged against the Members own chosen level of protection and not simply compared to the measure currently in place. There are, however, cases where Members either do not explicitly state what level of protection they have chosen, or do so in such a vague manner that it is impossible to apply Article 5.6. The Appellate Body has thus held that there is an implied obligation in the *SPS Agreement* on Members to determine their level of protection. Only in cases where a government does not adequately determine its level of protection, may a panel infer it from the measure applied in order to prevent the avoidance of disciplines under the *SPS Agreement*.⁹⁷

Significantly less trade restrictive

The third requirement for a violation of Article 5.6 is that the available alternative measure be "significantly less restrictive to trade" than the measure actually applied. It is notable that the alternative measure must be *significantly* less trade-restrictive before a Member's measure will be deemed "more trade-

⁹⁴ Panel Report, *Australia - Salmon*, para. 95.

⁹⁵ Appellate Body Report, *Australia - Salmon*, para. 194.

⁹⁶ Appellate Body Report, *Australia - Salmon*, para. 194. This finding was reiterated in Appellate Body Report, *Japan - Agricultural Products*, para. 95.

⁹⁷ Appellate Body Report, *Australia - Salmon*, paras. 205-207.

restrictive than required.” Thus a small difference in the trade impacts of the two measures is not sufficient to oblige a Member to adopt the alternative measure.⁹⁸

3.4 Provisional Measures and the Precautionary Principle

Precautionary principle

It is generally accepted that there are situations where governments need to take measures to prevent risks to health even when sufficient scientific evidence regarding the risk is lacking. Thus, governments may act with precaution in order to protect against risks without waiting for the conclusive results of scientific analyses. This is commonly referred to as acting in accordance with the precautionary principle or the precautionary approach.

The extent to which the precautionary principle is taken into account in the *SPS Agreement* is shown below. Article 5.7 of the *SPS Agreement* allows for provisional measures when there is insufficient scientific evidence, under certain conditions, and thus could be said to reflect the precautionary principle. In *EC - Hormones*, the EC had categorized its SPS measure as final, rather than provisional, so it could not rely on Article 5.7. Instead it had tried to rely on the precautionary principle outside the framework of Article 5.7, as a general customary rule of international law or at least a general principle of law, applicable to the interpretation of the scientific disciplines in the *SPS Agreement*.

The Appellate Body expressed its doubts as to whether the precautionary principle has developed into a principle of general or customary international law, outside the field of international environmental law, but found it unnecessary to decide this issue.⁹⁹ The Appellate Body then held that the precautionary principle could not override the explicit requirements of Articles 5.1 and 5.2, in cases of scientific uncertainty.¹⁰⁰ On the relationship between the “precautionary principle” and the *SPS Agreement*, the Appellate Body noted the following four elements:

First, the principle has not been written into the SPS Agreement as a ground for justifying SPS measures that are otherwise inconsistent with the obligations of Members set out in particular provisions of that Agreement. Secondly, the precautionary principle indeed finds reflection in Article 5.7 of the SPS Agreement. We agree, at the same time, with the European Communities, that there is no need to assume that Article 5.7 exhausts the relevance of a precautionary principle. It is reflected also in the sixth paragraph of the preamble and in Article 3.3. These explicitly recognize the right of Members to establish their own appropriate level of

⁹⁸ This requirement was examined by both the Panel and the compliance Panel in *Australia-Salmon* and the Panel in *Japan-Agricultural Products* (see Panel Report, *Australia – Salmon*, para. 8.182; Compliance Panel Report, *Australia – Salmon*, paras. 7.150-7.153; and Panel Report, *Japan – Measures Affecting Agricultural Products WT/DS76/R*, paras. 8.79, 8.89, 8.95-8.96 and 8.103-8.104).

⁹⁹ Appellate Body Report, *EC –Hormones*, para. 123.

¹⁰⁰ Appellate Body Report, *EC –Hormones*, para. 125, where it held, “We accordingly agree with the finding of the Panel that the precautionary principle does not override the provisions of the *SPS Agreement*.”

sanitary protection, which level may be higher (i.e., more cautious) than that implied in existing international standards, guidelines and recommendations. Thirdly, a panel charged with determining, for instance, whether 'sufficient scientific evidence' exists to warrant the maintenance by a Member of a particular SPS measure may, of course, and should, bear in mind that responsible, representative governments commonly act from perspectives of prudence and precaution where risks of irreversible, e.g. life-terminating, damage to human health are concerned. Lastly, however, the precautionary principle does not, by itself, and without a clear textual directive to that effect, relieve a panel from the duty of applying the normal (i.e. customary international law) principles of treaty interpretation in reading the provisions of the SPS Agreement.¹⁰¹

Article 5.7 SPS

Thus, it is clear that Members that wish to impose SPS measures in the absence of sufficient scientific evidence must do so in accordance with Article 5.7 and cannot rely on an overriding “precautionary principle” to soften the scientific disciplines of the *SPS Agreement*. In *Japan - Agricultural Products*, the Appellate Body held that Article 5.7 represents a “qualified exemption from the obligation under Article 2.2 not to maintain SPS measures without sufficient scientific evidence.”¹⁰² It is therefore necessary to examine what the requirements under Article 5.7 are. It provides:

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

The Appellate Body in *Japan - Agricultural Products* identified four requirements for provisional measures under Article 5.7, namely that the measure must:

- (1) be imposed in respect of a situation where “relevant scientific information is insufficient”;
- (2) be adopted “on the basis of available pertinent information”;
- (3) not be maintained unless the Member seeks to “obtain the additional information necessary for a more objective assessment of risk”; and
- (4) be reviewed accordingly “within a reasonable period of time”.

These requirements were held to be *cumulative*. Thus, all four conditions of Article 5.7 must be met in order to avoid the scientific disciplines of Articles 2.2 and 5.1 of the *SPS Agreement*.

¹⁰¹ Appellate Body, *EC-Hormones*, para. 124

¹⁰² Appellate Body Report, *Japan- Agricultural Products*, para. 80.

3.4.1 Insufficient Relevant Scientific Evidence

The first requirement, namely that “relevant scientific evidence is insufficient”, must be met for Article 5.7 to apply.¹⁰³ It is thus crucial to determine in what circumstances this criterion will be met. The Panel in *Japan - Agricultural Products*, the only case so far where Article 5.7 was relied upon, found it unnecessary to decide on this issue for reasons of judicial economy, which the Appellate Body agreed with. There is thus no guidance in the case law with regard to the interpretation of this requirement.

3.4.2 Based on Available Pertinent Information

The second criterion contained in Article 5.7 requires that the provisional measure be adopted “on the basis of available pertinent information.” Judicial economy also precluded the examination of this requirement in *Japan - Agricultural Products*.

3.4.3 Obligation to Obtain Necessary Additional Information

Article 5.7 further prohibits the maintenance of a provisional measure unless a Member “seeks to obtain the information necessary for a more objective assessment of the risk.”

In *Japan - Agricultural Products*, the Appellate Body held in this regard:

Neither Article 5.7 nor any other provision of the SPS Agreement sets out explicit prerequisites regarding the additional information to be collected or a specific collection procedure. Furthermore, Article 5.7 does not specify what actual results must be achieved; the obligation is to ‘seek to obtain’ additional information. However, Article 5.7 states that the additional information is to be sought in order to allow the Member to conduct ‘a more objective assessment of risk’. Therefore, the information sought must be germane to conducting such a risk assessment, i.e., the evaluation of the likelihood of entry, establishment or spread of, in casu, a pest, according to the SPS measures which might be applied. We note that the Panel found that the information collected by Japan does not ‘examine the appropriateness’ of the SPS measure at issue and does not address the core issue as to whether ‘varietal characteristics cause a divergency in quarantine efficacy’. In the light of this finding, we agree with the Panel that Japan did not seek to obtain the additional information necessary for a more objective risk assessment.¹⁰⁴

3.4.4 Review within a Reasonable Period of Time

The last requirement contained in Article 5.7 refers to the obligation to review

¹⁰³ It should, however, be noted that neither the Panel nor the Appellate Body in *Japan-Agricultural Products* began by determining whether this requirement was met and thus Article 5.7 was applicable to the case.

¹⁰⁴ Appellate Body, *Japan - Agricultural Products*, para. 92.

the measure within a “reasonable period of time.” Thus Article 5.7 creates only a time-limited exemption from the normal SPS disciplines, pending review of the measure in the light of new evidence.

The Appellate Body in *Japan - Agricultural Products* had to decide on what constitutes a “reasonable period of time” within which to review the measure. The Appellate Body held that this has to be established on a case-by-case basis with regard to the specific circumstances of each case, including the difficulty of obtaining the additional information necessary for the review and the characteristics of the provisional SPS measure. The Appellate Body’s finding that one of the factors to be considered in a given case is the difficulty of obtaining the additional information necessary for the review is significant. Clearly, the state of scientific knowledge has a direct impact on the difficulty of obtaining the required information and would thus affect the determination whether a “reasonable period” has elapsed. This is important in that it waters down the temporary nature of measures allowed under Article 5.7 and makes provision for circumstances where scientific uncertainty persists for extended periods or where the risks involved are expected to materialize only in the long term. Therefore, artificially linking the requirement of review within a “reasonable period of time” to specific deadlines is avoided. In this way, Members need not fear that reliance on Article 5.7 to justify their measures will compromise their ability to maintain the measure as long as is necessary for scientific evidence to come up with clear answers.

On the other hand, it is important to note that the difficulty of obtaining information is not the sole criterion. The specific circumstances of the case will be evaluated, including factors such as the characteristics of the SPS measure at stake, amongst others, in order to establish whether this criterion has been met.

3.5 Test Your Understanding

- 1. Distinguish when each of the definitions of a risk assessment would apply and set out the requirements for each.**
- 2. Describe the limits to the exercise of the right of a Member to set its own appropriate level of protection and explain whether they could result in a Member being forced to lower its appropriate level of protection.**
- 3. If a Member wants to impose SPS measures in a situation of scientific uncertainty, what are the requirements it must meet? Can these requirements be softened by reliance on the precautionary principle?**

4. OTHER SUBSTANTIVE PROVISIONS

After completing this section the reader will be able:

- to identify the obligations relating to the recognition of equivalence of different SPS measures as well as those obligations concerned with the adaptation of SPS measures to regional conditions.
- to assess the potential benefits of these provisions for developing countries and to identify problems with their implementation.

4.1 Equivalence

Article 4 SPS

Harmonization of SPS measures around international standards is not always possible or desirable as local conditions, consumer preferences and technical capacity differ between countries. In addition, there are many areas where no international standards yet exist. In all these cases, exporters are faced with a variety of different SPS standards that they must meet to gain access to markets. This variety of SPS standards has a negative impact on trade.

This negative impact on trade of divergent SPS measures can be reduced by recognizing that these different SPS measures may be equally effective in reducing risk, and thus achieve the same level of protection. Article 4 of the *SPS Agreement* sets out the obligations of Members with regard to the recognition of equivalence.

4.1.1 Acceptance of Equivalence

Article 4.1 SPS

The recognition of equivalence most often occurs on an *ad hoc* basis and is not reflected in formal equivalence agreements. Article 4.1 promotes the recognition of equivalence by obliging Members to accept different SPS measures as equivalent, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the appropriate level of protection of the importing Member. For this purpose, the importing Member must be given reasonable access, upon request, for inspection, testing and other relevant procedures.

4.1.2 Agreements on Recognition of Equivalence

Article 4.2 SPS

In practice, it is possible for the recognition of equivalence to be negotiated and embodied in bilateral, regional or multilateral agreements, in which criteria are set out for the acceptance of different SPS measures as equivalent, either on a systems-wide or product-by-product basis. Article 4.2 encourages the conclusion of equivalence agreements by obliging Members to enter into consultations, upon request, with the aim of achieving bilateral and multilateral agreements on the recognition of equivalence of specified SPS measures. However, there is no obligation to actually conclude such agreements.

4.1.3 *Significance of Recognition of Equivalence for Developing Countries*

If importing countries recognize that various measures can achieve the same level of protection and are thus equivalent, the fact that developing countries have different capabilities regarding the imposition and control of SPS measures need not result in the rejection of their agricultural and food products in their export markets. For this reason, Article 4 could go a long way towards improving market access for food and agricultural products from developing countries.

4.1.4 *Problems of Implementation Faced by Developing Countries*

Concerns have been raised by developing countries regarding the implementation of Article 4 of the *SPS Agreement*. They claim that developed countries require “sameness” rather than equivalence of SPS standards and control and inspection systems. This deprives developing countries of the flexibility in the choice of measures that Article 4 aims to achieve. At present the recognition of equivalence by means of agreements takes place in very limited cases, and mostly between developed countries.

Developing countries have also criticised the lack of an obligation in the *SPS Agreement* to notify bilateral or multilateral agreements reached on equivalence.¹⁰⁵ Such an obligation would enable developing country Members that can comply with the conditions set in such agreement to become a party to the existing agreement or conclude a similar bilateral agreement with the importing country. However, it has been noted that Members’ Enquiry Points are obliged to provide answers to questions regarding equivalence agreements.¹⁰⁶ The WTO Secretariat has proposed a format for the notification of equivalence agreements.¹⁰⁷

Some Members, particularly developed countries, hold the view that the negotiation of equivalence agreements is too costly and resource intensive for the limited trade benefits to be gained therefrom. Thus, they advocate recourse to other provisions of the *SPS Agreement* which yield more immediate gains in market access, such as the rules on risk assessment, transparency, technical assistance and control and inspection procedures.¹⁰⁸ Developing countries counter that the burden of negotiating an equivalence agreement is justified as the improved market access gained thereby can be very important for developing countries, especially as their exports are often concentrated in a few products and enterprises.¹⁰⁹

¹⁰⁵ G/SPS/W/111, dated 4 July 2001.

¹⁰⁶ This obligation is contained in Annex B.3(d) and was confirmed by the SPS Committee at its meeting of March 2001 (*Ibid.*, para. 8).

¹⁰⁷ G/SPS/W/114/Rev.1.

¹⁰⁸ G/SPS/W/111, dated 4 July 2001.

¹⁰⁹ *Ibid.*, para. 6.

4.1.5 Equivalence Decision

The problems with implementation of Article 4 were referred to the SPS Committee by the General Council.¹¹⁰ In October 2001, the SPS Committee adopted the *Decision on the Implementation of Article 4 of the Agreement on the Application of Sanitary and Phytosanitary Measures*,¹¹¹ commonly known as the *Equivalence Decision*. This Decision sets out some guidelines for any Member who requests the recognition of equivalence of their SPS measures and for the importing Member who is the addressee of such a request.

In particular, the importing Member should, on request, supply information regarding the aim of its SPS measure, the risks it addresses, the appropriate level of protection chosen by the Member, and the underlying risk assessment for the measure. It must respond in a timely manner to the request for recognition of equivalence. The exporting Member must provide science-based and technical information to show that its measure achieves the level of protection chosen by the importing Member and provide reasonable access for testing and inspection. The importing Member should evaluate the scientific and technical information with a view to determining if the SPS measure of the exporting Member achieves its level of protection and must give full consideration to requests for technical assistance for the implementation of Article 4.¹¹²

4.2 Adaptation to Regional Conditions

The prevalence of pests and diseases is not determined by national boundaries, and may differ between various regions within a country. This may be the case either due to variations in climatic, environmental or geographic conditions within a country or due to the efforts of the regulatory authorities to eradicate a pest or disease from specific areas. In practice, however, it is common to ban products from an entire country where it has been established that a pest or disease of significance for the importing country occurs, even if its prevalence is limited to certain regions. If importing countries adapt their SPS measures to the conditions prevailing in the region of origin of the product, this may greatly improve market access possibilities. This possibility is significant for developing countries, especially large countries where conditions vary greatly from region to region, as the costs of eradicating a pest or disease or keeping a region pest- or disease-free can be limited by focusing on specific areas.

Article 6.1 SPS

In order to ensure that an area is free of pests or diseases and to prove that this is so, countries often have to invest large amounts of money and resources and comply with lengthy procedures. Thus, in order to make the investment worthwhile, countries need to be sure that their efforts will result in increased

¹¹⁰ WT/GC/M/59, dated 18 October 2000.

¹¹¹ G/SPS/19, dated 24 October 2001.

¹¹² This technical assistance may be in the form of help in identifying and implementing equivalent measures, otherwise enhancing market access opportunities or the development and provision of science-based information to support the recognition of equivalence request.

market access. Article 6.1 aims to provide this security by obliging Members to ensure that their SPS measures are adapted to the sanitary or phytosanitary characteristics of the region of origin of the product or the region to which it is destined.

4.2.1 Factors to be Taken into Account

In determining what the sanitary or phytosanitary characteristics of a region are, Article 6.1 obliges Members to take into account the level of prevalence of specific pests or diseases, the existence of eradication or control programmes and guidelines developed by international organizations. However, the list of factors in Article 6.1 is not exhaustive.

4.2.2 Pest- or Disease-free Areas or Areas of Low Pest or Disease Prevalence

Article 6.2 SPS

Article 6.2 specifically creates the obligation on Members to recognize the concepts of pest- or disease-free areas and areas of low pest or disease prevalence. These areas shall be determined with regard to factors such as geography, ecosystems, epidemiological surveillance and the effectiveness of SPS controls.

4.2.3 Obligations on Exporting Members

Article 6.3 SPS

An exporting Member that claims that regions within its territory are pest- or disease-free or have low pest or disease prevalence must provide the necessary evidence of this fact to the importing Member. For this purpose, it must give the importing Member reasonable access for inspection, testing and other relevant procedures.

4.3 Test Your Understanding

- 1. Discuss why the rules on recognition of equivalence could be to the benefit of developing countries and mention how problems with implementation of this provision are being addressed.**
- 2. Explain what is entailed by the obligation of adaptation to regional conditions and what obligations rest on exporting Members who claim pest- or disease-free status.**

5. INSTITUTIONAL AND PROCEDURAL PROVISIONS

On completion of this section the reader will be able:

- to discuss the operation of the institutional and procedural provisions of the *SPS Agreement* and specifically, the transparency and notification obligations on Members as well as the disciplines on Members' use of control, inspection and approval procedures.
- to evaluate the role of the SPS Committee and to identify those aspects of the WTO dispute settlement procedure specific to the *SPS Agreement*.

5.1 Transparency and Notification

A significant hurdle faced by exporters is the lack of transparency regarding SPS measures on their export markets. SPS measures are often complex and subject to change, leading to lack of certainty for exporters. Finding out about the SPS measures they have to comply with is often a costly and burdensome process for exporters. In addition, in order to identify which SPS measures are unjustified and subject to challenge under the SPS Agreement, details regarding these measures are necessary. For this reason, transparency and notification obligations are crucial in ensuring market access.

5.1.1 Publication and Notification Obligations

Article 7 SPS

Under Article 7 of the *SPS Agreement*, Members are obliged to notify changes in their SPS measures and must provide information on their SPS measures in accordance with Annex B.

Annex B.1 and 5-11 SPS

In terms of Annex B.1, Members must publish all adopted SPS regulations in a way that enables all interested Members to become acquainted with them. A footnote to this paragraph defines SPS regulations as SPS measures such as laws, decrees or ordinances of general application. The Appellate Body in *Japan - Agricultural Products* noted as follows with respect to this footnote:¹¹³

We consider that the list of instruments contained in the footnote to paragraph 1 of Annex B is, as is indicated by the words 'such as', not exhaustive in nature. The scope of application of the publication requirement is not limited to 'laws, decrees or ordinances', but also includes, in our opinion, other instruments which are applicable generally and are similar in character to the instruments explicitly referred to in the illustrative list of the footnote to paragraph 1 of Annex B. The object and purpose of paragraph 1 of Annex B is 'to enable interested Members to become acquainted with' the sanitary and phytosanitary regulations adopted or maintained by other Members and thus to enhance transparency regarding these measures. In our opinion, the scope of application of the

¹¹³ Appellate Body Report, *Japan - Agricultural Products II*, paras. 105-108.

publication requirement of paragraph 1 of Annex B should be interpreted in the light of the object and purpose of this provision.¹¹⁴

Where no international standards exist or where a proposed SPS measure is not substantially the same as the international standard, and the measure may have a significant effect on trade, Annex B.5 sets out the notification procedure to be followed for new SPS measures.¹¹⁵ Under this procedure, other Members are allowed a reasonable period of time to comment at an early stage in the adoption process so that amendments to the proposed measures can still be made.¹¹⁶ Members are not obliged to disclose confidential information that could hamper the enforcement of their SPS measures or prejudice the legitimate interests of enterprises. The Secretariat has established guidelines on transparency, contained in the handbook *How to Apply the Transparency Provisions of the SPS Agreement*.¹¹⁷ These are particularly aimed at helping developing countries comply with their transparency obligations.

5.1.2 Notification Authority

Annex B.10 SPS

Members are further required to create the infrastructure necessary for the implementation of their notification obligations. Under Annex B.10, Members must designate a single central government authority as responsible for implementing the notification procedures in Annex B.5-8 on national level. The WTO Secretariat regularly updates and circulates lists of Members' Notification Authorities.¹¹⁸

5.1.3 Enquiry Points

Annex B.3 and 4 SPS

As part of the infrastructure necessary for transparency, the *SPS Agreement* obliges each Member to establish a national Enquiry Point. A Member's national Enquiry Point must provide answers to all reasonable questions from other Members as well as provide relevant documents regarding *inter alia*: any adopted or proposed SPS measures in its territory; the risk assessment basis for the measure; control and inspection procedures, production and quarantine treatment, pesticide tolerance and food additive approval procedures. Requested copies of documents must be supplied to other Members at the same price as to nationals. The WTO Secretariat maintains an updated list of Enquiry Points which it circulates to Members.¹¹⁹

¹¹⁴ Appellate Body, *Japan - Agricultural Products II*, paras. 105-106.

¹¹⁵ Notifications received by the Secretariat are circulated to Members as part of the official document series G/SPS/N/*.

¹¹⁶ In urgent cases, Members may follow a shorter procedure under Annex B.6.

¹¹⁷ Published in November 2000, available at: http://www.wto.org/english/tratop_e/sps_e/spshand_e.pdf. The guidelines are non-binding and are not intended as a legal interpretation of the relevant provisions of the SPS Agreement. In addition, the Secretariat has drawn up and revised recommended procedures for the implementation of transparency obligations (G/SPS.7/Rev.2, dated 2 April, 2002).

¹¹⁸ These can be found in the G/SPS/NNA/* series of official WTO documents. By 11 March 2002, 115 of the then 144 WTO Members had established national Notification Authorities (G/SPS/GEN/27/Rev.9, dated 14 March 2002).

¹¹⁹ These can be found in the G/SPS/ENQ/* series of official WTO documents. By 11 March 2002, 122 of the then 144 WTO Members had established national Enquiry Points (*Ibid.*).

5.1.4 Explanation of Reasons

Article 5.8 SPS

A Member may request another Member to provide reasons for the latter's SPS measure where it is not based on international standards and it constrains or could potentially constrain the former Member's exports. The importing Member is then obliged to provide such reasons. This obligation is significant as it can assist a Member in establishing a *prima facie* case that another Member's SPS measure is not based on a risk assessment.

5.1.5 Importance of Notification for Developing Countries

Developing countries stand to gain particularly from the improvements in transparency achieved by the *SPS Agreement* as the cost and difficulty of obtaining information on their trading partners' SPS measures are thereby greatly reduced.

5.2 Control, Inspection and Approval Procedures

In order to ensure that their SPS measures are complied with, countries usually have control, inspection and approval procedures in place. If these procedures are lengthy, costly or complex, they may effectively restrict market access. The SPS Agreement addresses this problem in Article 8 and Annex C.

Article 8 SPS

According to Article 8, Members must comply with Annex C as well as the other provisions on the *SPS Agreement* in the operation of their control, inspection and approval procedures. This includes their national systems for approval of additives and establishment of tolerances for contaminants.

Annex C SPS

Annex C contains more detailed rules relating to control, inspection and approval procedures. These are mainly aimed at ensuring that the procedures are not more lengthy or burdensome than reasonable and necessary. In addition, exporting Members are obliged to facilitate the work of other Member's controlling authorities on their territories, where the SPS measure relates to control at the level of production.

5.3 SPS Committee

Article 12.1 SPS

A Committee on Sanitary and Phytosanitary Measures (SPS Committee) is established under Article 12.1. The SPS Committee consists of representatives¹²⁰ of all WTO Members¹²¹ and takes its decisions by consensus. The SPS Committee is serviced by the Agriculture and Commodities Division of the WTO Secretariat. The SPS Committee usually holds three meetings per year, and may convene informal meetings as necessary.

¹²⁰ Members may send representatives of their choice, and normally send officials from their food safety authorities or veterinary or plant health officials.

¹²¹ Observer status is granted to governments that have observer status in higher WTO bodies as well as representatives from certain international intergovernmental organizations with a mandate in this area (G/SPS/GEN/229, dated 23 February 2001).

The aim of the SPS Committee is to provide a regular forum for consultations and further the implementation of the *SPS Agreement* and the achievement of its aims, in particular the harmonization of standards.¹²²

5.3.1 Forum for Consultations

Article 12.2 SPS

Article 12.2 mandates the SPS Committee to encourage and facilitate consultations between Members on specific SPS issues. Coupled with the transparency obligations, this provision may go a long way towards allowing developing countries to solve SPS conflicts in a low-cost manner. Discussions on notified changes in SPS legislation take place, with concerns being raised by exporting Members and clarifications given by the Member imposing the measure.¹²³ This could lead to the revision of the notified measure or further bilateral consultations between the Members involved. In this way, disputes can be resolved without recourse to the expensive and time-consuming process of formal dispute settlement. In a recent study¹²⁴ it was shown that during SPS Committee meetings, around 120 SPS issues have been raised, almost half involving complaints by developing countries or transition economies.

5.3.2 Role Regarding the Process of International Harmonization

Article 12.2-6 SPS

The SPS Committee is given various tasks regarding the process of international harmonisation of SPS standards. It must encourage the use of international standards, guidelines and recommendations by all Members, and maintain close contact with the three main international standard-setting organizations. Further, the SPS Committee must develop a procedure to monitor the process of international harmonization and the use of international standards. A provisional procedure was established,¹²⁵ in terms of which the SPS Committee draws up annual reports based on information and comments from Members and international standard-setting organizations regarding the use of existing international standards, the need for new international standards and work on the adoption of such standards. Further, Article 12.5 allows the SPS Committee to use information gathered by the international organizations, to avoid duplication. Finally, the Committee may, in terms of Article 12.6, invite the international organizations to examine specific matters with regard to a particular standard, guideline or recommendation, including the basis for explanations of non-use of the standard.

¹²² In terms of this power, the SPS Committee adopted the Equivalence Decision in 2001, in order to facilitate the implementation of Article 4 of the SPS Agreement. This decision is further discussed in section 4 above.

¹²³ The Secretariat provides a summary of all specific trade-related concerns raised in the SPS Committee, together with an indication of the resolution of the issue, if notified (G/SPS/GEN/204/Rev.1, dated 5 March 2001).

¹²⁴ Micheal Friis Jensen, *Reviewing the SPS Agreement: A Developing Country Perspective Working Paper 02.3*, Centre for Development Research: Copenhagen at 18, table 1 (2002).

¹²⁵ G/SPS/11, dated 22 October 1997. This procedure was extended twice.

5.3.3 *Periodic Review of the Operation and Implementation of the SPS Agreement*

Article 12.7 SPS

The SPS Committee was obliged by Article 12.7 to review the operation and implementation of the *SPS Agreement* three years after its entry into force, and thereafter as the need arises. Where appropriate, the SPS Committee may make proposals to the Council for Trade in Goods regarding amendments to the *SPS Agreement*. The SPS Committee established a procedure for this review¹²⁶ and the first review was conducted in 1998, resulting in a report of the SPS Committee.¹²⁷ However, no amendments were proposed. The SPS Committee noted that the review had not been comprehensive and recognized that Members could raise any issue for the consideration of the Committee at any time.

Doha Decision on Implementation

In the Ministerial *Decision on Implementation* adopted in Doha, the SPS Committee is instructed to review the operation and implementation of the *SPS Agreement* at least once every four years.

5.4 Dispute Settlement

In order to enforce their rights under the SPS Agreement, Members can have recourse to the dispute settlement system of the WTO, as embodied in the Dispute Settlement Understanding (DSU).¹²⁸ The rules and procedures set out in the DSU apply fully and unconditionally to disputes arising under the SPS Agreement.

To date, there have been 21 complaints under the SPS Agreement regarding 18 separate issues. Three disputes have resulted in panel and Appellate Body reports¹²⁹ and one dispute is currently before a panel.¹³⁰ Developing countries¹³¹ have been involved in seven disputes, in four cases as complainant¹³² and in six as defendant.¹³³

Three issues regarding the settlement of disputes arising under the SPS Agreement deserve particular attention: the burden of proof; the standard of review; and the use of scientific experts and expert review groups.

5.4.1 Burden of Proof

The question of which party bears the evidentiary burden is particularly

¹²⁶ G/SPS/10, dated 21 October 1997.

¹²⁷ G/SPS/12, dated 11 March 1999.

¹²⁸ The dispute settlement system is discussed in detail in Modules 3.1 to 3.4. Thus here attention will only be given to specific aspects applicable to SPS disputes.

¹²⁹ These are EC – Hormones, Australia – Salmon and Japan – Agricultural Products. The findings in these cases have been discussed above where relevant.

¹³⁰ A panel was established on 3 June 2002 to address the United States complaint against Japan's restrictions on apples due to fire blight (WT/DS245).

¹³¹ Developing countries here is interpreted broadly to include economies in transition.

¹³² WT/DS134, WT/DS205, WT/DS237 and WT/DS256.

¹³³ WT/DS96, WT/DS133, WT/DS203, WT/DS205, WT/DS237 and WT/DS256.

significant in the case of disputes on health measures due to the degree of scientific uncertainty that exists in this area. In *EC - Hormones* the Appellate Body emphasised the importance of this issue, in the light of the “multiple and complex issues of fact” that may arise under the *SPS Agreement*.¹³⁴ It held that the normal rule with respect to the burden of proof applies, namely that the party asserting a fact must establish a *prima facie* case that it is true and then the evidentiary burden shifts to the other party who must rebut the presumption or lose the case.¹³⁵

In *Japan - Agricultural Products*, the United States claimed that requiring the complainant to prove that there is insufficient scientific evidence for a measure under the *SPS Agreement* amounts to requiring it to prove a negative, placing an impossible burden on the complainant.¹³⁶ The Appellate Body rejected this argument, finding that the United States was not being required to prove a negative, but merely to raise a presumption that there were no relevant studies or reports. According to the Appellate Body, the United States could have requested Japan, under Article 5.8, to provide an “explanation of the reasons” for its measure as it related to the products at issue. The failure of Japan to do so would have amounted to a strong indication that such studies or reports did not exist. Further, the United States could have questioned the Panel’s experts or submitted an opinion of its own experts on the question whether such reports exist.

Aside from the issue of the burden of proof under the *SPS Agreement* generally, the harmonization provision contained in Article 3 of this Agreement presents interesting specific burden of proof issues. The Appellate Body in *EC - Hormones* rejected the panel’s finding that Article 3.3 embodies an exception to the general rule contained in Article 3.1 and thus that the burden of proof shifts to the defending Member to show that its measure complies with Article 3.3. Instead, the Appellate Body held that Article 3.1 of the *SPS Agreement* merely excludes from its scope situations falling under Article 3.3. Article 3.3 contains an autonomous option available to Members and it is for the challenging Member to prove that the conditions laid down in this article for SPS measures not based on international standards are not met.¹³⁷

5.4.2 Standard of Review

Article 11 DSU

The issue of the appropriate standard of review is an important one, as it raises the question of the extent to which panels are entitled to interfere in Members’ regulatory determinations. In *EC - Hormones*¹³⁸ the question of the appropriate standard of review was first dealt with. The Appellate Body rejected the extension of the deferential standard of review set in the *Anti - Dumping Agreement* to the *SPS Agreement*, holding that this standard is textually specific

¹³⁴ Appellate Body Report, *EC - Hormones*, para. 97.

¹³⁵ Appellate Body Report, *EC - Hormones*, paras 102-105.

¹³⁶ Appellate Body Report, *Japan - Agricultural Products*, para. 38.

¹³⁷ Appellate Body Report, *EC - Hormones*, para. 104.

¹³⁸ Appellate Body Report, *EC - Hormones*, para. 133.

to the former Agreement and there is no evidence of an intention to adopt it in the latter Agreement.

The Appellate Body found that although the *SPS Agreement* is silent on the issue of the standard of review, the DSU articulates this standard both for the determination of the facts and the legal characterization of these facts, in Article 11.¹³⁹ The standard of review established by this Article is neither total deference nor *de novo* review, but rather the objective assessment of the facts (with respect to fact-finding) and an objective assessment of the matter, including the applicability of and conformity with the relevant covered agreements (with respect to legal issues).¹⁴⁰

The Appellate Body held that a claim that the panel failed to conduct an objective assessment of the facts requires proof that there has been deliberate disregard of or refusal to consider submitted evidence or wilful distortion or misrepresentation of the evidence. These do not indicate a mere error of judgement but imply an egregious error, which calls into question the good faith of the panel.¹⁴¹

5.4.3 Scientific Experts and Expert Review Groups

Article 11.2 SPS

An attempt to deal with the problems inherent to the evaluation of scientific evidence is reflected generally in Article 13 of the DSU and for health matters more specifically in Article 11.2 of the *SPS Agreement*. Article 13.1 of the DSU authorizes panels to seek information and technical advice from any individual or body. Article 13.2 allows panels to seek information from any source and to consult experts or request advisory reports from expert review groups. Article 11.2 of the *SPS Agreement* states that in disputes under that Agreement, involving scientific or technical issues, a panel should consult experts chosen by it in consultation with the parties. For this purpose, a panel may set up advisory technical experts groups or consult relevant international organizations.

It is within a panel's discretion¹⁴² whether to consult individual experts or to establish an expert review group.¹⁴³ All panels dealing with issues under the *SPS Agreement* thus far have consulted individual experts.

5.5 Test Your Understanding

1. Set out the main transparency obligations under the SPS Agreement and discuss their importance for developing countries.

¹³⁹ Appellate Body Report, *EC –Hormones*, para. 116.

¹⁴⁰ Appellate Body Report, *EC –Hormones*, para. 117.

¹⁴¹ Appellate Body Report, *EC –Hormones*, para. 133.

¹⁴² Appellate Body Report, *EC –Hormones*, para. 147.

¹⁴³ The rules and procedures applying to expert review groups are set out in Appendix 4 of the DSU.

- 2. What are the main functions of the SPS Committee? Which of these would you consider most important for developing countries and why?**
- 3. Discuss the standard of review that panels must apply when examining claims under the SPS Agreement.**

6. SPECIAL PROVISIONS FOR DEVELOPING COUNTRIES

On completion of this section the reader will be able:

- **to identify those rules in the *SPS Agreement* that take account of the special position of developing countries.**
- **to assess in how far the *SPS Agreement* provides flexibility for developing countries in the implementation of their commitments and encourages developed countries to take account of developing country constraints.**

6.1 Recognition of Constraints of Developing Countries

The general disciplines of the *SPS Agreement* apply equally to developed and developing countries. However, the *SPS Agreement* does reflect a recognition of the financial and technical resource constraints that developing countries face.¹⁴⁴ For this reason, special provisions exist that take into account the special position of developing countries. These provisions relate to the provision of technical assistance to developing countries as well as to special and differential treatment in favour of developing countries. In addition, it should not be forgotten that some of the disciplines in the *SPS Agreement* discussed above contain elements of flexibility that can be used to the benefit of developing countries.¹⁴⁵

6.2 Technical Assistance

The technical assistance needs of developing countries relate not only to improving their understanding of the rules applicable under the *SPS Agreement* but also to the acquisition of technical and scientific capacity to meet their obligations and enforce their rights under the *SPS Agreement*. Thus technical assistance is a broad term, encompassing:

- the provision of information to enhance Member's understanding of their rights and obligations under the *SPS Agreement*;
- the provision of practical and detailed training on the operation of the *SPS Agreement*; the provision of "soft" infrastructure (training and formation of technical and scientific personnel and the development of national regulatory frameworks); and
- "hard" infrastructure (laboratories, equipment, veterinary services, establishment of disease free areas).¹⁴⁶

¹⁴⁴ This recognition is first mentioned in the 7th preambular paragraph of the *SPS Agreement*.

¹⁴⁵ For example, Article 5.1 requires a risk assessment "as appropriate to the circumstances"; Article 5.6 allows technical and economic feasibility to be taken into account in the choice of an *SPS measure*; Annex B para. 8 exempts developing countries from the requirement to provide copies or summaries of documents covered by a notification.

¹⁴⁶ This typology was drawn up by the Secretariat (G/SPS/GEN/206, dated 18 October 2000).

The provision of technical assistance to developing countries involves several actors, including other WTO Members, the WTO Secretariat as well as other international organizations such as the FAO (including Codex and the IPPC), the WHO, the OIE and the World Bank. It should be noted that the active participation and contribution of developing countries in this process is essential in order to ensure that the provision of technical assistance is demand-driven.

Article 9 SPS

Under Article 9.1, Members *agree to facilitate* the provision of technical assistance to other Members, especially developing countries, either bilaterally or through international organizations. This assistance may take various forms, including advice, credits, grants and donations and may be in the areas of processing technologies or research and infrastructure, including the creation of national regulatory bodies. This form of assistance may also aim at helping developing countries adjust to and comply with SPS measures on their export markets.

Article 9.2 refers specifically to the case where an importing Member's SPS requirements necessitate substantial investments by a developing country exporting Member in order to comply with these SPS requirements. In such a case, the importing Member must consider providing technical assistance that will enable the developing country Member to maintain and expand its market access opportunities for that product. However, there is no obligation to actually provide such technical assistance.

Technical assistance is a standing item on the agenda of SPS Committee meetings, where Members are encouraged to identify specific technical assistance needs and report on technical assistance activities. The SPS Committee¹⁴⁷ has undertaken a survey of technical assistance needs and activities by means of questionnaires¹⁴⁸ and drawn up a technical assistance typology.¹⁴⁹ In addition, informal discussions on technical assistance and cooperation have been held in the SPS Committee.¹⁵⁰ Further, high-level as well as technical meetings have been held between the WTO and other international organizations to coordinate the provision of technical assistance.¹⁵¹

Doha Decision on Implementation

The *Decision on Implementation* taken at the Ministerial Conference in Doha urges the WTO Director-General to continue cooperative efforts with the international standard-setting organizations to facilitate the provision of technical and financial assistance to ensure the effective participation of least-developed countries. In addition, Members are urged to provide technical and

¹⁴⁷ A compilation of all documents on this issue submitted to and drafted by the SPS Committee was circulated to all Members (G/SPS/GEN/332, dated 24 June 2002).

¹⁴⁸ In July 1999 a questionnaire was circulated to Members to gather information on technical assistance requested, received or provided under the SPS Agreement (G/SPS/W/101, dated 23 July 1999) but few developing countries replied. In October 2001 a second questionnaire was circulated regarding technical assistance needs (G/SPS/W/113, dated 15 October 2001) to which 24 Members have responded to date (see addenda to G/SPS/GEN/295, dated 6 February 2002).

¹⁴⁹ G/SPS/GEN/206, dated 18 October 2000.

¹⁵⁰ The first meeting was held in July 2002 (G/SPS/GEN/267, dated 16 July 2001) and the second in March 2002 (no unrestricted report available yet).

¹⁵¹ See reports: WT/GC/42, dated 11 December 2000; WT/GC/46/Rev.1, dated 16 July 2001; WT/GC/54, dated 7 November 2001; WT/GC/45, dated 7 March 2001.

financial assistance to least-developed countries to enable them to respond to SPS measures which may negatively affect their trade as well as to ensure that technical assistance is provided to these countries in response to the special problems they face in implementing the *SPS Agreement*.¹⁵²

**Standards and Trade
Development Facility**

The World Bank and the WTO established a new fund, on 27 September 2002, to provide funding to developing countries to assist them to meet SPS standards. The World Bank has pledged US\$300,000 and the WTO will contribute from the Doha Development Trust Fund. The fund will be administered by the WTO. The FAO, WHO and OIE are expected to join in this initiative.¹⁵³

6.3 Special and Differential Treatment

Special and differential treatment under the *SPS Agreement* is aimed at ensuring that the special constraints faced by developing country Members are taken into account in the implementation of certain provisions of the *SPS Agreement*. This may refer to implementation of provisions in a manner favourable to developing countries by other Members, flexibility in the obligations in favour of developing countries, or actions by the SPS Committee or Secretariat to assist developing countries.

6.3.1 Preparation and Application of SPS Measures

Article 10.1 SPS

Article 10.1 obliges Members to *take account of* the special needs of developing country Members, and in particular least-developed country Members when preparing and applying SPS measures. However, beyond requiring that these needs be considered in the regulatory process, there is *no obligation* to adapt the SPS measures or their application in accordance with developing country needs.

6.3.2 Phased-in Introduction of Measures

Article 10.2 SPS

Article 10.2 encourages Members, without obliging them, to allow longer time frames for compliance with new SPS measures for developing country Members, where the appropriate level of protection of the importing Member allows scope for this. This is aimed at allowing developing countries to maintain their export opportunities while adjusting to the new measures.

**Doha Decision on
Implementation**

The *Decision on Implementation* adopted at the Doha Ministerial Conference sets the longer time frame for compliance under Article 10.2 at “normally a period of not less than six months” where there is scope for phased introduction of the new measure. Where such phased introduction is not possible, if a Member identifies specific problems it faces with regard to the new measure, the importing Member must enter into consultations with a view to reaching a

¹⁵² WT/MIN(01)/17, dated 14 November 2001.

¹⁵³ See WTO Press Release 314 “World Bank grant kicks off Bank-WTO assistance on standards” dated 27 September 2002.

mutually satisfactory solution, while continuing to achieve the importing Member's appropriate level of protection.¹⁵⁴

6.3.3 Reasonable Adaptation Period

Annex B.2 SPS

Members are obliged,¹⁵⁵ under paragraph 2 of Annex B, to allow a reasonable period between the publication of a SPS measure and its entry into force for exporting Members (especially developing countries) to adapt to the new measure.

Doha Decision on Implementation

The *Decision on Implementation* adopted at the Doha Ministerial Conference sets the reasonable adaptation period at "normally a period of not less than six months," but notes that the particular circumstances of the measure and the actions needed for its implementation must be considered. In addition, it clarifies that the entry into force of SPS measures that liberalize trade should not be unnecessarily delayed. This takes into account the fact that some new SPS measures may set lower or easier requirements than existing ones.¹⁵⁶

6.3.4 Time-Limited Exemptions

Article 10.3

Article 10.3 allows the SPS Committee to grant developing countries, upon request, specified, time-limited exemptions to all or some of their obligations under the *SPS Agreement*. This is done with the aim of enabling developing countries to comply with their obligations, and takes account of their financial, trade and development needs. No developing country has requested such an exemption to date.

6.3.5 Facilitation of Participation in International Organizations

Article 10.4 SPS

Article 10.4 provides that Members should encourage and facilitate the active participation of developing countries in the relevant international organizations. This is clearly a reference to the international standard-setting organizations, namely the CAC, IPPC and OIE. Article 10.4 is purely hortatory and contains no binding obligation.

6.3.6 Special Provisions on Notification

Annex B.8 and 9 SPS

Under the transparency provisions of Annex B, developing countries are exempted from the obligation to provide copies of the documents on which a notification is based in one of the official languages of the WTO. In addition, the Secretariat is obliged to draw the attention of developing countries to any notifications relating to products of interest to them. This is done by means of the circulation of monthly lists of notifications to all Members.

¹⁵⁴ *Ibid.*, para. 3.1.

¹⁵⁵ *Except in cases of urgency.*

¹⁵⁶ *WT/MIN(01)/17, dated 14 November 2001.*

6.3.7 *Transitional Periods*

Article 14 SPS

Article 14 of the *SPS Agreement* made provision for delayed implementation of the obligations under the Agreement for developing and least-developed country Members. Least-developed Members were granted a five-year period, from the entry into force of the *WTO Agreement*, for delayed application of all their obligations. Other developing Members were given a two-year grace period, where lack of technical expertise, infrastructure or resources prevented immediate application of their obligations. However, this possibility did not extend to their transparency and information obligations. The period for delayed application expired in 2000 for least-developed Members and 1997 for other developing Members.

6.4 *Test Your Understanding*

- 1. Do developing countries have a right to receive technical assistance in order to comply with the SPS measures of their trading partners?**
- 2. What initiatives have been taken by the SPS Committee to facilitate the implementation of the provisions on technical assistance?**
- 3. List the ways in which special and differential treatment for developing countries is provided for in the *SPS Agreement* and mention any improvements agreed upon in the Doha Ministerial Conference.**

7. CASE STUDIES

1. The Republic of Agricola, a developing country WTO Member, relies primarily on its exports of mangoes and tomatoes for its foreign revenue earnings. Its main export market is Industria, a developed country Member of the WTO. In recent years, exporters from Agricola have faced increasing obstacles to the entry of their products into the market of Industria, due to concerns that these products do not meet the SPS standards deemed appropriate by the government of Industria. In particular, Industria has enacted a law requiring fumigation treatment for all mangoes from Agricola, due to its detection of the presence of black borer beetles (a pest of quarantine significance for Industria) in a shipment of mangoes from Agricola five years ago. In addition, due to its zero-risk policy with respect to carcinogens, Industria has provisionally set a no-residue level for the presence of Xenogen, an herbicide that is a suspected carcinogen, on imports of vegetables. Xenogen is a cheap and effective herbicide and in common use among Agricolan tomato farmers.

In a meeting with the Agricolan Department of Agriculture, the farmers' union of the Republic of Agricola raised several concerns regarding these measures, viewing them as a disguised form of protection of the agricultural industry of Industria rather than legitimate SPS measures. Firstly, the farmers' union points out that black borer beetles are only to be found in the humid eastern province of Agricola, since this species of beetle does not thrive in the drier western provinces. Secondly, it notes that new phytosanitary legislation in Agricola requires mangoes to be subject to refrigeration treatment in order to destroy pests. It claims that this treatment as effective as fumigation for the extermination of black borer beetles and is less detrimental to the shelf life of the fruit. However, despite requests from Agricola, Industria has been unwilling to recognise refrigeration treatment as equivalent to fumigation. Thirdly, the farmers' union points out that the carcinogenic potential of Xenogen has never been conclusively proven. Lastly, the farmers note that no reasonable period of time was allowed for them to adapt to the new requirement of Industria with regard to Xenogen. As a result, they stand to lose their market share while they switch to a new herbicide. In addition, the added costs of the new herbicide make it impossible for many smaller farmers to make this change and remain competitive.

You are the representative of the Republic of Agricola at the SPS Committee of the WTO. Your government approaches you for advice on how it should proceed in this matter. It asks you to write an opinion on this issue. In particular, it asks you to address the following points:

- (a) Are there mechanisms available to the government of Agricola to resolve this dispute without resorting to dispute settlement?
- (b) In case Agricola decides to resort to dispute settlement, should it challenge Industria's measures under the GATT 1994, the *SPS Agreement* or the *TBT Agreement* or a combination of these?

- (c) In case of a challenge under the *SPS Agreement*, which party would bear the burden of proof? If Agricola bears the burden of proof, is there any mechanism in place to assist it in obtaining information from Industria regarding its measures?
 - (d) Are there provisions in the *SPS Agreement* which Agricola, as a developing country, could rely upon to complain that Industria did not take its special needs into account when enacting and implementing these measures? If so, what are the chances of success in challenging measures under such provisions?
 - (e) Can Agricola challenge Industria's refusal to recognize the existence pest-free areas in Agricola and to adapt its requirements accordingly or to recognize Agricola's phytosanitary measures as equivalent to its own? If so, what would Agricola have to prove?
 - (f) Can Agricola challenge the zero-risk level of protection adopted by Industria with regard to carcinogens or its zero-residue level with regard to Xenogen?
 - (g) Does the *SPS Agreement* make it possible for Agricola to challenge Industria's measure with regard to Xenogen on the grounds that there is insufficient scientific evidence of a risk? Are there any special rules applicable to "provisional" measures?
2. As a small, island developing country, Agricola is a net importer of food, which it buys from the revenue it earns from its mango and tomato exports. Traditionally, Agricolan people eat large quantities of beans, which Agricola imports from neighbouring countries, especially Bundastan (also a developing country WTO Member). As a result of the importance of beans in the national diet, food safety legislation has been in place in Agricola for the last 15 years, setting a maximum residue level for Fitolene a certain chemical commonly used as a fertiliser in bean production, including in Bundastan. This legislation was enacted in response to a sudden increase in epilepsy cases in a region where fertiliser with Fitolene was introduced. There are some indications that there is a link between the Fitolene and epilepsy. The Agricolan government is trying to establish whether this link can be shown scientifically, but due to the complexity of epilepsy and resource constraints this is taking a long time. In recent years, Fitolene has come to the attention of the Codex Alimentarius Commission. In 2001, the Codex Alimentarius Commission decided not to adopt a maximum residue level for Fitolene, based on the conclusion of the Joint FAO/WHO Meeting on Pesticide Residues that scientific studies show Fitolene to be safe, if used in accordance with good farming practice. Due to financial and resource constraints, Agricola was not able to participate in the discussions which led to the adoption of this decision in the Codex. It has come to its attention that the same is true for several small developing countries. In addition, a small group of Nordic scientists have recently published a peer-reviewed study which they believe shows that Fitolene, when ingested in large amounts, can have adverse health effects.

In order to balance the diet of its citizens, Agricola also imports rice and maize. Recently there has been an outbreak of blue fungus on maize crops in

neighbouring Bundastan, which is a disease that can spread to mangoes and cause great economic harm to Agricola's export crops. Agricola has therefore banned the importation of maize from Bundastan. A recent study by the United Nations Food and Agricultural Organization has shown that yellow rot, often found in rice, is a disease which can spread just as easily to mango trees, yet Agricola has no measures in place to restrict the importation of rice with yellow rot. In the last meeting of the SPS Committee, Bundastan has raised its concerns regarding Agricola's measures with regard to its bean and maize exports. It has also tabled a detailed document in which it sets out more specifically its complaints regarding the Agricolan measures. You are the representative of Agricola on the SPS Committee. You take note of Bundastan's concerns and undertake to respond to them at the next meeting of the SPS Committee, both orally and by means of a written document in the hope of avoiding a dispute settlement proceeding. You are now drafting this response. You must address the specific claims raised by Bundastan, which are the following:

- (a) Agricola's maximum residue level for Fitolene is not based on the international standard set by Codex, which is "no maximum residue level" for Fitolene. Thus the requirements of Article 3.1 of the *SPS Agreement* are not complied with and Agricola must prove that its measure falls within the exception provided for under Article 3.3.
- (b) Agricola's maximum residue level for Fitolene does not comply with Article 3.3 as it is not based on a risk assessment in terms of Article 5.1.
- (c) Agricola's maximum residue level for Fitolene is not a provisional measure under Article 5.7 as it has been in place for 15 years.
- (d) Agricola is not consistent in the application of its appropriate level of protection and makes arbitrarily distinctions in the level of protection it deems appropriate in different situations, in violation of Article 5.5, when it bans maize from Bundastan due to risks from blue fungus while allowing free importation of rice bearing equally significant risks from yellow rot.

Your government would like you to include the following arguments in your response, where appropriate, in addition to your own arguments. You should identify which of these arguments are valid under the *SPS Agreement* and only refer to those.

- (a) As Agricola's maximum residue level was already in place at the time of coming into force of the *SPS Agreement*, it does not have to comply with its requirements.
- (b) Since Agricola and several other developing countries did not participate in the Codex meetings setting the standard for Fitolene, this is not an "international standard" for purposes of the *SPS Agreement* (or Agricola and these other developing countries are not bound by the international standard).
- (c) The Codex standard is not appropriate for Agricola due to the large quantities of beans consumed by its citizens. The international standard therefore does not meet the level of protection set by Agricola.

- (d) Agricola's status as a developing country should be taken into account in determining whether a risk assessment "as appropriate to the circumstances" exists.
- (e) Agricola's maximum residue level for Fitolene is based on the risk assessment conducted by the Nordic scientists.
- (f) The distinction in levels of protection deemed appropriate for risks from blue fungus and from yellow rot is not arbitrary but is based on the fact that yellow rot is easy to cure by simply spraying the mango trees with salt water, whereas the eradication of blue fungus is difficult and costly.

8. FURTHER READING

8.1 Articles

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- **Victor, D.G.** 2000, “The Sanitary and Phytosanitary Agreement of the World Trade Organization: An Assessment after Five Years.” *Journal of International Law and Politics* 32, no. 4: 865-938.
- **Walker, V.R.** 1998, “Keeping the WTO from Becoming the ‘World Trans-Science Organization’: Scientific Uncertainty, Science Policy, and Factfinding in the Growth Hormones Dispute.” *Cornell International Law Journal* 31: 251-320.
- **Zarrilli, S.**, 2001, “United Nations Conference on Trade and Development: International Trade in Genetically Modified Organisms and Multilateral Negotiations - a New Dilemma for Developing Countries.” *Business Law International*, no. 3: 330-369.

8.2 Appellate Body Reports

- Appellate Body Report, *Australia – Measures Affecting the Importation of Salmon* (“*Australia - Salmon*”), WT/DS18/AB/R, adopted 6 November 1998.
- Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* (“*EC - Hormones*”), WT/DS26/AB/R; WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135.
- Appellate Body Report, *Japan - Measures Affecting Agricultural Products* (“*Japan - Agricultural Products II*”), WT/DS76/AB/R, adopted 19 March 1999.

8.3 Panel Reports

- Panel Report, *Australia – Measures Affecting Importation of Salmon, Complaint by Canada* (“*Australia - Salmon*”), WT/DS18/R, adopted 6 November 1998 as modified by the Appellate Body Report, WT/DS18/AB/R.
- Compliance Panel Report, *Australia – Measures Affecting Importation of Salmon - Recourse to Article 21.5 of the DSU by Canada* (“*Australia – Salmon*”), WT/DS18/RW, adopted 20 March 2000.
- Panel Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, complaint by the United States (“*EC - Hormones (US)*”), WT/DS26/R/USA, adopted 13 February 1998 as modified by the Appellate Body Report, WT/DS26/AB/R; WT/DS48/AB/R, DSR 1998:III, 699.
- Panel Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, complaint by Canada (“*EC - Hormones (Canada)*”), WT/DS48/R/CAN, adopted 13 February 1998 as modified by the Appellate Body Report, WT/DS26/AB/R; WT/DS48/AB/R, DSR 1998:II, 235.
- Panel Report, *Japan - Measures Affecting Agricultural Products*, complaint by the United States (“*Japan - Agricultural Products II*”), WT/DS76/R, adopted 19 March 1999 as modified by the Appellate Body Report, WT/DS76/AB/R.

8.4 Documents and Information

- Official WTO documents can be obtained by searching on the WTO’s online document database, available at: <http://docsonline.wto.org/>
- Official documents of the Codex Alimentarius Commission can be obtained by searching on the official website of the Codex Alimentarius Commission, available at: <http://www.codexalimentarius.net/>
- Official documents of the International Plant Protection Convention can be obtained by searching on the official website of the International Plant Protection Convention, available at: <http://www.fao.org/WAICENT/FAOINFO/AGRICULT/AGP/AGPP/PQ/Default.htm>

- Official documents of the International Office of Epizootics can be obtained by searching on the official website of the International Office of Epizootics, available at: <http://www.oie.int/>

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.10 TECHNICAL BARRIERS TO TRADE



UNITED NATIONS
New York and Geneva, 2003

NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

The WTO *Agreement on Technical Barriers to Trade* (“*TBT Agreement*”), which entered into force in 1995, is the multilateral successor to the *Standards Code*, signed by 32 GATT contracting parties at the conclusion of the 1979 Tokyo Round of Trade Negotiations. The purposes of the *TBT Agreement* can be broadly described as: (1) assuring that technical regulations, standards and conformity assessment procedures, do not create unnecessary obstacles to international trade, while (2) leaving Members adequate regulatory discretion to protect human, animal and plant life and health, national security, the environment, consumers, and other policy interests.

This Module provides a detailed examination of the *TBT Agreement*, one of the more technical agreements negotiated during the Uruguay Round. Without compromising the details necessary to understand this Agreement, a serious effort has been made to explain the Agreement in terms that someone with only a minimal familiarity with the WTO will understand.

The legal analysis of the Agreement is divided into six sections. In the first Section, the reasons for the adoption of the *TBT Agreement* are set forth and the treatment of regulations and standards under the *General Agreement on Tariffs and Trade* (“GATT”) is examined. The second Section examines the general scope of the *TBT Agreement*. The definitions of the key concepts of “technical regulations”, “standards,” and “conformity assessment procedures” are provided. Certain important issues are analysed, in particular the relationship between the *TBT Agreement*, the GATT 1994, the *Agreement on the Application of Sanitary and Phytosanitary Measures* (“SPS Agreement”), and the *Agreement on Government Procurement* (“AGP”). In addition, the treatment pursuant to the *TBT Agreement* of import prohibitions and processes and production methods (“PPMs”) is discussed. The third Section deals with the structure of the *TBT Agreement* and the applicability of the Agreement on other than central government bodies. The fourth provides a nuts and bolts examination of the principles and rules of the *TBT Agreement*, such as the principle of non-discrimination, the obligation to prevent unnecessary obstacles to international trade and the obligation to use international standards as a basis for technical regulations. The fifth Section deals with technical assistance and special and differential treatment for developing country Members provided for in the *TBT Agreement*. Finally, the sixth Section deals with dispute settlement and institutional matters under the *TBT Agreement*.

1. WHY AN AGREEMENT ON TECHNICAL BARRIERS TO TRADE? OBJECTIVES

Objectives

On completion of this section, the reader will be able:

- **to assess why the *WTO Agreement* incorporates the *TBT Agreement*, an agreement on technical barriers to trade.**
- **to appreciate the competing policy goals present in the *TBT Agreement*.**
- **to discuss the history of the Agreement.**

1.1 Introduction

The phrase “technical barriers to trade” refers to the use of the domestic regulatory process as a means of protecting domestic producers.

The *TBT Agreement* seeks to assure that:

- (1) mandatory product regulations,
- (2) voluntary product standards, and
- (3) conformity assessment procedures (procedures designed to test a product’s conformity with mandatory regulations or voluntary standards)

do not become unnecessary obstacles to international trade and are not employed to obstruct trade.

The *TBT Agreement* seeks to balance two competing policy objectives:

- (1) The prevention of protectionism, with
- (2) the right of a Member to enact product regulations for approved (legitimate) public policy purposes (i.e., allowing Members sufficient regulatory autonomy to pursue necessary domestic policy objectives).

These goals are described in more detail below.

1.1.1 The Prevention of Protectionism

The progressive tariff reductions that have taken place in the GATT/WTO framework have left certain industrial and political leaders looking for other means of protecting their industries. These means of protection frequently take the form of non-tariff barriers (i.e., means other than tariffs for protecting business sectors).

Technical regulations, standards and conformity assessment procedures are all potential non-tariff measures that are sometimes used for protectionist purposes. As such, they can be potential barriers to international trade.

The TBT Agreement establishes rules and disciplines designed to prevent mandatory technical regulations, voluntary standards, and conformity assessment procedures from becoming unnecessary barriers to international trade. However the TBT Agreement seeks to leave Members with sufficient domestic policy autonomy to pursue legitimate regulatory objectives.

1.1.2 The legitimate regulation of products for public policy purposes

Juxtaposed with the desire to prevent protectionism, is the need to assure that Members retain sufficient regulatory autonomy to accomplish domestic policy goals. Domestic regulations can accomplish several objectives unrelated to protectionism. For example, domestic regulations can serve as a means of protecting consumer health and safety, the environment and national security. Domestic regulations can also further economies of scale, and increase consumer confidence, by assuring uniform technical and production standards. Economic development, and the improved education that should result, can lead to demands from consumers and sometimes the business community for an increase in regulations or standards.

Article 2.2 TBT

Both the preamble of the *TBT Agreement* and Article 2.2 of the *TBT Agreement* identify certain regulatory goals that are deemed “legitimate” for regulatory purposes. Article 2.2 sets forth a list of legitimate TBT objectives which includes:

- protection of life/health (human, animal and plant)
- safety (human),
- protection of national security,
- protection of the environment, and
- prevention of deceptive marketing practices.

The list of legitimate objectives in Article 2.2 is not exclusive. While not specified, it is widely agreed that technical harmonization (for example, regulations that standardize electrical products, computers, communications equipment, etc.), and quality standards (for example grading requirements for produce and commodities) are legitimate. Both technical harmonization and quality standards are already widely utilized, particularly by developed country Members.

The *TBT Agreement* seeks to achieve a fine balance between permitting Members the regulatory autonomy to protect legitimate interests (through the use of technical regulations, standards and conformity assessment procedures) *and* assuring that technical regulations, standards and conformity assessment procedures do not become unnecessary obstacles to international

trade. If the *TBT Agreement* is applied too strictly, the legitimate policy interests of Members will be thwarted. If the TBT is applied too laxly, technical regulations may be used for protectionist purposes and the gains Members have achieved through progressive rounds of tariff reductions may be lost.

Some sensitivity is required when dealing with TBT issues. Developing countries fear that trade measures (technical regulations and standards) allegedly taken by developed countries for social policy goals may in reality be for protectionist purposes. Developed countries fear that the *TBT Agreement* will be applied too strictly and that trade measures designed to pursue legitimate social policy objectives will be struck down.

1.2 History

1.2.1 *GATT 1947*

GATT 1947

Technical regulations and standards are not treated in great detail in the *General Agreement on Tariffs and Trade* (“GATT”). Although the term “regulation” appears throughout the GATT 1947, and the term “standards” is mentioned in Article XI, only GATT Articles III:4, XI:2, and Article XX have, from a regulatory perspective, much significance.¹ These articles are, however, vague with respect to the rules applicable to technical regulations and standards.

Historically, Article III of the GATT 1947 on national treatment was subject to abuse. Early in the life of the GATT 1947, certain contracting parties began to use technical regulations and inspection requirements as trade barriers, necessitating the establishment of a stronger regime governing the application of technical regulations and standards. This gave birth to the “*Standards Code*”.

1.2.2 *Standards Code of 1979*

Standards Code

After prolonged negotiations in the Tokyo Round of Trade Negotiations, a plurilateral agreement (i.e., an agreement not signed by all GATT contracting parties) was concluded in 1979. This early TBT agreement, dubbed the “*Standards Code*”, served as a basis for the WTO’s *TBT Agreement*. With only 32 signatories, and few teeth², the *Standards Code* nevertheless provided a good testing ground for how best to discipline the use of technical regulations and standards.

1.2.3 *TBT Agreement*

TBT Agreement

The Uruguay Round *TBT Agreement*, which entered into force on 1 January 1995, bears a resemblance to the Tokyo Round *Standards Code*. However, much was learned from the Tokyo Round experience, and some of the weaknesses of the Tokyo Round agreement were remedied in the WTO’s *TBT*

¹ Article XX of the GATT is also significant to the extent that the term “measure” includes regulations. However, only Article XX(d) specifically mentions regulations.

² Being dependent on consensus, the GATT system lacked a strong enforcement mechanism.

Agreement. First, the *TBT Agreement* is a multilateral as opposed to a plurilateral agreement meaning that it applies to all WTO Members – it forms part of the Uruguay Round’s “single undertaking”. Second, the *TBT Agreement* has a much stronger enforcement mechanism, being subject to the WTO’s Dispute Settlement Understanding (DSU).

1.3 Test Your Understanding

- 1. Why is the *TBT Agreement* a part of the WTO Agreement?**
- 2. What are the goals of the *TBT Agreement*?**
- 3. Which WTO Members are bound by the *TBT Agreement*?**
- 4. What was the *Standards Code*?
Who was bound by the *Standards Code*?**

2. SCOPE OF THE *TBT AGREEMENT* OBJECTIVES

Objectives

On completion of this section the reader will be able:

- to discuss the general scope of the *TBT Agreement*.
- to distinguish between key concepts of “technical regulations”, “standards,” and “conformity assessment procedures”.
- to appreciate the relationship between the *TBT Agreement* and (1) the *Agreement on the Application of Sanitary and Phytosanitary Measures*, and (2) the *Agreement on Government Procurement* which will be examined.

2.1 General Scope and the Key Concepts

The *TBT Agreement* is applicable to “technical regulations” “standards”, and “conformity assessment procedures” applicable to technical regulations and standards. These terms are each defined in Annex 1 of the Agreement. These definitions establish the general scope of the Agreement.

2.1.1 *Technical Regulation*

Annex I.1 TBT

Pursuant to paragraph 1 of Annex I of the TBT Agreement a “technical regulation” is a:

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

In *EC – Sardines* the Appellate Body referring back to its Report in *EC - Asbestos* set forth a three part test for determining if a measure is a technical regulation:

- 1) the document applies to an identifiable product or group of products;
- 2) the document must lay down one or more product characteristics; and
- 3) compliance with these characteristics must be mandatory.³

Example 1: A law stating that only refrigerators that are one meter high can be sold in State X is a technical regulation.

³ Appellate Body Report *European Communities – Trade Description of Sardines* (“*EC – Sardines*”) WT/DS231/AB/R, adopted 23 October 2002, paras. 189-195 referring to *European Communities - Measures Affecting Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, paras. 66-70,

Example 2: A law stating that all product packaging must be recyclable is an example of a technical regulation.

2.1.2 Standard

Annex I.2 TBT

Pursuant to paragraph 2 of Annex I of the *TBT Agreement* a “standard” is defined as a:

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

Example 1: A government guideline saying that all eggs weighing 62 grams or more are entitled to be labelled “Grade A” is a standard (provided that eggs weighing less may still be sold).

Example 2: A guideline defining what products can display a “recyclable symbol” is a standard (provided that products that do not bear the symbol may still be sold).

2.1.3 Conformity Assessment Procedure

Annex I.3 TBT

Pursuant to paragraph 3 of Annex I of the *TBT Agreement*, a “conformity assessment” procedure is:

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

Paragraph 3 further explains that conformity assessment procedures include, inter alia, procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combinations.

Example: Assume a country requires as a condition for the sale of spirits that the correct alcoholic content be displayed on the bottle. An official test of the beverage to determine that the correct alcoholic content is displayed would be a conformity assessment procedure implemented to verify compliance with a technical regulation.

2.1.4 Summary

The *TBT Agreement* is applicable to “technical regulations”, “standards”, and “conformity assessment procedures” applicable to technical regulations and standards.

The principle difference between a technical regulation and a standard is that compliance with a technical regulation is mandatory, while compliance with a standard is voluntary.

Conformity assessment procedures are used to determine whether a technical regulation or standard has been complied with.

2.2 Questions Concerning the Scope of Application of the TBT Agreement

2.2.1 *TBT measures and the GATT 1994*

With respect to the relationship between the GATT 1994 and the *TBT Agreement* and the applicability of the GATT 1994 to TBT measures, the Panel in *EC – Asbestos* found

Both the GATT 1994 and the TBT Agreement form part of Annex 1A to the WTO Agreement and may apply to the measures in question. Consequently, although we do not in principle exclude application of the TBT Agreement and/or the GATT 1994 to the Decree, we have to determine the order in which we should consider this case. According to the Appellate Body in European Communities – Regime for the Importation, Sale and Distribution of Bananas, when the GATT 1994 and another Agreement in Annex 1A appear a priori to apply to the measure in question, the latter should be examined on the basis of the Agreement that deals “specifically, and in detail,” with such measures.⁴

The Panel thus decided to examine first whether the measure at issue was consistent with the TBT Agreement, the agreement that deals specifically and in detail with what was allegedly a TBT measure.

2.2.2 *Non-Product-Related Processes and Production Methods*

The definitions of a “technical regulation” and a “standard” are ambiguous with respect to one point. Does the *TBT Agreement* govern technical regulations and standards applicable to manufacturing “processes and production methods” (“PPMs”) when the PPMs utilized are not detectable in the final product – so-called “Non-Product-Related PPMs” (“NPR-PPMs”)?

This is a controversial question. The view generally held in the trade community is that the *TBT Agreement* was not intended to apply to PPMs, unless the PPM is product-related (detectable in the final product). However, Members have notified certain NPR-PPMs to the TBT Committee.⁵ This has been the

⁴ Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-containing Products* (“*EC – Asbestos*”), WT/DS135/R, adopted as modified 5 April 2001, para. 8.16.

⁵ “Notification” in the TBT sense of the term means to inform officially other WTO members of a particular action through the WTO Secretariat.

case, for example, for eco-labelling schemes based on a life-cycle analysis.⁶

Example: The *TBT Agreement* would probably not apply to a law prohibiting the domestic sale or import of aluminium produced using electricity derived from nuclear power.

2.2.3 SPS v. TBT Measures

Article 1.5 TBT

Article 1.5 of the *TBT Agreement* provides;

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

Pursuant to Annex A(1) the *SPS Agreement*, an SPS measure is any measure applied:

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

Example: The *TBT Agreement* would not apply to a law regulating the use of artificial colouring in food products.

2.2.4 TBT Agreement and. Government Procurement Specifications

Article 1.4 TBT

The *TBT Agreement* is not applicable to purchasing specifications prepared by governmental bodies for production or consumption requirements of governmental bodies. Such measures could fall instead under the *WTO Agreement on Government Procurement* (“AGP”). However, not all WTO Members are bound by the AGP, and not all government procurement activities fall within the AGP.

⁶ Eco-labelling schemes are usually voluntary labelling programmes where a label is awarded to environmentally friendlier products based on an environmental assessment of all phases of a products life-cycle – including, production, use, and disposal.

Example: The *TBT Agreement* would not apply to purchasing specifications used to procure government trucks.

2.2.5 The TBT Agreement and Import Prohibitions

Although the definition of technical regulation does not list import prohibitions or bans among the covered measures, the *TBT Agreement* is applicable to certain import prohibitions and bans. The *TBT Agreement* applies when an import prohibition or ban is based on product characteristics, and exceptions to the prohibition or ban (based also on particular product characteristics) exist. This question was addressed by the Appellate Body in the *EC - Asbestos* case which found:

Like the Panel, we consider that, through these exceptions, the measure sets out the “applicable administrative provisions, with which compliance is mandatory” for products with certain objective “characteristics”. The exceptions apply to a narrowly defined group of products with particular “characteristics”. Although these products are not named, the measure provides criteria which permit their identification, both by reference to the qualities the excepted products must possess and by reference to the list promulgated by the Minister. Viewing the measure as an integrated whole, we see that it lays down “characteristics” for all products that might contain asbestos, and we see also that it lays down the “applicable administrative provisions” for certain products containing chrysotile asbestos fibers which are excluded from the prohibitions in the measure. Accordingly, we find that the measure is a “document” which “lays down product characteristics ... including the applicable administrative provisions, with which compliance is mandatory.” For these reasons, we conclude that the measure constitutes a “technical regulation” under the TBT Agreement.⁷

2.2.6 Application of the Agreement to TBT Measures Adopted Prior to 1 January 1995

In *EC - Sardines* the Appellate Body ruled that the *TBT Agreement* applies to measures adopted prior to the entry into force of the *WTO Agreement* (i.e., 1 January 1995) provided that the trade measure at issue has not ceased to exist.⁸

2.2.7 Summary

The *TBT Agreement* does not apply to SPS measures and does not apply to government procurement. The *TBT Agreement* applies to import prohibitions based on particular product characteristics.

The *TBT Agreement* probably does not apply to non-product-related processes and production methods (NPR-PMS). NPR-PPMs refers to manufacturing processes that are not detectable in the final product.

⁷ Appellate Body Report, *EC – Asbestos*, paras.74-75 (footnote omitted).

⁸ *Ibid.*, para. 216.

2.3 Test Your Understanding

- 1. What is a technical regulation? What is a standard? Give three examples of each.**
- 2. What is a conformity assessment proceeding? Why are they covered by the TBT Agreement?**
- 3. What matters are covered by the SPS Agreement and not the TBT Agreement?**
- 4. Does the TBT Agreement apply when a government seeks to procure goods? What is the AGP?**
- 5. What is the difference between “product related” and “non product-related” processes and production methods (PPMs and NPR-PPMs)? Do you think that “non-product-related processes and production methods” should be covered by the TBT Agreement? Why or why not?**
- 6. Can the TBT Agreement be applied to a technical regulation dated January 1985? Under what circumstances?**

3. ORGANIZATION OF THE *TBT AGREEMENT*

Objectives

On completion of this section, the reader will be able:

- **to discuss the structure and organization of the *TBT Agreement* and its applicability at various governmental levels.**
- **to consult the *TBT Agreement* when confronted with a potential TBT problem.**

3.1 Structure of the TBT Agreement

The *TBT Agreement* applies to technical regulations, standards, and conformity assessment procedures. They are each treated in separate portions of the *TBT Agreement*.

Technical regulations are dealt with in Articles 2 and 3 of the *TBT Agreement*. Standards are governed by Article 4. Article 4, however, makes an explicit reference to Annex 3 of the Agreement. Annex 3 of the Agreement contains the *Code of Good Practice for the Preparation, Adoption and Application of Standards* (“*Code of Good Practice*”). This “Code” is very important. It is in the Code where almost all of the substantive provisions governing the treatment of standards are found.

Conformity assessment procedures are dealt with in Articles 5 and 9 of the *TBT Agreement*.

The principles and rules discussed in Articles 10 through 15 of the *TBT Agreement* are applicable to each of these areas. There are however certain minor differences in scope and treatment.

In the *WTO Agreement*, important provisions, in particular definitions, are found in Annexes. In the *TBT Agreement*, Annex 1 provides definitions and Annex 3 contains the Code of Good Practice.

3.2 Applicability of the TBT Agreement at Various Governmental and Non-Governmental Levels

The *TBT Agreement* applies to various governmental and non-governmental organizations at different levels of society. This is because technical regulations, standards, and conformity assessment procedures are not only administered by national authorities, but also by international, regional and local authorities, as well as non-governmental organizations.

The *TBT Agreement* sets forth rules and disciplines applicable to international, regional, governmental and non-governmental organizations. The application of the basic TBT rules differs slightly depending on the regulatory level at

issue, and whether technical regulations, standards, or conformity assessment procedures are involved.

Within the limits of what is politically acceptable, the *TBT Agreement* has a wide field of application. This is evident from the broad definitions of central, local and non-governmental bodies found in Annex 1 and reproduced below.

3.2.1 Technical Regulations

Article 2 TBT

Pursuant to Article 2 of the *TBT Agreement*, Members have an obligation to ensure that *central government bodies* abide by the provisions of the *TBT Agreement* governing technical regulations. A “central government body” is defined in Annex 1 as:

[a] [c]entral government, its ministries and departments or any body subject to the control of the central government in respect of the activity in questions.

Article 3 TBT

With only very minor exceptions, pursuant to Article 3 of the *TBT Agreement*, Members have an obligation to take reasonable measures to ensure that *local governmental and non-governmental bodies* within their territories also comply with the rules set forth in the *TBT Agreement* governing the treatment of technical regulations. In addition, Members are not allowed to take measures that would require or encourage local government or non-governmental bodies to act inconsistently with the rules governing the treatment of technical regulations. A “local government body” is defined in Annex 1 as:

[a] [g]overnment other than a central government (e.g. states, provinces, Länder, cantons, municipalities, etc.) its ministries or departments or any.

A “non-governmental body” is defined as:

[a] [b]ody other than a central governmental body or a local governmental body, including a non-governmental body which has legal power to enforce a technical regulation.

Article 3 of the TBT Agreement establishes two exceptions. A Member is not responsible for taking reasonable measures to ensure that non-governmental bodies, and local governmental bodies beyond the level directly below the central government body, comply with the requirement to notify a technical regulation to other Members through the WTO Secretariat, as provided for in paragraph 9.2 and 10.1 of Article 2.

3.2.2 Standards

Article 4 TBT

Article 4 of the *TBT Agreement* references the *Code of Good Practice*. This Code is found in Annex 3 of the *TBT Agreement*. The Code is designed to regulate the use of voluntary standards. It is open for acceptance by standardizing bodies within a WTO Member, whether at the central, local or non-governmental level. It is also open to regional standardizing bodies.

Standardizing bodies that accept the *Code of Good Practice* accept obligations explained in Section 4 of this Module, including most-favoured-nation treatment, national treatment, harmonization, mutual recognition, and transparency obligations.

Pursuant to Article 4.1 of the *TBT Agreement*, Members must ensure that central government standardizing bodies accept and comply with the *Code of Good Practice*. Members must also take “such reasonable measures as may be available to them” to ensure that local governmental, non-governmental and regional standardizing bodies (of which they are a member) accept and comply with the Code.

Members are not permitted to take measures that would require or encourage local government or non-governmental bodies to act inconsistently with the Code.

3.2.3 Conformity Assessment Procedures

Articles 5 through 9 of the *TBT Agreement* set forth provisions relevant to determining the scope and applicability of the *TBT Agreement* to conformity assessment procedures. Article 5 provides for most-favoured-nation treatment, national treatment, harmonization of assessment procedures, notice, transparency, equivalence, and exceptions in case of urgent problems. Article 6 provides for equivalence, accreditation, mutual recognition, and foreign participation in conformity assessment procedures. These principles and rules are discussed in Section 4 below.

Articles 5 and 6, governing conformity assessment by central government bodies, are the most important – setting out the applicable legal obligations. They provide a reference point for Articles 7 through 9 of the *TBT Agreement* which govern the application of the *TBT Agreement* to local government bodies, non-governmental bodies and international and regional systems.

Articles 5-6 TBT

Members have an obligation pursuant to Articles 5 and 6 to ensure that *central government bodies* abide by the provisions of the *TBT Agreement* governing conformity assessment. Not only does Article 5 implement many of the general principles applicable throughout the *TBT Agreement* to conformity assessment procedures, it also establishes very detailed procedural obligations governing transparency, notice, harmonization, procedural requirements, and confidentiality.

Article 7 TBT

Members are required, pursuant to Article 7 of the *TBT Agreement*, to take reasonable measures to assure that *local government bodies* within their territory comply with TBT Articles 5 and 6 of the *TBT Agreement*. Article 7.1 provides an exception with respect to the obligation to notify, as referred to in paragraphs 6.2 and 7.1 of Article 5. However, Members must ensure that conformity assessment procedures of local government bodies on the level directly below the central government body be notified in accordance with paragraphs 6.2 and 7.1 of Article 5, except when the technical content of the local procedures is substantially the same as that previously notified by the central government body.

Members must not take measures that encourage local government bodies within their territories to act inconsistently with Articles 5 and 6 of the *TBT Agreement*.

Article 7.5 of the *TBT Agreement* makes Members fully responsible for the observance of Articles 5 and 6 by local government bodies. Members are required to implement a legal mechanism to “support the observance” of the provisions of Articles 5 and 6 by other than central government bodies.

Article 8 TBT

Article 8 of the *TBT Agreement* requires that Members take reasonable measures to ensure that *non-governmental bodies* within their territories that operate conformity assessment procedures comply with the provisions of Articles 5 and 6 of the *TBT Agreement*. Members are not required to ensure that non-governmental conformity assessment bodies comply with the requirement to notify proposed measures.

Members are not permitted to take measures that have the effect of requiring or encouraging non-governmental conformity assessment bodies from acting in a manner inconsistent with the provisions of Articles 5 and 6.

Members are required to ensure that central government bodies do not rely on conformity assessment procedures operated by non-governmental bodies unless these bodies comply with the legal obligations set forth in Articles 5 and 6 of the *TBT Agreement*.

Article 9 TBT

Members are encouraged to formulate and adopt international systems for conformity assessment, become members of such systems, and participate therein. Members must take reasonable measures to assure that *international and regional conformity assessment* bodies in which relevant bodies within their territory participate, comply with the obligations set forth in Articles 5 and 6 of the TBT Agreement, and that central government bodies only rely on international and regional assessment systems to the extent that these systems comply with the provisions of Articles 5 and 6.

3.3 Test Your Understanding

- 1. How is the *TBT Agreement* organized? What is the Code of Good Practice?**
- 2. What divisions does the *TBT Agreement* make between different governmental and non-governmental entities?**
- 3. To what extent does the *TBT Agreement* apply to the standardizing activities of governmental bodies, non-governmental bodies and international bodies?**
- 4. Does the *TBT Agreement* apply to international and regional conformity assessment bodies?**

4. KEY PRINCIPLES AND RULES OF THE *TBT AGREEMENT*

On completion of this section, the reader will be able to discuss the key legal principles and rules applicable to TBT measures as a result of the *TBT Agreement*, including non-discrimination, the prevention of unnecessary obstacles to international trade, harmonisation, equivalence and transparency. Many of these principles and rules may already be familiar to the reader from other portions of the *WTO Agreement*.

4.1 Overview

Although the *TBT Agreement* has three separate fields of application (technical regulations, standards, and conformity assessment procedures), there are common principles and rules that are generally applicable throughout. This section concerns these common principles and rules. Because the analysis is lengthy, an outline of the structure of this section is provided:

- Non-discrimination
- The prevention of unnecessary obstacles to international trade
 - Legitimate objectives
 - Necessity
 - Reasonableness
 - Changed circumstances
- Harmonization
- Use of international standards
- Equivalence and Mutual recognition
- Transparency
- Derogations in the event of urgent measures.

4.2 The Non-Discrimination Principle

The WTO's "non-discrimination" obligation is applicable to technical regulations, standards and conformity assessment procedures. The principle of non-discrimination is found in the following provisions of the *TBT Agreement*:

For technical regulations: Article 2.1

For standards: Annex 3(D) (Code of Good Practice)

For conformity assessment procedures: Article 5.1.1.

MFN and NT

The non-discrimination obligation has two elements: "most-favoured-nation treatment" ("MFN treatment"), and "national treatment". In a nutshell, "**most-favoured-nation**" (MFN) treatment is an obligation not to discriminate

between “like products” imported from different WTO Members. “**National treatment**” is an obligation not to discriminate between domestic and imported “like products.”

Example: State A manufactures widgets, and also buys widgets from States B and C. All are WTO Members. Assuming these widgets are “like products”, State A has an obligation to apply the *same* tax and regulatory treatment to widgets imports from States B and C (MFN treatment); State A also has an obligation not to favour (from a tax and regulatory perspective) domestic widgets over widget imports from States A or B (national treatment).

Non-discrimination is an obligation not to discriminate between imported and domestic “like products” and among imported “like products”. If two products are not like products, the non-discrimination principle does not apply as between those products. This raises the important question of what constitutes a like product for purposes of the TBT Agreement.

Like product

Whether two products are “like products” is one of the most difficult legal problems in the *WTO Agreement*. Likeness is determined on a case-by-case basis and the notion of likeness is not consistent throughout the *WTO Agreement*. To date there has not been a TBT case in the WTO in which the term “like product” has been defined. The concept of “like product” has been examined in a number of WTO disputes on Article III of the GATT 1994, but it is unknown to what extent the ruling in these cases should be applied to the concept of “like product” in the TBT Agreement.

One of the most important WTO dispute settlement decisions interpreting “likeness” is that of the Appellate Body in *Japan – Alcoholic Beverages II*.⁹ The Appellate Body noted in its interpretation of GATT Article III:2 of the GATT 1994, in what has become a famous passage, that:

The concept of ‘likeness’ is a relative one that evokes the image of an accordion. The accordion of ‘likeness’ stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term ‘like’ is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.¹⁰

The *Japan - Alcoholic Beverages* decision confirms that, with respect to likeness determinations, this is an area where absolute rules are not established, and may never be established. It is probable that in the event a TBT dispute arises involving a like product question, WTO panels and the Appellate Body will seek guidance from GATT 1947 and WTO decisions interpreting likeness

⁹ 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 1996:1, p. 97.

¹⁰ Appellate Body Report *Japan – Alcoholic Beverages II*, p. 114

within the context of the non-discrimination obligations of the GATT, Article I (MFN) and Article III (national treatment). Not only do both Articles I and III employ the term “like product”, because Article III:4 governs product regulations, there is a relation between it and the *TBT Agreement*. Cases interpreting the meaning of “like product” within Article III should therefore be of particular relevance when interpreting this language in the *TBT Agreement*.

Possible Test

WTO decisions examining Article III of the GATT 1994 have applied a four part test in which the following factors are examined:

- physical characteristics (the properties, nature and quality of a product),
- HS classification,¹¹
- consumers’ tastes and habits (perception and behaviour), and
- product end uses.¹²

Although this multi-part test is widely accepted in GATT Article III cases, until a panel or Appellate Body decision examines what is a like product for TBT purposes, there is no way to be certain that the same test will be applied in TBT cases. Its application does, however, seem likely.

4.3 The Prevention of Unnecessary Obstacles to International Trade

Technical regulations, standards and conformity assessment procedures must not be prepared, adopted or applied so as to create unnecessary obstacles to international trade. The prevention of unnecessary obstacles to international trade is a principle applicable to technical regulations, standards and conformity assessment procedures, but its application is not necessarily identical in all three areas. The obligation to prevent unnecessary obstacles to international trade is set forth in the following provisions:

For technical regulations: Article 2.2

For standards: Annex 3(E) (Code of Good Practice)

For conformity assessment procedures: Article 5.1.2.

With respect to *technical regulations*, the prevention of unnecessary obstacles to international trade is defined in Article 2.2 to mean that technical regulations must: (1) not be more trade restrictive than necessary to achieve a policy goal (the least-trade-restrictive measure), and must (2) fulfil a legitimate objective, taking into account the risks that non-fulfilment would create. The concepts of “necessary”, “legitimate objective” and “risk of non-performance” are discussed below.

¹¹ HS is the Harmonized System of tariff classification. It is used by WTO Members to classify products for tariff purposes.

¹² See, e.g., *Appellate Body Report, EC - Asbestos*, para. 101.

With respect to *standards*, the prevention of unnecessary obstacles to international trade is not defined in either Article 3 of the *TBT Agreement* or in the *Code of Good Practice*. Nor is it defined in any WTO panel or Appellate Body decision considering the *TBT Agreement*. Given the similarities between technical regulations and standards (the primary regulatory difference is that one is mandatory and the other voluntary), it is probable that the same definition that is applicable to technical regulations would also be applied in the case of standards, but this remains to be proven.

With respect to *conformity assessment procedures*, the phrase “unnecessary obstacles to international trade” is defined in Article 5.1.2 which provides:”

...conformity assessment procedures are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. This means, inter alia, that conformity assessment procedures shall not be more strict or be applied more strictly than is necessary to give the importing Member adequate confidence that products conform with the applicable technical regulations or standards, taking account of the risks non-conformity would create.”

The terms underlined in the above explanation of “unnecessary obstacles to international trade) are examined below. Understanding these terms is essential to comprehend what constitutes an unnecessary obstacle to international trade.

4.3.1 Legitimate Objectives

Technical regulations must fulfil a legitimate objective. This is, in fact, one of the “goals” of the *TBT Agreement* discussed in Section 2 of this Module. Examples of the legitimate objectives permissible with respect to technical regulations are set forth in a *non-exclusive* list in Article 2.2. Legitimate objectives for technical regulations include:

- national security requirements,
- prevention of deceptive practices,
- protection of human health or safety,
- protection of animal life or health,
- protection of the environment, and
- other undefined objectives.

As noted above, the other legitimate objectives, not listed in Article 2.2 almost certainly include:

- regulations designed to standardize electrical products, computers equipment, communications equipment; etc., and
- quality standards.

Both types of regulations already exist widely, particularly in developed countries.

Labour rights and human rights considerations are not specifically mentioned in the *TBT Agreement* as legitimate objectives – but the protection of human life and health is deemed a legitimate interest in Article 2.2. Should labour and human rights objectives be considered legitimate objectives for TBT purposes? This is a controversial issue, as well as a political question that goes beyond the scope of this Module. It bears noting, however, that PPM considerations may be involved, and that in the event NPR-PPMs are at issue, it is uncertain whether the *TBT Agreement* applies.¹³

If a Member bases a domestic regulation on an international standard, and if the domestic regulation is for one of the legitimate objectives explicitly mentioned in Article 2.2, it is rebuttably presumed not to create an unnecessary obstacle to international trade.¹⁴

The phrase “legitimate objective” is not used in the analogous provision relating to standards. However, there is no reason to believe that the objectives enumerated for technical regulations would not be considered legitimate for “standards”. This point has not yet been addressed in a dispute settlement proceeding.

4.3.2 *Necessity*

The concept of “necessity” is found in the provisions applicable to regulations, standards and conformity assessment procedures. Article 2.2 of the *TBT Agreement* provides that technical regulations cannot be more trade restrictive than necessary to achieve a policy goal. It is probable that the negotiators were influenced by language in GATT panel reports defining “necessary” within the context of Article XX of the GATT 1994 (General Exceptions).

In the *Thailand - Cigarettes* case (which cited earlier GATT cases) a GATT panel concluded that a measure could be considered to be “necessary” in terms of Article XX(b) of the GATT 1947 only if there were no alternative measure consistent with the GATT, or less inconsistent with it, which a contracting party could “reasonably” be expected to employ to achieve its regulatory (health policy) objective.¹⁵

This test (the least restrictive trade measure) appears to have been given voice in the Article 2.2 definition of “necessary”. With respect to technical regulations and conformity assessment procedures, an “assessment” of the risks of non-performance of the legitimate objective is carried out. A non-exclusive list of elements that can be considered in a risk assessment is provided in Article 2.2 of the *TBT Agreement* (applicable to technical regulations) of the *TBT Agreement*:

¹³ See above, Section 2.2.2.

¹⁴ Article 2.5 of the *TBT Agreement*. See below, Section 4.5.

¹⁵ Panel Report *Thailand - Restrictions on Importation of and Internal Taxes On Cigarettes* (“*Thailand - Cigarettes*”), adopted 7 November 1990 DS10/R - 37S/200, paras. 74-75.

- available scientific and technical information,
- related processing technology, and
- intended end-uses of products.

4.3.3 Reasonableness

The term “reasonable” does not appear in the (apparent) definition of “necessary” in the *TBT Agreement*, but there is little doubt that a requirement of reasonableness must be read into Article 2.2 of the *TBT Agreement*, as it was in Article XX of the GATT by panels and the Appellate Body. Without the requirement that a less restrictive trade measure be reasonably available, the “necessity” test would be unworkable – establishing a standard that would be extraordinarily difficult to achieve.

In both the *Korea-Beef*¹⁶ and the *EC - Asbestos*¹⁷ decisions the Appellate Body examined what constitutes a “reasonably available” measure for purposes of the exceptions (predicated on the necessary test) set forth in Article XX(b) and (d). The Appellate Body found that:

- A determination of whether a WTO consistent alternative measure is reasonably available requires a “weighing and balancing process” in which an assessment is made as to whether the alternative measure “contributes to the realization of the end pursued.”¹⁸
- The more vital or important the common interests or values pursued, the easier it would be to accept as “necessary” measures designed to achieve those ends.¹⁹
- A measure should be sufficient to achieve a member’s chosen level of health protection.²⁰
- A measure does not cease to be “reasonably” available simply because it involves *administrative difficulties* for a Member.²¹

Applying the “reasonableness standard” set forth in *Korea-Beef* and *EC - Asbestos* in conjunction with the “necessary test” set forth in the *TBT Agreement* would reduce the likelihood that legitimate TBT measures would be struck down based on an overly strict interpretation of the *TBT Agreement*. Without this standard, far fewer TBT measures would be permitted.

4.3.4 Changed Circumstances

In order to assure that unnecessary obstacles to international trade are avoided, Article 2.3 of the *TBT Agreement* provides with respect to *technical regulations*

¹⁶Appellate Body Report *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef (“Korea – Beef”)*, WT/DS161/AB/R, WT/DS169/AB/R, (10 January 2001), paras. 159-166.

¹⁷Appellate Body Report, *EC- Asbestos*, paras. 169-175.

¹⁸ *Ibid.*, para. 171 citing Appellate Body Report, *Korea-Beef*, paras. 166 and 163.

¹⁹ *Ibid.*, para. 172 citing Appellate Body Report, *Korea-Beef*, para 162.

²⁰ *Ibid.*, para.174.

²¹ *Ibid.*, para. 169 citing Panel Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2.

that if circumstances change or an objective can be addressed in a less trade-restrictive manner, the more restrictive trade measure must be removed.

The *Code of Good Practice*, applicable to *standards*, does not refer to “changed circumstances” This concept is nevertheless implicit in the avoidance of unnecessary obstacles to international trade. Not only is this evident from the notion of avoiding unnecessary obstacles, it is demonstrated by Article 5.2.7, which limits the scope of conformity assessment procedures used to verify that a standard is met in the event that product specifications are changed.

With respect to conformity assessment procedures, it should be noted that if a product’s specifications are changed after the product has been found to conform with a technical regulation or standard, pursuant to Article 5.2.7 the conformity assessment procedure for the modified product is to be limited to what is necessary to provide adequate confidence that the product still conforms with the technical regulation or standard. This provision reduces the potential that conformity assessments will be applied to impede trade. Instances may nevertheless arise when significant changes in a product’s specifications necessitate a complete conformity reassessment.

4.4 Harmonization

Harmonization is a central pillar of the *TBT Agreement*. Members are encouraged to participate in the international harmonization of standards, and to use agreed international standards as a basis for domestic technical regulations and standards. The emphasis on harmonization is based on the view that (a) trade is disrupted less if Members use internationally agreed standards as a basis for domestic regulations and standards, and (b) producers and consumers benefit from a degree of harmonization (because of economies of scale and questions of technical compatibility respectively). The relevant provisions of the *TBT Agreement* relating to harmonization and the use of relevant international standards are:

for *technical regulations*: Articles 2.4-2.6

for *standards*: Annex 3(F)-(G) (Code of Good Practice)

for *conformity assessment procedures*: Articles 5.4 and 5.5

Members have an obligation, within the limits of their resources, to participate in the work of international standardization organizations with respect to products for which they have adopted or expect to adopt technical regulations or standards. Members also have a similar obligation with respect to the preparation of “guides and recommendations” for conformity assessment procedures. The provisions of the *TBT Agreement* relating to this obligation are:

for *technical regulations*: Article 2.6

for *standards*: Annex 3(G) (Code of Good Practice)

for *conformity assessment procedures*: Article 5.5 .

Harmonization is a pillar of the *TBT Agreement*. Members are required, within the limits of their resources, to participate in the work of international organizations seeking to harmonize international standards. Technical regulations designed to further one of the “legitimate objectives” set forth in Article 2.2 benefit from a rebuttable presumption that they do not create unnecessary obstacles to international trade.

4.5 Use of Relevant International Standards

Article 2.4 TBT

With respect to technical regulations, Article 2.4 of the TBT Agreement provides that:

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

In the *EC - Sardines* decision the Panel found, and the Appellate Body confirmed, that a standard promulgated by Codex Alimentarius, the Codex Stan 94, is a relevant international standard for purposes of Article 2.4 of the *TBT Agreement*.²² The international standard need not be promulgated by consensus by the recognized standardizing body in order to fall within Article 2.4.²³

The Panel in *EC – Sardines* found that the Codex Stan 94, the international standard in question, had not been “used ... as a basis” for the TBT measure at issue. The European Communities appealed that finding. The Appellate Body held:

We agree with the Panel’s approach. In relying on the ordinary meaning of the term “basis”, the Panel rightly followed an approach similar to ours in determining the ordinary meaning of “based on” in EC – Hormones. 169 In addition to the definition of “basis” in Webster’s New World Dictionary that was used by the Panel, we note, as well, the similar definitions for “basis” that are set out in the The New Shorter Oxford English Dictionary, and also provide guidance as to the ordinary meaning of the term:

3 [t]he main constituent. ... 5 [a] thing on which anything is constructed and by which its constitution or operation is determined; a determining principle; a set of underlying or agreed principles.

From these various definitions, we would highlight the similar terms “principal constituent”, “fundamental principle”, “main constituent”, and “determining

²² Appellate Body Report *EC - Sardines*, para. 233

²³ *Ibid.*, para. 227.

principle”—all of which lend credence to the conclusion that there must be a very strong and very close relationship between two things in order to be able to say that one is “the basis for” the other.²⁴

The Appellate Body considered it unnecessary to determine in general the meaning of “used ... as a basis”. It held that it is clear that when a technical regulation is totally contradictory to a standard, that the standard is definitely *not* used as a basis for the technical regulation.²⁵ *In casu*, the TBT measure at issue prohibited something that is explicitly provided for under the international standard.

The Panel in *EC – Sardines* also found that the Codex Stan 94, the international standard in question, was not an “ineffective or inappropriate means for fulfilling the legitimate policy objectives pursued. These objectives were market transparency, consumer protection and fair competition. On appeal, the Appellate Body agreed with the Panel that an “ineffective means” is a means which does not have the capacity to accomplish the legitimate objective pursued and that an “inappropriate means” is a means which is not specially suitable for the fulfilment of the legitimate objective. Effectiveness bears on the result and appropriateness on the nature. The Appellate Body upheld the Panel’s finding that the use of the international standard was neither an ineffective nor an inappropriate means to fulfil the legitimate objectives pursued.²⁶

The Appellate Body also found that the burden of proof standard enunciated in the *EC - Hormones*²⁷ dispute, an SPS dispute, should also be applied in the *EC - Sardines* case. The complaining Member challenging a measure as inconsistent with Article 2.4 of the *TBT Agreement* has the burden of proving that: (1) the standard was not used as a basis for the challenged regulation, and that (2) the international standard is not ineffective and inappropriate to fulfil the legitimate objective at issue.²⁸

Article 2.5 TBT

If a Member prepares, adopts or applies a technical regulation for one of the legitimate objectives explicitly mentioned in article 2.2 and, the measure is in accord with the relevant international standard, this measure is, pursuant to Article 2.5 rebuttably presumed not to create an unnecessary obstacle to international trade. This presumption makes it harder for a complaining Member challenging the WTO consistency of a TBT to make a *prima facie* case that the measure at issue does create an unnecessary obstacle to international trade.

The creation of a rebuttable presumption in favour of certain technical regulations based on international standards should provide a greater incentive for international harmonization and for reliance on harmonized standards.

²⁴ Appellate Body Report, *EC – Sardines*, para. 244 (footnotes omitted)

²⁵ Para. 148.

²⁶ Appellate Body Report, *EC – Sardines*, para. 290.

²⁷ Appellate Body Report, *EC - Measures Concerning Meat and Meat Products (Hormones)* (“*EC - Hormones*”) WT/DS26/AB/R; WT/DS48/AB/R, adopted 13 February 1998.

²⁸ Appellate Body Report, *EC - Sardines*, paras. 275 - 282.

4.6 Equivalence and Mutual Recognition

Members are encouraged to accept foreign technical regulations as “equivalent” to their own technical regulations (even if they differ) provided that they fulfil the same objectives.²⁹ Likewise, Members are encouraged to accept foreign conformity assessment procedures as “equivalent” to their own procedures provided they are satisfied that those procedures offer an assurance of conformity with standards and technical regulations equivalent to their own procedures. Although the notion of equivalence is not mentioned in the Code of Good Practice (applicable to standards), the principle of equivalence is made applicable to standards through Article 6.1 (conformity assessment procedures).

Members are encouraged to enter into negotiations for the mutual recognition of the results of conformity assessment procedures. By accepting the results of another Member’s conformity assessment procedures, testing costs are reduced and less time is lost. Confidence in a trading partner’s testing procedures would seem to be a prerequisite to the acceptance of a mutual recognition agreement. The relevant provisions of the *TBT Agreement* on equivalence and mutual recognition are:

for *technical regulations*: Article 2.7 (on equivalence)

for *standards*: none but equivalence is incorporated in Article 6.1 re: conformity assessment procedures

for *conformity assessment procedures*: Article 6 (on both equivalence and mutual recognition).

There is some scepticism among WTO Members concerning the effectiveness of international standardization efforts, and the extent to which harmonization, equivalence and mutual recognition can be increased between countries at different stages of development

4.7 Transparency

Transparency is another central tenet of the *TBT Agreement*. Transparency is the process whereby the creation, terms, and application of technical regulations, standards and conformity assessment procedures are made public, and opportunities are provided for the public (including other Members) to comment on proposed technical regulations, standards and conformity assessment procedures. Transparency obligations are found throughout the *WTO Agreement*.

4.7.1 Transparency Obligations

The provisions of the *TBT Agreement* relating to transparency are:

²⁹ The term “equivalent” is not defined in the *TBT Agreement*.

for *technical regulations*: Articles 2.9 and 10

for *standards*: Annex 3(J)(Q) (Code of Good Practice) and Article 10

for *conformity assessment* procedures: Articles 5.5 and 10.

Transparency obligations take several different forms and are applicable at different points in the promulgation and application of a measure. They include the following requirements set out in Articles 2.9, 2.10, 5.6 and 5.8 as well as Annex 3 (L), (M), (N) and (O):

- The publication of a pre-implementation notice prior to enactment of a measure sufficient to allow interested parties to become acquainted with a proposed measure.³⁰
- Prior to the enactment of a technical regulation or a conformity assessment procedure (when amendments to the measure can still be introduced), the notification of other Members through the WTO Secretariat of the products to be covered and the provision of a brief indication of the objective and rationale for the technical regulation or procedure. For draft standards, the provision of a 60 day period for comments.³¹
- Upon request, provide Members with copies of draft technical regulations, standards, and conformity assessment procedures.³²
- Prior to the enactment of a measure, allow Members a reasonable time for written comment, and for discussions concerning proposed measures, and take these comments/discussions into consideration.³³
- Publish “or otherwise make available” technical regulations, standards, and conformity assessment procedures to other members and to interested parties.³⁴
- In addition, Members are required, pursuant to Article 10 of the *TBT Agreement*, to establish “enquiry points” to answer reasonable inquiries from, and provide relevant documents to, Members and other interested parties concerning technical regulations, standards and conformity assessment procedures. Enquiry points have the responsibility to provide information concerning a WTO Member’s participation in regional and international standardisation and conformity assessment bodies. Enquiry points also have the responsibility to provide certain information concerning the activities of non-governmental standardization organizations.

³⁰ See for technical regulations: Article 2.9.1; for standards: (L) (Code of Good Practice); and for conformity assessment procedures: Article 5.6.1.

³¹ See for technical regulations: Article 2.9.2; for standards: (L) (Code of Good Practice); and for conformity assessment procedures: Article 5.6.2.

³² See for technical regulations: Article 2.9.3; for standards: Annex 3 (M) (Code of Good Practice); and for conformity assessment procedures: Article 5.6.3.

³³ See for technical regulations: Article 2.9.4; for standards: Annex 3 (L) and (N) (Code of Good Practice); and for conformity assessment procedures: Article 5.6.4.

³⁴ See for technical regulations: Article 2.11; for standards: Annex 3 (O) (Code of Good Practice); and for conformity assessment procedures: Article 5.8.

Transparency is a cornerstone of the *TBT Agreement*. Transparency obligations exist prior to the formation of technical regulations, standards and conformity assessment procedures, and continue throughout the life of these measures.

Example: A Member seeking to enact an environmental law regulating automobile exhaust would be required, prior to enactment of the law, to provide drafts of the measure to other Members, permit comments from them, publish the measure, and notify Members through the Secretariat of the measure. Once enacted the Member would be obliged to provide information and relevant documents relating to the law to any interested party.

4.7.2 *Derogations from Transparency in the Event of Urgent Problems*

The transparency obligations applicable prior to the adoption of technical regulations and conformity assessment procedures may be omitted in the event of urgent problems related to safety, health, the environment or national security. In such cases, *post-facto* obligations exist to notify Members of the measures enacted, make copies available upon request, and to consider comments from other Members. With respect to draft standards, the 60 day period allowed for comment may be shortened in the event of urgent problems related to safety, health, or the environment. The provisions of the TBT Agreement providing for derogations from the transparency obligations are:

- for *technical regulations*: Article 2.10
- for *standards*: Annex 3, (L) (Code of Good Practice)
- for *conformity assessment procedures*: Article 5.7.

Example: State A discovers that a type of packing material produces deadly emissions when burned. It immediately outlaws its production and use within its territory. It must then immediately notify other WTO members of the ban, making copies of the ban available upon request, and permitting comments from all Members on the regulatory measure.

4.8 Test Your Understanding

1. **What does non-discrimination mean? What is the difference between national treatment and most-favoured-nation treatment?**
2. **What is a like product? Provide two examples of like products. What makes you think that the products you have identified are like products?**
3. **What does the obligation in Article 2.2 of the *TBT Agreement* to prevent unnecessary obstacles to international trade entail?**

4. **What does the term “necessary” mean for TBT purposes?**
5. **What regulatory goals are considered to be legitimate objectives for TBT purposes? Is the list in TBT Article 2.2 exclusive? In your opinion, what other objectives could or should be included?**
6. **What is the difference between harmonization, equivalence and mutual recognition?**
7. **What is transparency? Why is transparency important from the perspective of the *TBT Agreement*? What kinds of transparency obligations exist under the *TBT Agreement*?**

5. DEVELOPING COUNTRY MEMBERS AND THE *TBT* AGREEMENT

Objectives

On completion of this section, the reader will be able:

- **to assess the technical assistance that is available under the *TBT Agreement* to WTO Members and, in particular developing country Members.**
- **To appreciate the special and differential treatment provided for in the *TBT Agreement* for developing country Members.**

5.1 Technical Assistance

Article 11 *TBT*

Technical assistance can be defined as the provision of expert assistance by other Members, the WTO Secretariat, or third parties. Normally, developing countries are the recipient of technical assistance. Article 11 of the *TBT Agreement* sets forth a broad range of technical assistance provisions. WTO Members are required to:

- Advise other Members, especially developing country Members, on the preparation of technical regulations.
- Provide technical assistance, in particular to developing countries, regarding the establishment of national standards bodies, and participation in these bodies, and encourage their national standards bodies to do likewise.
- Take reasonable measures to arrange for regulatory bodies within their territories to advise other Members, in particular developing country members. Provide technical assistance on agreed terms regarding the establishment of regulatory and conformity assessment bodies, and assistance on the methods by which their technical regulations can best be met.
- Take reasonable measures, in particular with respect to developing country Members, to advise on the establishment of bodies for the assessment of conformity with standards.
- Grant technical assistance, especially to developing country Members, regarding the steps that should be taken by foreign producers seeking access to conformity assessment systems operated by governmental and non-governmental bodies.
- Encourage organizations within their territory which are members of, or participants in, international or regional conformity assessment systems to advise other Members, and consider requests for technical assistance from other Members (in particular developing countries) regarding the establishment of institutions which would enable relevant organizations within their territories to fulfil the obligations of membership or participation in international and regional conformity assessment systems.

- Grant other Members, especially developing country Members, technical assistance related to the institutions and legal framework of international and regional systems for conformity assessment sufficient to enable them to fulfil the obligations of membership or participation in such systems.
- Give priority to the needs of the least-developed country Members.

Developing countries are working to assure that commitments made with respect to such assistance are respected.

5.2 Special and Differential Treatment

Article 12 TBT

The *TBT Agreement* requires Members, in particular developed country Members, to provide more favourable treatment to developing country Members based on the financial and trade needs of the latter.

Article 12 of the *TBT Agreement* sets forth a broad range of provisions providing special and differential treatment to developing country Members. Although Article 12 does not provide developing country Members with permanent derogations to the substantive provisions of the TBT Agreement, the pro-developing country character of Article 12 is unambiguous.

Pursuant to Article 12 of the *TBT Agreement*, Members are required to provide special and differential, i.e., more favourable treatment, to developing country Members in several different forms. Article 12 requires:

- Members to recognize and to take into account the special needs of developing countries in the promulgation and application of technical regulations, standards and conformity assessment procedures. Factors to be recognized include the developmental, financial and trade needs of developing country Members, and the preservation of indigenous technology and production methods.
- The facilitation of participation of developing country Members in international standardisation and conformity assessment bodies. One means of facilitation is through encouraging developing country participation in the standardisation and conformity assessment process; a second means is to take measures to ensure that international standards are prepared for products of interest to developing countries.
- The provision of technical assistance in accordance with Article 1 of the *TBT Agreement*.
- The grant of time-limited exceptions obligations arising under the *TBT Agreement*.

Under the WTO Work Programme agreed at the Ministerial Conference in Doha in November 2001, the WTO provisions granting special and

differential treatment to developing country Members will be reviewed and their effectiveness evaluated.

5.3 Test Your Understanding

1. **What types of technical assistance are available under the *TBT Agreement*? Do you think that the technical assistance available is satisfactory? Why or why not?**
2. **What forms of special and differential treatment are available? Do you think they are satisfactory? Why or why not?**
3. **How are LDCs treated for purposes of technical assistance and special and differential treatment?**

6. DISPUTE SETTLEMENT AND INSTITUTIONAL MATTERS OBJECTIVES

Objectives

On completion of this section the reader:

- **will be familiar with how disputes are settled under the *TBT Agreement*.**
- **will have learned that the WTO’s *Dispute Settlement Understanding* (“DSU”) applies to TBT disputes. An important dispute involving the *TBT Agreement* will be noted.**
- **will be familiar with the Committee on Technical Barriers to Trade. This WTO Committee is charged with overseeing the application and administration of the *TBT Agreement*.**
- **will also be informed of the regular reviews of this Agreement that the WTO Members are required to conduct.**

6.1 Dispute Settlement

Article 14.1 TBT

As provided for in Article 14.1 of the *TBT Agreement* alleged violations of the *TBT Agreement* are handled pursuant to the provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied in the WTO Dispute Settlement Understanding (“DSU”).³⁵ This is the normal manner in which WTO disputes are handled.

Annex 2 TBT

At the request of a party to the dispute, or at its own initiative, a panel hearing a TBT dispute may, pursuant to Article 14.2 of the *TBT Agreement*, establish a “technical expert group” to assist in questions requiring technical expertise. Annex 2 of the *TBT Agreement* establishes a procedure governing the role of experts. Annex 2:

- provides criteria for the selection of as an expert,
- establishes the authority of experts to seek information and advice,
- protects confidential information, and
- allows the Members concerned (parties and third parties to a dispute) to comment on the draft report developed by a Technical Expert Group.

Article 14.4 TBT

Article 14.4 of the *TBT Agreement* provides that the dispute settlement provisions can be invoked when a Member considers that another Member has not achieved satisfactory results under Articles 3, 4, 7, 8 and 9 of the *TBT Agreement* and its trade interests are significantly affected. This means that with respect to technical regulations (Article 3), standards (Article 4), and conformity assessment procedures (Articles 7, 8 and 9), Members have an obligation, and are fully responsible for ensuring that local government bodies,

³⁵ See Chapters 3.1, 3.2, 3.3 and 3.4 of this Handbook.

non-government bodies, and international and regional systems, comply with the terms of the *TBT Agreement*. A DSU proceeding can be commenced against a Member in the event of non-compliance.

Today there has only been one WTO dispute in which the outcome depended on the *TBT Agreement*, *EC – Sardines* which was decided on the basis of the *TBT Agreement*. In *EC – Sardines*, the Panel and, on appeal, the Appellate Body found that the EC's regulation on the marketing of "preserved sardines" was inconsistent with Article 2.4 of the *TBT Agreement*.³⁶

The *EC - Asbestos* decision examined the applicability of the *TBT Agreement*, in particular what constitutes a technical regulation, but it was not based on the *TBT Agreement*.

The *TBT Agreement* also played a prominent role in the *EC – Asbestos dispute* concerning a French import ban on asbestos and asbestos-containing products, but this dispute was decided on the basis of the GATT 1994. In *EC – Asbestos*, the Panel had ruled that the *TBT Agreement* was not applicable to an import ban such as the measure at issue in the dispute. The Appellate Body reversed the Panel's finding on this point and found that the *TBT Agreement* was applicable.³⁷ However, the Appellate Body declined to complete the legal analysis and to apply the *TBT Agreement* to the import ban on asbestos and asbestos-containing products.

Until recently, panels have avoided applying the *TBT Agreement*, preferring instead to resolve potential TBT cases based on GATT rules. With the Appellate Body's 2001 decision in the *EC - Asbestos* case holding that the *TBT Agreement* was applicable to the import ban in question, and the 2002 decision in the *EC - Sardines* dispute finding the EC measure at issue inconsistent with Article 2.4 of the *TBT Agreement*, this has now changed. As a result, one can expect to see an increase in TBT disputes, primarily because, despite the need for domestic policy autonomy to address legitimate interests, technical regulations, standards, and conformity assessment procedures are indeed sometimes used as protectionist devices.

6.2 Committee on Technical Barriers to Trade

Article 13 of the *TBT Agreement* creates a Committee on Technical Barriers to Trade. Representatives of each of the WTO Members are entitled to participate. The Committee meets as necessary, but at least once a year.

The TBT Committee has several responsibilities:

- It provides Members with an opportunity to consult on TBT issues.

³⁶ See above, Section 4.5.

³⁷ See above, Section 2.2.5.

- It carries out whatever responsibilities the Members may assign to it, and establishes working parties and other bodies to carry out these responsibilities.
- It works to avoid duplication between its activities and the work of governments in other technical bodies.

Article 1.3 TBT

The *TBT Agreement* requires that the TBT Committee annually review the implementation and operation of the TBT Agreement taking into account the objectives of the Agreement.

Article 12.8 TBT

Pursuant to Article 12.8 of the *TBT Agreement*, the TBT Committee is authorized to grant “time-limited exception” to obligations under the *TBT Agreement* in order to ensure that developing countries are able to comply with the *TBT Agreement*. In granting such an exception the Committee is to consider:

- the special problems experienced by developing countries in the preparation and application of technical regulations, standards and conformity assessment procedures,
- the special development and trade needs of the developing country Member, and
- the stage of technological development of the particular developing country.

The Committee is required to take into account special problems experienced by the least-developed country Members (LDCs).

Article 12.10 TBT

Pursuant to Article 12.10 of the *TBT Agreement*, the TBT Committee is also obliged to “examine periodically the special and differential treatment, as laid down in this Agreement, granted to developing country Members on national and international levels.” It has done so in each of two triennial reviews discussed below.

Article 15.4 TBT

Every three years the TBT Committee must conduct a review of the implementation and operation of the *TBT Agreement*, with a view to recommending adjustments of the rights and obligations of the Agreement where necessary. This review is designed to ensure mutual economic advantage and balance of rights and obligations, without prejudice to the provisions concerning special and differential treatment of Article 12.

Based on the implementation experience, the TBT Committee is entitled to submit proposals to amend the *TBT Agreement* to the Council for Trade in Goods.

To date, two triennial reviews have been held, the first in 1997: G/TBT/5 (97-5092) 19 November 1997; and the second in 2000: G/TBT/9 (00-4811) 13 November 2000. These documents, referenced by number, are available on the WTO’s internet site. They offer a somewhat critical review of the successes and failures under the *TBT Agreement*

6.3 Test Your Understanding

- 1. Does the WTO's Dispute Settlement Understanding Apply to the *TBT Agreement*?**
- 2. What role, if any, do experts have in TBT disputes?**
- 3. Is a Member responsible if a technical regulation established within a region violates the *TBT Agreement*? Can another Member challenge the consistency of such a regulation with the *TBT Agreement* under the DSU?**
- 4. What is the Committee on Technical Barriers to Trade? What are its responsibilities?**
- 5. How often must the implementation and operation of the *TBT Agreement* be reviewed? What provisions must be reviewed?**
- 6. Does your country have a national TBT enquiry point and if so what is its address? Has it notified TBT measures to the WTO? Try to answer these questions by looking at the WTO website.**

7. CASE STUDIES

1. The State of Airmania is a developed country with very high environmental standards applicable to domestic industries. Consumers in Airmania have a strong demand for environmentally friendly products. They also have the technology to manufacture environmentally friendly products.

The State of Anxiety is a developing country with considerable industrial capability. It is a beneficiary of export driven development and is an important trading partner of Airmania. Airmania imports a large portion of Anxiety's manufactured goods. While the State of Anxiety has many environmental laws on its books, they are seldom enforced. Economic advancement for now plays a more important role than environmental protection. Both Airmania and Anxiety are founding Members of the WTO Agreement.

Airmania has just introduced a law implementing a variation on an "eco-labelling programme" pursuant to which manufactured goods that satisfy certain criteria will be eligible to be labelled as "Eco-Friendly". The criteria will be developed and administered by a local non-governmental organization in Airmania known as "Eco-Lab". Eco-Lab will examine all phases of a given product's life-cycle (a cradle-to-grave analysis). This will include an analysis of how a product is made (the production processes used and the environmental implications of these processes), as well as environmental factors associated with a product's packaging, its use, and its subsequent disposal. Eco-Lab will be entirely responsible for establishing the criteria and testing whether products satisfy the criteria and can wear the "Eco-Friendly" label.

Conformity with Airmania's programme is voluntary – in other words a manufacturer in Anxiety will not need a label from Eco-lab to sell its products in Airmania. However, it is expected that having the "Eco-Friendly" label will make products very popular among Airmania's environmentally conscious consumers.

You are an attorney for industrial exporters in the State of Anxiety. Your clients are worried that the eco-labelling scheme will make it more difficult to sell their goods in Airmania. Your clients have approached you with questions concerning the WTO Agreement, in particular the *TBT Agreement*.

Variation No. 1

- a) Does Airmania's law fall under the *TBT Agreement*?
- b) If yes, is it a technical regulation, a standard or a conformity assessment procedure?
- c) What are Airmania's obligations under the *TBT Agreement* with respect to notification and transparency?

- d) What are Airmania's obligations with respect to national treatment and MFN treatment?
- e) Is Airmania's objective legitimate? How does this point affect your analysis?
- f) Is it significant that because of their environmental knowledge and production skills, Airmania's domestic industries may benefit from the labelling scheme?
- g) Is Airmania allowed pursuant to the *TBT Agreement* to implement the scheme described above? If not, what changes must be made?
- h) How is your analysis affected by the fact that the labelling criteria includes processes and production methods?
- i) What would your evaluation of this dispute be under GATT Articles III and XX of the GATT 1994?

Variation No. 2

With one exception, the facts are the same:

Airmania's labelling programme is mandatory, but only applies to the use and disposal of products (and not to production processes). If your products do not qualify for a label, you can not sell them in Airmania.

- a) Does this change your analysis and your answer to the questions above? (Work your way through each question.)
 - b) What would your evaluation of this dispute be under Articles III and XX of the GATT 1994?
2. Westland is a developed country and a major exporter of agricultural goods. It has recently begun to plant genetically. It produces two products from these GMO seeds: edible soybean oil used for cooking, and a light oil used as a machine lubricant.

Graceland is a developing country that has, based on ethical grounds, for human safety, outlawed planting GMO seeds in its territory and has implemented a technical regulation outlawing the sale in its territory of any product derived from GMO seeds. The only exception to this ban is if less than one percent of the product is derived from GMOs. Graceland's technical regulation was implemented on an urgent basis without any notice to other WTO Members or to the WTO Secretariat. The measure has now been in effect for six months.

In order to improve its agriculture, Graceland has asked Westland for technical assistance in plant hybridization, and additional assistance in drafting a second

technical regulation banning GMO imports in the event that its present technical regulation is struck down in a WTO dispute settlement proceeding. Westland has refused to offer any technical assistance.

Westland has challenged Graceland's ban under the *TBT Agreement*. Graceland has retained your services to defend itself in a WTO dispute settlement proceeding. In particular Graceland seeks answers to the following questions.

- a) Does the *TBT Agreement* apply and if so to what extent?
- b) If the *TBT Agreement* does apply, which provisions are applicable?
- c) If Graceland invokes its right to special and differential treatment, what effect will this have in its dispute with Westland?
- d) What right does Graceland have to technical assistance and what kind of assistance is Westland obligated to offer?
- e) What arguments is Graceland likely to face in a dispute involving the *TBT Agreement*?
- f) Does Graceland have a potential counterclaim against Westland and how should it proceed?

8. SUGGESTED READING

8.1 Books and Articles

- **Cottier, T. and Mavroidis, P.** (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (University of Michigan Press, 2000).
- **The WTO Secretariat**, *Guide to the Uruguay Round Agreements*, Kluwer Law International (The Hague 1999).
- **Baldwin, R.**, *Regulatory Protectionism, Developing Nations, and a Two-Tier World Trade System*, Brookings Trade Forum 2000, 237-280.

8.2 Panel and Appellate Body Reports

- Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (“EC – Asbestos”), WT/DS135/R and Add.1, adopted 5 April 2001, as modified by the Appellate Body Report, WT/DS135/AB/R.
- Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (“EC – Asbestos”), WT/DS135/AB/R, adopted 5 April 2001.
- Panel Report, *European Communities – Trade Description of Sardines* (“EC – Sardines”), WT/DS231/R, adopted 23 October 2002, as modified by the Appellate Body Report, WT/DS231/AB/R.
- Appellate Body Report, *European Communities – Trade Description of Sardines* (“EC – Sardines”), WT/DS231/AB/R, adopted 23 October 2002.

8.3 Documents and Information

- WTO, A Training Package, Module 3, Goods: Rules on NTMs (1998).
- WTO, First Triennial Review of the Operation and Implementation of the Agreement on Technical Barriers to Trade, G/TBT/5 (97-5092), (19 November 1997).
- WTO, Second Triennial Review of the Operation and Implementation of the Agreement on Technical Barriers to Trade, G/TBT/9 (00-4811), (13 November 2000).
- WTO, Technical Barriers to Trade, <www.wto.org/english/tratop_e/tbt_e/tbt_e.htm> (visited 15 February 2002). (This is the WTO’s access point for TBT-related information.)

The WTO maintains an excellent website at www.wto.org. On this site one can find background information concerning the *TBT Agreement*, the complete text of the *TBT Agreement*, the results of the Annual and Triennial TBT

Committee Reviews, Member notifications, the WTO's TBT training guide, lists of national TBT Inquiry Points, Minutes of TBT Committee meetings, working documents of the TBT Committee, a list of Standardizing bodies that have accepted the Code of Good Practice, and many other TBT-related documents.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.11 TEXTILES AND CLOTHING



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

The *Agreement on Textiles and Clothing* (“ATC”) is one of a few sector-specific agreements in the WTO. It is limited in its scope and duration. It sets out provisions to be applied during a 10-year transitional period, starting from 1995. Its basic purpose is to secure the integration of trade in textile and clothing into the normal rules of the GATT, through gradual phase-out of quota restrictions that have long been applied by major developed countries to imports from developing countries and economies.

Reflecting the specific (and limited) scope of the ATC, not all disputes involving textile and clothing products come under its purview. For example, disputes relating to anti-dumping measures do not fall in the ambit of the ATC. These are covered by the *Anti-dumping Agreement*.

For disputes arising from violations of the ATC itself, the Agreement establishes a two-step procedure. This procedure is unique to the ATC in as much as it provides for an additional step in the shape of the Textiles Monitoring Body (“TMB”). A case has to be considered by the TMB before it can be referred to the panel process. During the seven and a half years that the ATC has been in force, there have been several dispute cases, some of which were resolved in the TMB. Three went through panels and the Appellate Body.

This Module gives an overview of the ATC, its main provisions, and how these have been clarified or interpreted by the TMB, or by panels and the Appellate Body.

The first Section gives a short introduction to the ATC and its main provisions. The second Section describes the role and procedures of the TMB and brings out some significant clarifications resulting from its work. The third Section reviews important panel and Appellate Body rulings in disputes raised under the ATC. It also reviews some pertinent findings from cases in which violation of ATC obligations was invoked as a supplementary issue. Finally, the fourth Section contains a summary overview of ATC dispute cases examined by panels and the Appellate Body.

1. INTRODUCTION

This section provides a brief background to the Agreement on Textiles and Clothing (ATC), why it was needed, what is its main purpose, and what is the scope of disputes under the ATC. The section also provides a summary overview of the main provisions of the Agreement.

1.1 Why ATC

ATC is essentially designed to correct a long standing anomaly in the multilateral trading system.

The background

Since 1961, international trade in textiles and clothing had been virtually excluded from the normal rules and disciplines of the GATT. It was governed by a system of discriminatory restrictions, which deviated from some of the basic principles of the GATT. The system was first incorporated in a so-called Short-Term Cotton Arrangement (“STA”), followed by a Long-Term Arrangement (“LTA”) and, later, by the Multi-fibre Arrangement (“MFA”). The MFA continued until the WTO Agreements came into effect on 1 January 1995.

While GATT rules prohibited the use of quantitative restrictions to provide protection to domestic industries, the system allowed the use of such restrictions. While the Most-Favoured-Nation (MFN) principle of the GATT required equal treatment for all supplying countries, the system permitted the imposition of restrictions against imports from particular countries.

Such an obvious departure from the basic principles of the multilateral trading system constituted a major distortion in international trade, more so as restrictions were applied mainly on imports from developing economies. It also meant an obstacle to the normal development of trade.

Among the principal aims of the Uruguay Round were the removal of such distortions and the further liberalization of trade. Consistent with these aims, it was agreed that negotiations should be undertaken to bring about the re-integration of the textiles and clothing sector into the same mainstream of multilateral rules as for any other industrial sector. Hence the ATC.

1.2 Purpose of the ATC

According to its terms, the purpose of the ATC is to integrate the textile and clothing sector into the normal rules and disciplines of the GATT.

Article 1:1 of the ATC

This Agreement sets out provisions to be applied by [WTO] Members during a transition period for the integration of the textiles and clothing sector into GATT 1994. (Emphasis added).

**“Integration”
explained**

The ATC however does not provide any explicit definition of the term “integration”. The ordinary meaning of the term “integration” is the act of unifying or ending the difference in treatment. Therefore, as used in the ATC, it implies the elimination of those practices from the sector which did not conform to the normal rules of the GATT.

Context of integration

In order to determine the practices which did not conform to the rules of the GATT, and which therefore constitute the context of the ATC, reference to Paragraph 2 of the Preamble to the ATC recalling the April 1989 Decision of the Trade Negotiations Committee can be helpful. That Decision specified that integration of the sector will cover the phase out of restrictions under the Multi-fibre Arrangement and other restrictions on textiles and clothing not consistent with GATT rules and disciplines. The Decision stipulated that:

**Trade Negotiations
Committee, April 1989
Decision¹**

(a) Substantive negotiations will begin in April 1989 in order to reach agreement within the time-frame of the Uruguay Round on modalities for the integration of this sector into GATT, in accordance with the negotiating objective;

(b) such modalities for the process of integration into GATT on the basis of strengthened GATT rules and disciplines should inter alia cover the phasing out of restrictions under the Multi-fibre Arrangement and other restrictions on textiles and clothing not consistent with GATT rules and disciplines, the time-span for such process of integration, and the progressive character of this process which should commence following the conclusion of the negotiations... (Emphasis added)

Thus the context of the ATC demonstrates that the object and purpose of “integration” is the phase-out of restrictions on textile and clothing products that were maintained under the Multi-fibre Arrangement and any other restrictions that were not consistent with GATT rules and disciplines.

Although the April 1989 Decision of the Trade Negotiations Committee also referred to “other restrictions not consistent with GATT rules and disciplines” in addition to restrictions under the multi-fibre agreement, such other restrictions were actually rather rare. Therefore the main purpose of the ATC is the phasing out of restrictions applied under the MFA. These restrictions were applied by major developed countries, almost exclusively, on imports from developing countries and economies.

1.3 Scope of ATC Disputes

The ATC is a sector-specific agreement pertaining to trade in textiles and clothing. However, as shown above, its scope is limited to securing the phasing out of restrictions on imports of textile and clothing products over a transitional period of ten years. The Agreement sets out the mechanics for bringing this about. *In addition*, ATC provides for disciplines to be observed for (i) the

¹ GATT, MTN.TNC/9.

operation and administration of restrictions until these are gradually removed and the respective products are integrated into the normal rules of the GATT 1994, (ii) the introduction of any new restrictions during the transitional period under carefully defined criteria, and (iii) a regular supervision of its implementation.

1.3.1 Disputes Involving Textile and Clothing Products

Due to the specific (and limited) scope and purpose of the ATC, not all disputes involving textile and clothing products come under its purview. Since the ATC does not cover such matters as tariff bindings, anti-dumping or countervailing measures, customs valuation issues or the like, disputes involving alleged breaches in these areas are covered by other relevant WTO agreements. The disputes that come under the purview of the ATC are those in which violations of ATC provisions are the main issue.

In some cases however, violation of some ATC provisions may be alleged *in addition* to violations under other WTO agreements. Indeed, there have been several cases in which violation of one or two ATC provisions was also invoked as supplementary issues.

The ATC has now been in force for over seven years. During this period (1995 to the beginning of 2002), there have been many disputes involving textile and clothing products. However, all of them were not raised under the ATC.

1.3.2 Disputes Under The ATC

The following table lists cases in which the violation of the ATC provisions was raised as the main issue.

Cases in which ATC was the main issue	Violations alleged
<i>United States - Restrictions on Imports of Cotton and Man-Made Fibre Underwear, complaint by Costa Rica, WT/DS24</i>	ATC Articles 2, 6 and 8
<i>United States - Measure Affecting Imports of Women's and Girls' Wool Coats, complaint by India, WT/DS32</i>	ATC Articles 2, 6 and 8
<i>United States - Measure Affecting Imports of Woven Wool Shirts and Blouses, complaint by India, WT/DS33</i>	ATC Articles 2, 6 and 8
<i>Colombia - Safeguard Measure on Imports of Plain Polyester Filaments, complaint by Thailand, WT/DS181</i>	ATC Articles 2 and 6



<i>Argentina - Transitional Safeguard Measures on Certain Imports of Woven Fabrics of Cotton and Cotton Mixtures</i> , complaint by Brazil, WT/DS190	ATC Articles 2, 6 and 8
<i>United States - Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan</i> , complaint by Pakistan, WT/DS192	ATC Articles 2 and 6

1.3.3 Mixed disputes

There were several other cases in which the main violations were alleged with respect to obligations under other WTO agreements. In addition to such violations, breaches of some of the ATC obligations were also raised as supplementary issues.

Cases in which violation of the ATC was a supplementary issue	Violations alleged
<i>Turkey - Restrictions on Imports of Textiles and Clothing Products</i> , complaint by India; WT/DS34	GATT Art. XI, and XIII; ATC Art. 2
<i>Turkey - Restrictions on Imports of Textile and Clothing Products</i> , complaint by Thailand; WT/DS47	GATT Art. I, II, XI and XIII; ATC Art. 2
<i>Argentina - Certain Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items</i> , complaint by United States; WT/DS56	GATT Art. II, VII, VIII and X; TBT Agreement; Customs Valuation Agreement; ATC Art.7
<i>Argentina - Measures Affecting Textiles and Clothing</i> , complaint by European Communities; WT/DS77	GATT Art. II; ATC Art. 7
<i>United States - Measures Affecting Textiles and Apparel Products</i> , complaint by European Communities; WT/DS85	ATC Art. 2 and 4; Agreement on Rules of Origin; GATT Art. III and TBT Agreement
<i>United States - Measures Affecting Textile and Apparel Products</i> , complaint by European Communities; WT/DS151	ATC Art. 2 and 4; Agreement on Rules of Origin; GATT Art. III and TBT Agreement
<i>Brazil - Measures on Minimum Import Prices</i> , complaint by United States; WT/DS197	GATT Art. II and XI; Customs Valuation Agreement; Agreement on Import Licensing Procedures; ATC Art. 2 and 7; Agreement on Agriculture

1.3.4 Disputes Under Other WTO Agreements

In still other cases concerning textile and clothing products, ATC issues were not raised; only violations under other WTO agreements.

Cases in which violation of the ATC was not an issue	Violations alleged
<i>Turkey - Restrictions on Imports of Textile and Clothing Products</i> , complaint by Hong Kong, China, WT/DS29	GATT Art. XI, and XIII;
<i>Australia - Textiles, Clothing and Footwear Import Credit Scheme</i> , complaint by United States, WT/DS57	Subsidies and Countervailing Measures Agreement
<i>India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products</i> , complaint by United States, WT/DS90	GATT Art. XI, and XVIII; Agreement on Agriculture; Agreement on Import Licensing Procedures
<i>India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products</i> , complaint by Australia; WT/DS91	GATT Art. XI, and XVIII; Agreement on Agriculture; Agreement on Import Licensing Procedures
<i>India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products</i> , complaint by Canada, WT/DS92	GATT Art. XI, and XVIII; Agreement on Agriculture; Agreement on Import Licensing Procedures
<i>India - Quantitative Restrictions on imports of Agricultural, Textile and Industrial Products</i> , complaint by New Zealand, WT/DS93	GATT Art. XI, XVIII and XXIII Agreement on Agriculture; Agreement on Import Licensing Procedures
<i>India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products</i> , complaint by Switzerland, WT/DS94	GATT Art. XI, and XVIII; Agreement on Import Licensing Procedures
<i>India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products</i> , complaint by European Communities, WT/DS96	GATT Art. XI, XIII; XVII and XVIII; Agreement on Agriculture; Agreement on Import Licensing Procedures; SPS Agreement
<i>European Communities - Anti-Dumping Investigations Regarding Unbleached Cotton Fabrics</i> , complaint by India, WT/DS140	Anti-Dumping Agreement; GATT Art. I and VI



<i>European Communities - Anti-Dumping Duties on Imports of Cotton Type Bed-Linen</i> , complaint by India, WT/DS141	Anti-Dumping Agreement; GATT Art. I and VI
<i>Brazil - Measures on Import Licensing and Minimum Import Prices</i> , complaint by European Communities, WT/DS183	GATT II, VIII, X and XI; Agreement on Agriculture; Agreement on Import Licensing Procedures; Customs Valuation Agreement
<i>Brazil - Anti-Dumping Duties on Jute Bags</i> , complaint by India, WT/DS229	GATT Art. VI and X; Anti-Dumping Agreement; WTO Agreement Art. XVI
<i>United States - Rules of Origin for Textiles and Apparel Products</i> , complaint by India, WT/DS243	Agreement on Rules of origin

It is worth noting however that all cases shown in the preceding tables did not result in the establishment of dispute settlement panels. From amongst those in which violation of ATC obligations was the principal issue, three were pursued through the dispute settlement process and resulted in panels and the Appellate Body issuing significant findings and rulings. The main aspects of these findings and rulings are reviewed in Section 3 of this Module. Section 3 also brings out important panel findings with reference to ATC provisions in some mixed disputes, in which violation of an ATC obligation was a supplementary claim.

1.4 Main Provisions of the ATC

In this subsection, a brief overview of the main provisions of the ATC is provided, without however going into any interpretative issues. These aspects are dealt with alongside the clarifications or findings resulting from the work of the TMB, or Panel and Appellate Body rulings in Sections 2 and 3 of this Module.

1.4.1 *An Introductory Point*

The ATC is designed with the central objective of bringing an end to the long-standing system of restrictions applied by major developed countries on textile and clothing imports from developing countries, because these restrictions deviated from some of the fundamental principles and rules of the GATT.

The Agreement sets out a framework by which to achieve this objective in a gradual and systematic manner over a transitional period of ten years.

The main elements of the ATC framework are fairly straightforward, despite the somewhat complex mechanics of the integration process. The principal

elements of the framework are explained below. The clarifications and findings developed by the Textiles Monitoring Body and, in certain cases, by panels and the Appellate Body will be reviewed in later sections of this Module.

1.4.2 *Product coverage*

The ATC sets out, in an Annex, a detailed list of products to which it applies. The list is based on the Harmonized Commodity Description and Coding System Nomenclature (the so-called HS), and defines particular products at the six-digit level of the HS.

Article 1:7 of the ATC

The textile and clothing products to which this Agreement applies are set out in the Annex.

In general, the products covered are those in Section XI (Textiles and Textile Articles) of the HS, excluding however natural fibres such as raw cotton, jute, silk, etc. In addition, the list includes products from outside Section XI defined under some HS lines or part lines. In all, the list consists of 781 full lines at the 6-digit level of the HS, and another 14 lines of which only certain portions are covered by the ATC.

This extensive product coverage that has been at the root of concerns about the so-called “back-loading” of the integration process.

1.4.3 *The Integration Process and Its Mechanics*

Article 2:6 and 2:8 ATC

The second, and the central element of the ATC framework relates to its integration process. Pursuant to this, each importing Member is required to notify and integrate products from the list covered by the Agreement, in accordance with the following schedule²:

As of 1 January 1995: Products that accounted for at least 16 per cent of the Member’s imports in 1990, in volume terms

As of 1 January 1998: Another at least 17 per cent

As of 1 January 2002: A further at least 18 per cent

As of 1 January 2005: All remaining products.

Article 9 of the ATC provides:

Article 9 of the ATC

This Agreement and all restrictions thereunder shall stand terminated on the first day of the 121st month that the WTO Agreement is in effect, on which date the textiles and clothing sector shall be fully integrated into GATT 1994. There shall be no extension of this Agreement.

² Articles 2:6 and 2:8(a), (b) and (c) of the ATC.

Once a particular product is integrated, all quota restrictions on its imports from WTO Members are terminated. Integration also means that the importing country is henceforth bound to observe full GATT rules and disciplines with respect to that product.

The Agreement left the actual choice of products for integration in the first three steps (i.e., from January 1995, 1998 and 2002 respectively) at the discretion of the importing Member concerned, the only condition being that the list at each stage should include a mix of products from all four sub-sectors, (i.e., tops and yarns, fabrics, made-up textile products, and clothing).

In actual implementation, the importing restraining countries took full advantage of this discretion and the extensive product coverage as follows:

- (i) First, the list of products covered by the Agreement included a significant number in which trade was never restricted under the MFA. According to estimates, in the case of the EU, such non-restrained products accounted for some 42 per cent of total imports. In the case of the United States, the comparable figure was about 40 per cent. The percentage for Canada was even higher.

All these countries chose to include the un-restrained products in their integration schedules notified for the first three steps. Consequently, they avoided integrating products in which trade was actually restrained.

- (ii) Second, since they had discretion on the choice of products, they also elected to first take up mostly tops and yarns, fabrics or made-up textile products, with as little as possible from clothing items in which developing countries have the most comparative advantage due to the labour intensive nature of the processes required in their manufacture and, on which quota restrictions have been most pronounced.

Thus, while the obligation in terms of fulfilling the mechanics of integrating the required minimum percentages might have been met, the same cannot perhaps be said of the realisation of the object and purpose of the Agreement.

This is why widespread concerns have been voiced about the process of implementation, in so far as the realization of the central objective of the ATC is concerned.

1.4.4 *Increases in Quota Growth Rates*

The third element of the ATC framework relates to the increases in quota growth rates. Under this element, the Agreement stipulated that, until the relevant products are integrated, the levels of quota restrictions on those products should be increased according to the following formulae³:

³ Articles 2:13 and 2:14(a) and (b) of the ATC.

<i>As of 1 January 1995:</i>	All annual quota growth rates, which existed in respective bilateral agreements prior to the ATC, be increased by a factor of at least 16 per cent. Thus an annual growth rate of 6 per cent should be increased to 6.96 per cent; 5 per cent to 5.80 per cent; 4 per cent to 4.64 per cent; 3 per cent to 3.48 per cent; 2 per cent to 2.32 per cent; 1 per cent to 1.16 per cent.
<i>As of 1 January 1998:</i>	The annual growth rates resulting from the above formula should be increased further by at least 25 per cent
<i>As of 1 January 2002:</i>	The rates resulting from the above (i.e. 1998) should be increased by at least another 27 per cent.

In actual practice, under MFA bilateral agreements, there existed a wide range of growth rates, the average being between 3 per cent and 5 per cent. They also varied in each of the three restraining countries. Consequently, quota levels have increased from their pre-ATC levels. However, the average overall increase in access (particularly for the main traded products) has not been significant enough to eliminate the restrictive effect of quotas.

1.4.5 Transitional Safeguard

This, the fourth key element of the ATC, recognizes that during the transition period it may be necessary to apply a specific transitional safeguard mechanism. Article 6 of the Agreement lays down the procedures and conditions under which an importing Member can introduce new restrictions on imports of particular products.

As a general matter, Article 6 stipulates that the transitional safeguard should be applied as sparingly as possible, consistent with the provisions of this Article and the effective implementation of the process of integration.

Article 6:1 of the ATC

Members recognize that during the transition period it may be necessary to apply a specific transitional safeguard mechanism (referred to in this Agreement as “transitional safeguard”). The transitional safeguard may be applied by any Member to products covered by the Annex, except those [products] integrated into GATT 1994 under the provisions of Article 2... The transitional safeguard should be applied as sparingly as possible, consistently with the provisions of this Article and the effective implementation of the integration process under this Agreement. (Emphasis added)

All transitional safeguard actions are required to be reviewed by the TMB. Even in cases where the importing and exporting countries concerned agree that the situation called for the establishment of a restraint, the TMB is required to determine whether the restraint is justified in accordance with the provisions of Article 6.⁴

1.4.6 Supervision of Implementation

Article 8:1 of the ATC

Fifthly, unlike the other agreements negotiated in the Uruguay Round, the ATC did not envisage a Committee to review and consult on the implementation of the Agreement periodically. Instead, it created a standing Textiles Monitoring Body to regularly supervise the implementation of the ATC and, perhaps most significantly, to examine *all* measures taken under the ATC and their conformity with its provisions.

Article 8:1 of the ATC

In order to supervise the implementation of this Agreement, to examine all measures taken under this Agreement and their conformity therewith, and to take actions specifically required of it by this Agreement, the Textiles Monitoring Body (“TMB”) is hereby established.

In addition, for oversight of implementation of the ATC at multilateral level, the Agreement provides for the WTO Council for Trade in Goods (“CTG”) to conduct a major review before the end of each stage of the integration process.

Article 8:11 of the ATC

In order to oversee the implementation of this Agreement, the Council for Trade in Goods shall conduct a major review before the end of each stage of the integration process. To assist in this review, the TMB shall, at least five months before the end of each stage, transmit to the Council for Trade in Goods a comprehensive report on the implementation of this Agreement during the stage under review, in particular in matters with regard to the integration process, the application of transitional safeguard mechanism, [etc.]... The TMB’s comprehensive report may include any recommendation as deemed appropriate by the TMB to the Council for Trade in Goods.

Article 8:12 of the ATC

In the light of these reviews, the CTG is required to take appropriate decisions to ensure that the balance of rights and obligations embodied in the Agreement is not being impaired.

Article 8:12 of the ATC

In the light of its review, the Council for Trade in Goods shall by consensus take such decisions as it deems appropriate to ensure that the balance of rights and obligations embodied in this Agreement is not being impaired.

⁴Articles 6:9 and 6:10 of the ATC.

1.4.7 Other Miscellaneous Provisions

Besides the main elements of the ATC summarized here, the Agreement contains provisions for preferential treatment in access for small suppliers⁵, for the administration of restrictions⁶, and for the prevention of circumvention⁷ of the Agreement. It also provides that Members take such actions as may be necessary to abide by GATT rules and disciplines so as to achieve improved access to markets and, ensure the application of policies relating to fair and equitable trading conditions in such areas as antidumping rules, subsidies and countervailing measures and the protection of intellectual property rights.⁸

⁵Articles 1:2, 2:18 and 6:6 of the ATC.

⁶Articles 2:17 and 4 of the ATC.

⁷Article 5 of the ATC.

⁸Article 7 of the ATC.

2. TEXTILES MONITORING BODY

The ATC establishes a two-step procedure for the resolution of disputes arising from violations of its provisions. Any unresolved issue has first to be reviewed by the Textiles Monitoring Body (“TMB”) before it can be referred to the Dispute Settlement Body for the establishment of a panel.

This Section to provides an overview of (i) the role and functions of the TMB, (ii) the TMB procedures with respect to dispute cases, and (iii) some pertinent findings and clarifications resulting from the TMB’s work. These clarifications can be seen as means to prevent recourse to dispute panels.

2.1 TMB Functions

Article 8 ATC

Article 8 of the ATC describes the role and functions of the TMB. It provides that the TMB was established: (i) to supervise the implementation of the ATC, (ii) to examine all measures taken under the ATC and their conformity with its provisions, and (iii) to take other actions specifically required of the TMB under various Articles of the Agreement.

The TMB thus performs a dual function: (1) a review and supervisory function; and (2) a dispute resolution function. In its review and supervisory role, the TMB undertakes regular, ongoing oversight of the operation and implementation of the Agreement. It may make observations and recommendations as deemed appropriate. In its dispute resolution role, the TMB’s remit is not to conciliate between the parties. Rather, in a certain sense, it acts as a tribunal of first instance and examines the conformity of the disputed measure with the provisions of the ATC. While the TMB may make findings and recommendations in cases of disagreement brought before it, the parties are not bound to accept its recommendations.

2.1.1 The TMB’s Review and Supervisory Role

The TMB’s review and supervisory role is spread in the ATC over a number of articles. Without describing this role in detail, the following are a few significant areas in which the TMB is required to review and supervise the implementation of the ATC.

Firstly, the TMB receives, reviews and circulates notifications required of WTO Members with respect to their implementation under specific provisions of the ATC. Thus, it serves as a sort of inventory of information relating to textile matters.

Secondly, in so far as the implementation of integration obligations is concerned, the TMB is required to keep under review the implementation and progress of

the integration process.

Thirdly, where in cases of alleged circumvention, Members agree to any remedies in mutual consultations, the TMB can make appropriate recommendations to them.

Fourthly, if, following requests for consultations made for establishing new restrictions under transitional safeguards of the ATC, Members reach mutual understanding on establishing restraint measures, the ATC requires that the TMB determine whether the agreement between the Members is justified in accordance with the provisions of Article 6 of the Agreement. If there is no agreement between the parties and the safeguard action is taken, the matter has also to be referred to the TMB to decide whether the action taken by the importing Member is justified and to make recommendations to the Members concerned.

2.1.2 TMB's Dispute Resolution Role

Article 8:5 and 8:6 ATC

The ATC provides that in the absence of mutually agreed solutions in bilateral consultations, the matter may be referred to the TMB by any Member. In such cases, the ATC requires the TMB to conduct a thorough and prompt consideration of the matter and make recommendations to the Members concerned. Going through the TMB process in a dispute case is a necessary first step before it can be referred to the DSB for establishing a panel under the DSU.

Articles 8:5 and 8:6 of the ATC

In the absence of any mutually agreed solution in the bilateral consultations provided for in this Agreement, the TMB shall, at the request of either Member, and following a thorough and prompt consideration of the matter, make recommendations to the Members concerned.

At the request of any Member, the TMB shall review promptly any particular matter which that Member considers to be detrimental to its interests under this Agreement and where consultations between it and the Member or Members concerned have failed to produce a mutually satisfactory solution. On such matters, the TMB may make such observations, as it deems appropriate to the Members concerned ...

Article 8:9 and 8:10 ATC

However, Members are not obliged to accept the recommendations of the TMB, only to endeavour to do so. If following any TMB recommendations, the matter remains unresolved, the Member concerned may bring it before the DSB and directly invoke Article XXIII of the GATT 1994. It is not necessary to ask for any further consultations pursuant to Article 4 of the DSU. In this sense, the TMB process replaces the consultation phase of the dispute settlement process under the DSU.

**Articles 8:9 and 8:10
of the ATC**

The Members shall endeavour to accept in full the recommendations of the TMB...

If a Member considers itself unable to conform with the recommendations of the TMB, it shall provide the TMB with reasons therefore not later than one month after receipt of such recommendations. Following thorough consideration of the reasons given, the TMB shall issue any further recommendations it considers appropriate forthwith. If, after such further recommendations, the matter remains unresolved, either Member may bring the matter before the Dispute Settlement Body and invoke paragraph 2 of Article XXIII of GATT 1994 and the relevant provisions of the Dispute Settlement Understanding.

Article 1.2 DSU

It is worth noting that the DSU also provides that, to the extent that there is a difference between rules and procedures of the DSU and the special or additional rules and procedures contained in different covered Agreements (including the ATC), the special or additional rules and procedures of the covered Agreements shall prevail.⁹

2.2 TMB Composition

Article 8:1 ATC

The TMB consists of a Chairman and 10 members. The TMB members are appointed by WTO Members designated by the Council for Trade in Goods. TMB members are required to discharge their functions on the TMB on an *ad personam* basis.

Article 8:1 of the ATC

The TMB shall consist of a Chairman and 10 members. Its membership shall be balanced and broadly representative of the [WTO] Members and shall provide for rotation of its members at appropriate intervals. The members shall be appointed by [WTO] Members designated by the Council for Trade in Goods to serve on the TMB, discharging their functions on an ad personam basis.

Article 8:3 ATC

As a standing body, the TMB meets frequently to discharge its functions. It is given significant latitude in terms of getting information from a variety of sources.

Article 8:3 of the ATC

The TMB shall be considered as a standing body and shall meet as necessary to carry out the functions required of it under this Agreement. It shall rely on notifications and information supplied by the Members under the relevant Articles of this Agreement, supplemented by any additional information or necessary details they may submit or it may decide to seek from them. It may also rely on notifications to and reports from other WTO bodies and from such other sources as it may deem appropriate.

⁹Article 1.2 of the DSU.

2.3 TMB Procedures

Article 8:2 of the ATC

The ATC authorized the TMB to develop its own working procedures.¹⁰ According to a decision of the WTO General Council adopted in January 1995, the TMB is required to take all decisions by consensus.¹¹ This is however subject to the condition that consensus does not require the concurrence of TMB members that are appointed by WTO Members involved in an unresolved issue under review by the TMB.¹²

2.3.1 Working Procedures

TMB Working Procedure

Accordingly, the TMB developed detailed procedures for its work.¹³ With respect to dispute cases, these procedures require that the TMB invite representatives of WTO Members that are parties to a dispute to present their views and answer questions that may be asked by TMB members. Parties to the dispute are also invited to designate a representative who can be present in the deliberations of the TMB but cannot participate in the actual drafting of its findings, observations or recommendations.

Rules 6:1 and 6:2 of the TMB Working Procedures

The TMB shall invite representatives of the WTO Members that are parties to a dispute to present their views fully and answer questions put by TMB Members...

Parties to a dispute shall each be invited to designate a representative who... may be present in ... the discussion up to, but not including, the drafting of recommendations, findings or observations. Interventions by such representatives should be limited to key aspects relevant to the discussion...

2.3.2 TMB Reports

The TMB Working Procedures provide that the reports of the TMB shall be composed of (a) factual presentation of the issues examined, (b) in the case of a dispute, a summary of the main arguments, (c) the text of any recommendations, observations or findings made by the TMB, and (d) a common (agreed) rationale for such recommendations, observations or findings.¹⁴

2.3.3 TMB Limitations

By the terms of its mandate, the TMB is required to review and supervise the implementation of the ATC, in all its aspects, in an impartial manner and strictly on the basis of the same standards as required under any other WTO agreement, the ATC being an integral part of the WTO.

¹⁰ Article 8:2 of the ATC.

¹¹ WT/L/26, para. 6.

¹² Article 8:2 of the ATC.

¹³ G/TMB/R/1.

¹⁴ Ibid., Rule 8.

In its dispute resolution role it is expected also to observe the same high standards.

However as the TMB is required to take all its decisions by consensus, this can sometimes be difficult to achieve because in a large group of ten members, there can be genuine differences of views about the meaning of various provisions of the ATC. Furthermore, the TMB's performance is conditioned by the fact that its members are designated by WTO Members representing particular approaches to the issue of protection of domestic producers in the sector. Likewise, due to long experience with the MFA, whose standards were rather lax and ambiguous, certain TMB members, at least in the initial years of the ATC, viewed the role of the TMB as one of promoting conciliation and accommodation among contesting views. Finally, the ATC provided for rotation of the members of the TMB. In reality however, those designated by countries applying restrictions have generally been serving on the TMB for long periods. Those nominated by countries on whose export these restrictions are applied change quite frequently. This produces an inherent imbalance in the effective functioning of the TMB.

2.4 Significant TMB Findings

This Section provides an overview of some key TMB findings, first under its review or supervisory role, and second, under its dispute resolution role. In most cases, TMB findings can be seen as contributing to preventing recourse to the procedures of the DSU. They also contribute to full and effective implementation of the Agreement.

2.4.1 TMB Findings Under Its Supervisory Role

Pursuant to its review or supervisory role, the TMB scrutinizes all aspects of ATC implementation. It has some latitude in seeking information from a variety of sources. Although, its findings or recommendations are not binding on the parties, yet its scrutiny can shed light on the validity or otherwise of some issues and thereby contribute to preventing unnecessary recourse to dispute settlement procedures of the DSU.

Over the past seven and a half years that the ATC has been in effect, the TMB has had to review and scrutinize a host of notifications by WTO Members pursuant to the requirements of various ATC provisions. This sub-section is devoted to bringing out some significant areas in which TMB scrutiny resulted in correcting errors in ATC implementation.

The cases referred to the TMB under its dispute resolution function will be dealt with in a later section.

ex-HS positions question

In the section describing the products covered by the ATC, it was noted that the ATC Annex lists these products at the 6-digit level of the HS but that, in case of 14 HS lines, only parts of products falling under the 6-digit HS lines

are covered by the ATC. Such parts are defined by a short description of the covered portion.

For example, in the HS classification, heading 3921.90 relates to “other plates, sheets, film, foil and strip, of plastics of non-cellular materials”. The ATC includes this heading but covers only “woven, knitted or non-woven fabrics that are coated, covered or laminated with plastics”.

When the TMB reviewed the integration programmes notified by some WTO Members pursuant to Article 2:6 and 2:8 of the ATC, it was pointed out that the European Communities had counted the volume of trade falling under the entire 6-digit lines rather than limiting to the portions that were covered by the Agreement. The TMB upheld this view and recommended that the EC re-examine its programme. Following such re-examination, the EC corrected the list by withdrawing a volume of trade accounting for over 2 per cent of its total imports which it had otherwise counted as belonging to the ATC.

A similar phenomenon was found during TMB scrutiny of the integration lists filed by Canada. In this case too, questioning by the TMB resulted in Canada correcting the lists by withdrawing about 9.5 per cent of volume of trade which it had reckoned as belonging to the ATC.

It was thus a concrete example in which review and supervision by the TMB contributed to ensuring correct and proper implementation of a key provision of the ATC, and prevented unnecessary recourse to dispute settlement procedures.

In examining the issue however, the TMB observed that the corrections made by the EC, Canada, etc., were on the basis of their estimates as to what proportions of total trade registered under the relevant 6-digit HS lines could have conformed to the definitions of products covered by the ATC and that it was not in a position to verify the estimates provided by Members.¹⁵

Visa requirements question

Under the MFA regime of bilateral agreements, various restraining countries developed their own procedures to control and administer trade in products subject to quota restrictions.

Since, in essence, quotas were voluntary export restrictions, these procedures required exporting countries to issue export certificates. The United States named these export certificates as “visas”, devised as an administrative tool to monitor and control imports in restrained textiles and clothing products. It required these visas to accompany all shipments in addition to the normal shipping documents.

The procedure obligated the exporting countries to designate officials to issue the visas. Each visa should indicate the precise category of the product, the quantity of the shipment, the date of issuance of the visa, and signature of the

¹⁵ *G/TMB/R/41, paras. 4-26.*

designated official. Without a visa, the entry of the shipment could be denied. Any error in the visa certificate could also result in the shipment being denied entry.

To accommodate such administrative practices and procedures, a provision in the ATC stipulated that these administrative arrangements will be a matter of agreement between the Members concerned.

Article 2:17 of the ATC

Administrative arrangements, as deemed necessary in relation to the implementation of any provision of this Article, shall be a matter for agreement between the Members concerned. Any such arrangements shall be notified to the TMB.

The visa certificates are not required of all exporting countries; only from those on whose exports quota restrictions were imposed. They are therefore discriminatory and, hence, inconsistent with the GATT rule of Most-Favoured-Nation (MFN) treatment. They can amount to an indirect means to restrict imports and, therefore, are inconsistent with Article XI of the GATT 1994 which requires that no restrictions “whether made effective through quotas, import or export licences or other measures shall be instituted or maintained”.

Furthermore, the preparation and issuance of visa documents involves an additional administrative burden and cost for processing export shipments.

The visa requirement was established for the purpose of implementing quota restrictions and was inconsistent with normal GATT rules. It followed that, with the integration of relevant textiles and clothing products and consequential elimination of quota restrictions on them, the requirement should be abolished. The United States however, did not do so. Instead, it announced that the visa requirement would continue even after the relevant products had been integrated into GATT 1994.¹⁶

As the purpose of integration is that once a particular product is integrated, WTO Members are bound to observe full GATT rules and disciplines with respect to that product, some Members referred the matter to the TMB. Following this, the United States conceded and withdrew the visa requirement in respect of integrated products.

Later, the TMB confirmed that full integration under the ATC meant not only the elimination of quota restrictions but also that of any related administrative procedures.

TMB report

The TMB recalled that the respective visa arrangements had been notified by the United States, pursuant to Article 2:17 as parts of administrative arrangements and that, under Article 2:17, administrative arrangements could

¹⁶See TMB report in G/L/459, para. 58.

be deemed necessary [only] in relation to the implementation of restrictions applied under Article 2.¹⁷

Penalizing quota circumvention

Article 5 of the ATC provides for Members to cooperate to address problems arising from circumvention of restrictions by trans-shipment, re-routing, false declaration concerning country or place of origin, and falsification of official documents. It also provides that they agree to take necessary action to prevent, to investigate and, where appropriate, to take legal and/or administrative action against circumvention practices.

Where, as a result of investigation, there is sufficient evidence that circumvention had occurred (e.g., where evidence is available concerning the country or place of true origin, and the circumstances of such circumvention), Article 5 provides for procedures for appropriate action, to the extent necessary to address the problem. Such action may include denial of entry of goods, or where goods have already entered, adjustment to charges to quotas to reflect the true country or place of origin.

Shortly before the coming into effect of the WTO and the ATC, and as a result of concerted United States campaign, the exporting countries accepted modifications in administrative arrangements falling within the purview of Article 2:17 of the ATC (also described in the previous subsection). These arrangements added a detailed procedure to the administrative arrangements by which the exporting countries were required to cooperate in instances of circumvention or alleged circumvention to address the problem, and to establish relevant facts including facilitation of joint visits to production plants in the exporting countries.

A significant further stipulation in the United States administrative arrangements however, added that in instances of repeated circumvention by exporters from a particular country, the United States *may deduct amounts from quotas up to three times the amounts trans-shipped*. The United States claimed this provision to be consistent with Article 2:17 of the ATC and included this so-called triple charges clause in its notifications to the TMB under that Article.

However, in reviewing the United States Article 2:17 notifications, the TMB did not agree with the United States contention.

TMB report

The TMB noted, inter alia, that Article 5:4 of the ATC seemed to provide some flexibility in terms of remedies or agreed actions that could be foreseen in cases when circumvention had occurred, but observed, however, that Article 5 contained no reference to the possibility for the importing Member to impose triple charges on quotas, as a deterrent to circumvention... The TMB recalled that the United States had stated that when provisions of the administrative arrangements were inconsistent with the ATC, the provisions of the ATC would apply.¹⁸

¹⁷ Textiles Monitoring Body, Report of the Seventy-seventh meeting, G/TMB/R/76, para. 8.

¹⁸ G/L/179, para. 221.

Here again a close scrutiny by the TMB discouraged the United States to resort to what could amount to an unfair situation of penalizing the exporting country.

Question of new restrictions

Article 2:1 of the ATC provided that all WTO Members notify the TMB of any quantitative restrictions that they maintained under the MFA, within 60 days following the entry into force of the WTO Agreement. The restrictions thus notified shall constitute the totality of restrictions by the respective Members and shall, henceforth, be governed by the provisions of the ATC. Any new restrictions can only be introduced in accordance with the provisions of the ATC, i.e., under Article 6 relating to transitional safeguards.

Article 2:4 of the ATC

... No new restrictions in terms of products or Members shall be introduced except under the provisions of this Agreement or relevant GATT 1994 provisions.¹⁹

During the seven and a half years of the ATC, there have been a number of cases of the introduction of new restrictions. A majority of these have been pursuant to the transitional safeguard mechanism of the ATC. Such restrictions are however permitted, if justified under the requirements of Article 6 of the ATC.

In several cases the invocation of Article 6 safeguards was contested by affected Members, including by recourse to the DSU. In three such cases, panels and the Appellate Body made key findings and developed important interpretations. These will be reviewed under Section 3 of this Module.

In addition however, there have been some instances in which new restrictions were introduced without any apparent justification under any provision of the ATC. Such restrictions could potentially undermine the disciplines of the ATC. In one case, the United States introduced a new restriction on a particular product from Turkey, *albeit* after the two countries had reached a mutual understanding.

The TMB became seized of the issue and invited the two parties (United States and Turkey) to notify the restriction to the TMB. The United States took the plea that the restriction in question was justified by “a provision” of the ATC, which did not require a notification to the TMB.

Following this and on its own initiative pursuant to its general mandate under Article 8:1 of the ATC which requires the TMB “to examine all measures taken under [the ATC] and their conformity therewith...”, the TMB undertook to examine all provisions of the ATC with a view to identifying whether there was any provision under which such a measure could be agreed without notifying the TMB. *The TMB concluded that the measure agreed upon between the two parties did not conform to any provision of the ATC.*

¹⁹ *The relevant GATT 1994 provisions shall not include Article XIX in respect of products not yet integrated into GATT 1994, except as specifically provided in paragraph 3 of the Annex.*

In addition, the TMB made a number of observations clarifying that new restrictions could not be introduced except under Article 6 transitional safeguards.

TMB report

The TMB observed ... that Articles 1, 7, 8 and 9 do not provide the possibility of introducing restraint measures on imports from other WTO Members.

... No provision under Article 2 provides the possibility of introducing new restrictions.

Article 3 does not exclude the possibility, inter alia, of introducing new restrictions on textile and clothing products. However... [it] limits the possibility of applying... new restrictions to those cases where the measures were taken under any GATT 1994 provision [not the ATC]

A reading according to which the introduction of a new restriction in the sense of Article 2:4... pursuant to Article 4... was, in the view of the TMB, not consistent with the intentions of the drafters of the ATC, since Article 4 relates to the implementation or administration of restrictions referred to in Article 2 [i.e., those already existing] or applied under Article 6.²⁰ (Emphasis added)

2.4.2 TMB Findings Under Its Dispute Resolution Role

In cases of disagreement between WTO Members on any matter affecting the operation of the ATC, the matter is required to be referred to the TMB before recourse can be made to the procedures of the DSU. In this sense, the TMB acts as a tribunal of first instance. Its process replaces the consultation stage of Article 4 of the DSU. If a matter remains unresolved as a result of the TMB process, then it can be referred to the DSB for the establishment of a panel without any need for further consultations under the DSU.

Since the ATC has been in effect, several cases have been referred to the TMB for its examination and recommendation. These have largely pertained to the invocation of transitional safeguard actions. As explained elsewhere in this Module, the TMB is required to determine the justification of all safeguard actions whether these are referred to it following failure of bilateral consultations, or after two Members agree on establishing a restraint measure.

Transitional safeguard actions

This Section gives an overview of TMB findings with respect to safeguard actions.

In such cases, if there is mutual understanding between the Members concerned that the situation calls for the establishment of a new restriction, details of the agreed restraint measure are required to be communicated to the TMB. The TMB in turn is required to determine whether the agreement is justified in accordance with the provisions of Article 6 of the ATC.

²⁰ G/TMB/R/60, paras. 30 and 31.

Article 6:9 of the ATC

Details of the agreed restraint measure shall be communicated to the TMB within 60 days following the conclusion of the agreement. The TMB shall determine whether the agreement is justified in accordance with the provisions of [Article 6].

If there is no agreement between the parties concerned and the safeguard action is taken, the matter has to be referred to and examined by the TMB.²¹

Initially the TMB review of some safeguard actions gave rise to concerns about the standards followed by the TMB. Subsequently however its examination of these actions improved significantly, especially in light of panel and Appellate Body rulings (discussed in Section 3 of this Module).

Out of a total of 46 safeguard actions reviewed by the TMB from the start of the ATC to the beginning of 2002, it ruled a large majority of these actions to be inconsistent with the provisions of Article 6. It thus contributed to preventing recourse to the DSU.

TMB examination of safeguard actions also clarified a number of the requirements of Article 6. The following section (relating to WTO jurisprudence under the ATC) is devoted largely to the review of these requirements. However, it is necessary to highlight out a very significant clarification given by the TMB relating to the structure of Article 6.

TMB report

The TMB noted that a determination of serious damage caused by increased quantities of imports was a staged process comprised of the following parts:

- *Verification of whether the product in question was being imported in increased quantities;*
- *Determination of serious damage caused to the domestic industry;*
- *Establishment of the causal link between the increased quantities of imports and the serious damage.*

If any of the three above conditions had not been met, the safeguard measures could not be found to be justified in accordance with the provisions of Article 6 and, in such a case, the TMB, therefore, was not required to make findings and conclusions on all the three parts.²²

²¹Article 6:10 of the ATC.

²²G/TMB/R/60, para. 14.

3. DISPUTE SETTLEMENT UNDER THE ATC

To date, three ATC cases have been the subject of litigation in panels and the Appellate Body, all pertaining to transitional safeguard actions taken by the United States. Although three further cases of transitional safeguard actions were also referred to the panels, these were not pursued by the complaining Members as the restrictions in question were withdrawn. In addition, in a few other cases, ATC issues were raised as supplementary matters.

In all three cases in which the validity of transitional safeguard actions was challenged, panels and the Appellate Body found that they were not justified under the ATC. Their reports contain a number of pertinent rulings.

While brief summaries of the three cases of transitional safeguard actions litigated in the panels are provided in Section 4 of this Module, this section provides an overview of key aspects of panel and Appellate Body rulings. It also discusses some findings from cases in which ATC was not the main issue. It does not however discuss general interpretative issues such as those relating to apportioning or distributing the burden of proof, the principle of judicial economy, or similar other matters. Although these issues did come up in cases of ATC disputes, they are of more general application and appropriately belong to another Module of this Course.²³

Outcome of ATC disputes

The following table lists the outcome in cases referred to the panel process under the ATC, including those in which ATC issues were raised only as supplementary concerns.

Cases in which the ATC was the main issue	Panel / Appellate Body Outcome
<i>United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear</i> , complaint by Costa Rica, WT/DS24	Panel and AB ruled measure violated ATC obligations
<i>United States - Measure Affecting Imports of Women's and Girls' Wool Coats</i> , complaint by India, WT/DS32	The United States withdrew the measure. Complainant terminated panel process

²³ See Modules 3.1, 3.2, 3.3 and 3.4 of this Course.

<i>United States - Measure Affecting Imports of Woven Wool Shirts and blouses</i> , complaint by India, WT/DS33	Panel and AB ruled measure violated ATC obligations
<i>Colombia - Safeguard Measure on Imports of Plain Polyester Filaments</i> , complaint by Thailand, WT/DS181	Panel process not pursued, one-year measure expired
<i>Argentina – Transitional Safeguard Measures on Certain Imports of Woven Fabrics of Cotton and Cotton Mixtures</i> , complaint by Brazil, WT/DS190	Panel process discontinued due to withdrawal of measures
<i>United States - Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan</i> , complaint by Pakistan, WT/DS192	Panel and AB ruled measure violated ATC obligations
Cases in which violation of ATC was a supplementary issue	
<i>Turkey - Restrictions on Imports of Textile and Clothing Products</i> , complaint by India, WT/DS34	Panel and AB ruled restrictions were inconsistent with ATC Article 2:4 also

The following sub-sections present an overview of key panel and Appellate Body rulings under topical headings.

3.1 Standard of Review

In all three cases, the issue of standard of review that should be applied under the ATC was extensively argued: as a general interpretative issue, as to the applicability of jurisprudence from other WTO agreements, and regarding the relationship of MFA to the ATC.

Applicable standard

In *US - Underwear* case, the United States advocated a standard of review similar to the *Fur Felt Hat* case in which the US authorities were afforded considerable discretion by a GATT Working Party.²⁴ The Working Party had concluded that, in reviewing the US safeguard measure applied against Czechoslovak imports pursuant to Article XIX of GATT 1947, the United States were entitled to the benefit of reasonable doubt.

²⁴United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear, *complaint by Costa Rica, WT/DS24* (“US – Underwear”).

The the *US – Wool Shirts and Blouses* Panel was also confronted with the same line of reasoning by the United States.²⁵ In the latest *US - Cotton Yarn* case, too, the United States argued that the Panel was to review only whether the United States measure was based on the *best available data* as provided in the market statement at the time when the United States conducted its determination that the situation called for the establishment of a restriction.²⁶

The panels and the Appellate Body rejected the United States line of reasoning. They ruled, instead, that the ATC did not have any particular provision concerning the standard of review. Therefore, Article 11 of the DSU should be used to review the measures taken by a Member under the ATC. Article 11 of the DSU provides that "... a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and conformity with the relevant covered agreements...". The Panel in *US – Underwear* held:

Panel, US – Underwear

... a policy of total deference to the findings of the national authorities could not ensure an 'objective assessment' as foreseen by Article 11 of the DSU.

... In our view, the task of the Panel is to examine the consistency of the US action with the international obligations of the United States, and not the consistency of the US action with the US domestic statute implementing the international obligations of the United States.²⁷

Relevance of WTO jurisprudence

Another issue extensively examined by panels in connexion with transitional safeguard actions under the ATC relates to the relevance or otherwise of WTO jurisprudence developed under other WTO agreements. The United States has vigorously argued that the ATC was a specific agreement, for a transition period and negotiated with a specific purpose. Therefore, applying the interpretations developed with reference to similar concepts or terms under other WTO agreements was not appropriate.

In the United States view the ATC differs significantly from other, non-transitional WTO agreements in terms of its status as a transitional agreement, in its purpose of gradually integrating the sector into GATT, and in its language, etc. Accordingly, the panels should interpret ATC provisions by remaining within its 'four corners', they should look to the text and the unique purpose of the ATC, and to no other agreements or to interpretations under other agreements. It asserted that interpretations of similar terms from Articles III and XIX of the GATT 1994, or the agreements on anti-dumping, safeguards, etc., were not relevant to the context of the ATC.²⁸

²⁵ United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India, *complaint by India*, WT/DS33/R, ("US – Wool Shirts and Blouses").

²⁶ United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan, *complaint by Pakistan*, WT/DS192/R ("US – Cotton Yarn").

²⁷ *Panel Report*, United States-Underwear, paras. 7.10 and 7.12.

²⁸ *Panel Report*, United States – Cotton Yarn, paras. 4.9 and 7.43.

Disagreeing with the United States, the complaining countries argued that the ATC was an integral part of the *WTO Agreement* and that therefore interpretations of similar terms under other WTO agreements were relevant.

The Panel in *US - Cotton Yarn* seems to have put the controversy to rest, ruling against the United States line of reasoning and interpreting that, as an integral part of the *WTO Agreement*, ATC provisions should be seen as only one part of the whole WTO treaty.

**Panel, US –
Cotton Yarn**

Article 3.2 of the DSU provides that the dispute settlement system of the WTO “serves ... to clarify the existing provisions of those agreements [i.e. the WTO covered agreements] in accordance with customary rules of interpretation of public international law.” With respect to the “customary rules of interpretation of public international law”, the Appellate Body repeatedly refers to Articles 31 and 32 of the Vienna Convention on the Laws of Treaties (the “Vienna Convention”) as interpretative guidelines. Paragraph 1 of Article 31 provides 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 the light of its object and purpose.” ...

As indicated in Article 31(2) of the Vienna Convention, the “context” within the meaning of Article 31(1) comprises “the text” of the treaty itself, including its preamble and annexes. The treaty in question here is the WTO Agreement, of which the ATC is an integral part. Thus, it is the WTO Agreement in its entirety, including GATT Article III, that provides the context of Article 6 of the ATC. ...

...[As] the Permanent Court in an early Advisory Opinion stressed..., the context is not merely the article or section of the treaty in which the term occurs, but the treaty as a whole.

In this case, the “treaty as a whole” is the WTO Agreement and all its annexes; it is not just the ATC.²⁹

**Relationship
with the MFA**

A third interpretative issue that has been litigated is the relationship of the ATC with the MFA. The United States stressed that in interpreting the ATC the panels should be guided by the fact that the ATC replaced the MFA and retained several concepts and phrases from the MFA. It argued that the MFA was therefore relevant as “context” for interpreting the ATC and that the panels should draw strong inferences from the MFA and, in fact, from United States practices under the MFA.³⁰

Here again the Panel in *US - Cotton Yarn* appears to have settled the issue. It rejected the United States assertion and ruled that the MFA could not be taken as part of the “context” of the ATC in the sense of Article 31(2) of the Vienna Convention which was the guiding basis for all WTO jurisprudence. In the *US-Underwear* case, the Appellate Body had also ruled on the same lines.

²⁹Ibid., para. 7.46.

³⁰Ibid., paras. 4.62 and 7.72.

**Panel, US –
Cotton Yarn**

The Panel first notes that Article 31(2) of the Vienna Convention sets forth as follows:

“The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

- (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;*
- (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.”*

This clearly indicates that the MFA cannot be part of the “context” of the ATC within the meaning of Article 31(2) of the Vienna Convention. The MFA is not an integral part of the WTO Agreement, and was not made “in connexion with the conclusion of” this treaty. We further note that the Appellate Body Report on US – Underwear mentioned as part of the “context” of Article 6.10 of the ATC, not the MFA itself, but “the prior existence and demise ... of the MFA”. They are occurrences rather than “any agreement” or “any instrument”. Clearly, in our view, the Appellate Body used the MFA not as part of the “context” of the ATC within the meaning of Article 31(2) of the Vienna Convention, but as part of the circumstances of the conclusion of the ATC.³¹

3.2 Structure of Article 6 of the ATC

Article 6 ATC

As all disputes under the ATC have so far pertained to transitional safeguard actions and, therefore Article 6 of the ATC has been the relevant ATC provision at issue, it is advisable to reproduce here the major provisions of this Article. Article 6 states in relevant part:

- 2. Safeguard action may be taken under this Article when, on the basis of a determination by a Member, it is demonstrated that a particular product is being imported into its territory in such increased quantities as to cause serious damage, or actual threat thereof, to the domestic industry producing like and/or directly competitive products. Serious damage or actual threat thereof must demonstrably be caused by such increased quantities in total imports of that product and not by such other factors as technological changes or changes in consumer preference. (footnote omitted)*
- 3. In making a determination of serious damage, or actual threat thereof, as referred to in paragraph 2, the Member shall examine the effect of those imports on the state of the particular industry, as reflected in changes in such relevant economic variables as output, productivity, utilization of capacity, inventories, market share, exports, wages, employment, domestic prices, profits and investment; none of which, either alone or combined with other factors, can necessarily give decisive guidance.*
- 4. Any measure invoked pursuant to the provisions of this Article shall be applied on a Member-by-Member basis. The Member or Members to*

³¹ Panel Report, United States – Cotton Yarn, para. 7.73.

whom serious damage, or actual threat thereof, referred to in paragraphs 2 and 3, is attributed, shall be determined on the basis of a sharp and substantial increase in imports, actual or imminent³², from such a Member or Members individually, and on the basis of the level of imports as compared with imports from other sources, market share, and import and domestic prices at a comparable stage of commercial transaction; none of these factors, either alone or combined with other factors, can necessarily give decisive guidance. Such safeguard measure shall not be applied to the exports of any Member whose exports of the particular product are already under restraint under this Agreement.

Structure of Article 6

Just as the TMB panels also devoted considerable attention to uncovering and clarifying the structure of Article 6 of the ATC, they noted that the overall purpose of Article 6 is to give Members the possibility to adopt new restrictions on products not yet integrated into GATT, and that Article 6 establishes a *three-step approach* which has to be followed for a new restriction to be imposed.

First, the importing country must make a determination that the particular product, subject of a safeguard action, was being imported in increased quantities (in absolute terms, not merely relative to domestic production as is permitted, e.g., under the *Agreement on Safeguards*).

Second, the importing country must determine that the increase in imports was such as to cause serious damage or actual threat thereof to the domestic industry producing like and/or directly competitive products and, that the serious damage or threat of serious damage was due to increased imports, not to other factors.

Third, after having satisfied the above conditions, the Member must attribute the serious damage or actual threat of serious damage to a particular Member or Members whose exports were responsible for it.

A determination as above is necessary because no safeguard action can be taken on the basis of any of the above steps alone.

Panel, US - Underwear

... Article 6 of the ATC, in our view, establishes a three-step approach which has to be followed for a new restriction to be imposed. Articles 6.2 and 6.4 of the ATC constitute the first two steps which, taken together, amount to a determination that serious damage has occurred or is actually threatening to occur and that it may be attributed to a sharp and substantial increase in imports from a particular Member or Members: No action can be taken on the basis of Article 6.2 alone.

A determination under Article 6.2 of the ATC is, therefore, a necessary but not sufficient condition to have recourse to bilateral consultations under Article

³² Original footnote: "Such an imminent increase shall be a measurable one and shall not be determined to exist on the basis of allegation, conjecture or mere possibility arising, for example, from the existence of production capacity in the exporting Members."

6.7 of the ATC. Only when serious damage or actual threat thereof has been demonstrated under Article 6.2 and has been attributed to a particular Member or Members under Article 6.4 of the ATC, can recourse to Article 6.7 of the ATC be made in a way consistent with the provisions of the ATC.³³

The Appellate Body also clarified the structure of Article 6 on the same lines as the Panel in *US - Underwear*, although it did so in the context of attribution analysis under Article 6:4 of the ATC, and specifically with reference to the interpretation of the terms ‘application’ and ‘attribution’ therein.

**Appellate Body, US –
Cotton Yarn**

... we have to distinguish three different, but interrelated, elements under Article 6: first, causation of serious damage or actual threat thereof by increased imports; second, attribution of that serious damage to the Member(s) the imports from whom contributed to that damage; and third, application of transitional safeguard measures to such Member(s).³⁴

3.3 Relevant Information to Be Examined

A new restriction under transitional safeguards of the ATC can be imposed, in a manner consistent with its Article 6, only after making a determination which can demonstrate (a) that imports of the particular product have increased, (b) that this increase is such as to be the cause of serious damage or actual threat of damage to the domestic industry producing like and/or directly competitive products, (c) that damage is not the result of factors unrelated to increased imports, and (d) that the increase is attributable to particular Members whose exports are not already under restriction. Article 6:7 obliges the importing Member to provide factual information on the basis of which these phenomena can be demonstrated.

The provision concerning factual information is therefore central to determining whether the restraint action is justified. The precise nature and scope of this information has however been a matter of contention. A few points from WTO jurisprudence, so far, are discussed here.

First, Article 6:3 provides that a demonstration of serious damage or actual threat thereof must be based on the examination of the effects of imports reflected in such variables as output, productivity, utilization of capacity, inventories, market share, exports, wages, employment, domestic prices, profits and investment.

The Panel in *US – Wool Shirts and Blouses* ruled that the importing Member must examine *at least each one* of these factors. Moreover, the importing country must demonstrate that it also considered and addressed the issue that the damage or threat of damage was not due to other factors, such as technological changes or changes in consumer preferences.

³³ Panel Report, *US - Underwear*, paras. 7.23 and 7.24.

³⁴ Appellate Body Report, *US - Cotton Yarn*, para. 109.

**Panel, US – Wool
Shirts and Blouses**

In our view, the wording of Article 6.2 and 6.3 of the ATC makes it clear that all relevant economic factors, namely, all those factors listed in Article 6.3 of the ATC, had to be addressed by CITA, whether subsequently discarded or not, with an appropriate explanation.

The wording of the first sentence of Article 6.3 of the ATC imposes on the importing Member the obligation to examine, at the time of its determination, at least all of the factors listed in that paragraph. The importing Member may decide — in its assessment of whether or not serious damage or actual threat thereof has been caused to the domestic industry — that some of these factors carry more or less weight. At a minimum, the importing Member must be able to demonstrate that it has considered the relevance or otherwise of each of the factors listed in Article 6.3 of the ATC

Article 6.2 of the ATC requires that serious damage or actual threat thereof to the domestic industry must not have been caused by such other factors as technological changes or changes in consumer preferences. The explicit reference to specific factors imposes an additional requirement on the importing Member to address the question of whether the serious damage or actual threat thereof was not caused by such other factors as technological changes or changes in consumer preference.³⁵ (Emphasis added)

Second, and perhaps more importantly, the precise nature and scope of information to be examined has been the subject of some controversy. The Panel in *US – Underwear* ruled that its examination of the matter should be restricted to the review of information provided by the United States to Costa Rica in a so-called March Statement and that any subsequent information should not be viewed as a legally independent basis for establishing serious damage or actual threat thereof.³⁶ In the course of its examination however, the Panel went on to remark that it could legitimately take [a subsequent] July Statement into account as evidence submitted by the United States in our assessment of the overall *accuracy* of the March Statement.³⁷

The Panel in *US – Wool Shirts and Blouses* also remarked that it was bound to examine the case only on the basis of information that had actually been used by the national investigating authority at the time when it made its determination. In other words, that any subsequent information could not be taken into account.

**Panel, US – Wool
Shirts and Blouses**

... Unlike the TMB, a DSU panel is not called upon, under its terms of reference, to reinvestigate the market situation. When assessing the WTO compatibility of the decision to impose national trade remedies, DSU panels do not reinvestigate the market situation but rather limit themselves to the evidence used by the importing Member in making its determination to impose the measure. In addition, such DSU panels, contrary to the TMB, do not consider developments subsequent to the initial determination...³⁸

³⁵ Panel Report, *US – Wool Shirts and Blouses*, paras. 7.25-7.27.

³⁶ Panel Report, *US - Underwear*, para. 7.26.

³⁷ *Ibid*, para. 7.29.

³⁸ Panel Report, *US – Wool Shirts and Blouses*, para. 7.21.

In the *US - Cotton Yarn* case, the complainant, Pakistan, alleged that the United States had based its determination on the state of its domestic industry on unverified, incorrect and incomplete data supplied by an association of United States yarn producers who were seeking protection for the industry. While agreeing with the finding of the Panel in *US – Wool Shirts and Blouses* that panels should not reinvestigate *de novo* the market situation when reviewing decisions by national authorities, the Panel in *US – Cotton Yarn* remarked that “we should examine any evidence, without regard to whether it was available or considered at the time of investigation *for the purpose of evaluating the thoroughness and sufficiency of the investigation underpinning the decision of the United States authority.*”³⁹ The Panel consequently examined later evidence for purposes of verification.

The Appellate Body however faulted the Panel and reversed its aforesaid finding, ruling that it exceeded its mandate under Article 11 of the DSU.

**Appellate Body, US –
Cotton Yarn**

A Member cannot, of course, be faulted for not having taken into account what it could not have known when making its determination. If a panel were to examine such evidence, the panel would, in effect, be conducting a de novo review and it would be doing so without having had the benefit of the views of the interested parties. The panel would be assessing the due diligence of a Member in reaching its conclusions and making its projections with the benefit of hindsight and would, in effect, be reinvestigating the market situation and substituting its own judgment for that of the Member. In our view, this would be inconsistent with the standard of a panel’s review under Article 11 of the DSU.⁴⁰

The controversy does not seem to have come to an end however. Pakistan vigorously protested in the DSB at the time of adoption of the Panel and Appellate Body reports arguing that without the benefit of testing the accuracy of information used by the national authorities which is often provided by interested parties, the panels are left with the choice of relying only on the good faith of the importing Member, rather than making an objective assessment of the facts of the case.

3.4 Reference Period for Purposes of Information Used

In the *US -Cotton Yarn* case, the complainant argued that an analysis on the basis of data for a mere eight-month period was not enough for determining serious damage to the domestic industry. It referred to the recommended guidelines adopted by the Committee on Anti-Dumping Practices for the time period for investigation, which states that “the period of data collection for injury investigation normally should be *at least three years.*” It also pointed out that “five-year investigation periods are common” under Article XIX of the GATT. The United States contended that the ATC did not provide for a specific minimum time period for investigation.

³⁹ *Panel Report, US – Cotton Yarn, para. 7.33.*

⁴⁰ *Appellate Body Report, US – Cotton Yarn, para. 78.*

The Panel disagreed with the complainant on the notion of a general guideline as to the length of period during which damage could occur.

**Panel, US –
Cotton Yarn**

In our view, whether or not the chosen period is justifiably long would depend on, at least partly, the extent of the damage suffered by a subject domestic industry during that period. Thus, we deem it inappropriate to set out a general guideline on the length of the period during which damage or causation occurs, when there is no specific treaty language in the ATC.⁴¹

3.5 Definition of Domestic Industry

In the *US - Cotton Yarn* case, the central issue was the definition of the domestic industry producing cotton yarn in the United States.

This same issue was the basis on which the United States had adopted another safeguard action restricting the imports of yarn of artificial staple fibre from Thailand. Following a mutual understanding between the two, the TMB, after its consideration of the restriction pursuant to Article 6:9 of the ATC, had declared the restriction to be justified.⁴²

In both these cases, the United States defined the domestic industry as the producers of yarn who produced it for sale on the merchant market. It excluded from the scope of its definition of domestic industry the vertically integrated fabric producers who produced yarn for their own internal use.

Pakistan claimed that in doing so the United States violated Article 6.2 of the ATC because it did not investigate its entire domestic industry producing cotton yarn. It referred to long-standing GATT/WTO jurisprudence under Article III of the GATT in which the term “directly competitive products” has been consistently interpreted as referring not only to products in actual competition at a particular time, but also to those that have the potential to compete. Thus the term “competitive products” has also been seen as including products that are capable of competing.⁴³

The United States argued that production by so-called integrated fabric producers did not compete directly with imports. The United States asserted it was necessary to give full meaning to the connector “and/or” in the phrase “domestic industry producing like and/or directly competitive products” in Article 6:2 of the ATC and, ignoring it would amount to rendering the word “and” useless. It went on to assert that the connector “and/or” was unique to the ATC. It is not found in any other WTO agreement where the relationship between domestic and imported products has been defined.⁴⁴

⁴¹ *Panel Report, US – Cotton Yarn, para. 7.115.*

⁴² *G/TMB/R/42, paras. 5-13.*

⁴³ *US-Cotton yarn, para. 7.37.*

⁴⁴ *Appellate Body Report, US - Cotton Yarn, para. 84.*

The Panel held that yarn produced by the integrated producers was directly competitive with the yarn imported from outside and that the United States violated the requirement of Article 6:2 by excluding the captively-produced yarn from the scope of domestic industry.

The Appellate Body confirmed and ruled that “...we do not accept the contention of the United States that yarn produced by the vertically integrated fabric producers is not directly competitive with yarn imported from Pakistan.”⁴⁵

Appellate Body, US – Cotton Yarn

The definition of the domestic industry, in terms of Article 6.2, is determined by what the industry produces, that is, like and/or directly competitive products. In our view, the term “producing”, in itself, cannot be given a different or a qualified meaning on the basis of what a domestic producer chooses to do with its product.

...
The word “competitive” must be distinguished from the words “competing” or “being in actual competition”. It has a wider connotation than “actually competing” and includes also the notion of a potential to compete. It is not necessary that two products be competing, or that they be in actual competition with each other, in the marketplace at a given moment in order for those products to be regarded as competitive. Indeed, products which are competitive may not be actually competing with each other in the marketplace at a given moment for a variety of reasons, such as regulatory restrictions or producers’ decisions. Thus, a static view is incorrect, for it leads to the same products being regarded as competitive at one moment in time, and not so the next, depending upon whether or not they are in the marketplace.⁴⁶

3.6 Threat of Serious Damage

In terms of Article 6:2 of the ATC a safeguard action may be taken on the basis of a determination demonstrating that there was serious damage or actual threat of serious damage to the domestic industry.

The United States seemed to take the two concepts of serious damage and threat of serious damage as though they were interchangeable, and that a determination in either case could be made on the basis of the same assessment of facts, i.e., without conducting an independent assessment in cases alleging threat of serious damage.

The panels however have interpreted these concepts as being different. Thus, the Panel in *US-Underwear* ruled that while a finding on serious damage “requires the party that takes action to demonstrate that the damage has already occurred, a finding on threat of serious damage requires the same party to demonstrate that, unless action is taken, damage will most likely occur in the near future.”⁴⁷ In other words that a determination of threat of serious damage requires a ‘prospective analysis’.

⁴⁵ *Appellate Body Report, US – Cotton Yarn, para. 103*

⁴⁶ *Appellate Body Report, US – Cotton Yarn, paras. 87 and 96.*

⁴⁷ *Panel Report, US - Underwear, para. 7.55.*

The Panel in *US - Cotton Yarn* ruled likewise. It found that: "... to make an independent finding of actual threat of serious damage, further analysis would need to be done to substantiate the finding. In other words, a prospective analysis is required if an independent finding of actual threat is to be made rather than a redundant and dependant one [i.e., dependant just on the determination of serious damage]"⁴⁸

3.7 Attribution of Serious Damage

In the *US-Cotton Yarn* case, the issue of attribution of serious damage was also a key consideration. In its determination, the United States attributed the alleged damage to imports from Pakistan without making a comparative assessment of imports from Pakistan and Mexico and their respective effects. The Panel as well as the Appellate Body concluded that by not examining the effect of imports from Mexico (and possibly other appropriate Members) individually, the United States acted inconsistently with Article 6 of the ATC.

The question of attribution is addressed in Article 6:4 of the ATC.

Article 6:4 of the ATC

The Member or Members to whom serious damage, or actual threat thereof, referred to in paragraphs 2 and 3, is attributed, shall be determined on the basis of a sharp and substantial increase in imports, actual or imminent, from such a Member or Members individually, and on the basis of the level of imports as compared with imports from other sources, market share, and import and domestic prices at a comparable stage of commercial transaction; none of these factors, either alone or combined with other factors, can necessarily give decisive guidance. (footnote omitted)

The United States argued that Article 6:4 authorizes the importing Member to apply safeguard measures on a Member-by-Member basis, and that the obligation of the importing Member is only that it compare imports from any particular Member to imports from "all other sources taken together", not from each of them individually. The opposing view was that a proper attribution of damage could not be done if the largest exporter, in this case, was simply ignored. Doing so would in effect shift the responsibility for entire damage to the other Member.

The Panel in *US – Cotton Yarn* rejected the United States argument and found that analysis of the effect of imports from individual Members was necessary, in order for it to be consistent with the requirement of Article 6:4.

Panel, US – Cotton Yarn

... unlike other safeguard investigations, and resulting applications of measures, which are done on an MFN basis, ... the Member imposing a safeguard under the ATC must then do a further attribution analysis and narrow the causation down to only those Members whose exports are causing

⁴⁸Panel Report *US - Cotton Yarn*, para. 7.138.

the serious damage. This does not mean, however, that a Member imposing a safeguard restraint can then pick and choose for which Member(s) it will make an attribution analysis. The attribution cannot be made only to some of the Members causing damage, it must be made to all such Members. The language of Article 6.4 leads to this conclusion. The first sentence contains a requirement that safeguard measures shall be applied on a Member-by-Member basis. However, this is a reference to the application of the measure, not [to] the attribution analysis of which Members are subject to such measure(s). That is covered by the second sentence which specifically speaks of “attribution” of causation of serious damage in contrast to the first sentence which describes how the measure is to be “applied”. The second sentence reads:

“The Member or Members to whom serious damage, or actual threat thereof, referred to in paragraphs 2 and 3, is attributed, shall be determined on the basis of a sharp and substantial increase in imports, actual or imminent, from such a Member or Members individually, and on the basis of the level of imports as compared with imports from other sources, market share, and the import and domestic prices at a comparable stage of commercial transaction...”

[The] explicit linking back to the serious damage determination, in our view, requires that all the Members causing the serious damage must have it so attributed.⁴⁹

The Appellate Body also ruled as the Panel:

**Appellate Body,
US – Cotton Yarn**

... where imports from more than one Member contribute to serious damage, it is only that part of the total damage which is actually caused by imports from such a Member that can be attributed to that Member under Article 6.4, second sentence. Damage that is actually caused to the domestic industry by imports from one Member cannot, in our view, be attributed to a different Member imports from whom were not the cause of that part of the damage. This would amount to a “mis-attribution” of damage and would be inconsistent with the interpretation in good faith of the terms of Article 6.4. Therefore, the part of the total serious damage attributed to an exporting Member must be proportionate to the damage caused by the imports from that Member. Contrary to the view of the United States, we believe that Article 6.4, second sentence, does not permit the attribution of the totality of serious damage to one Member, unless the imports from that Member alone have caused all the serious damage.

*...
An assessment of the share of total serious damage, which is proportionate to the damage actually caused by imports from a particular Member, requires, therefore, a comparison according to the factors envisaged in Article 6.4 with all other Members (from whom imports have also increased sharply and substantially) taken individually.⁵⁰*

⁴⁹ Panel Report, US – Cotton Yarn, paras. 7.126 and 7.127.

⁵⁰ Appellate Body Report, US – Cotton Yarn, paras. 119 and 124.

3.8 Backdating of Safeguard Measures

The date from which the application of a safeguard measure should take effect was raised in both the *US - Underwear* and *US – Wool Shirts and Blouses* cases. The United States imposed the restrictions (unilaterally), after the parties failed to reach mutual understanding on the measures, backdating the effective date of restrictions to the dates on which it had requested consultations with the respective exporting Members. The complaining exporting Members – Costa Rica and India – took issue with the United States approach.

The Panel in *US – Wool Shirts and Blouses* declined to rule on the question, saying that since it had concluded that the restriction itself was not consistent with the requirements of Article 6:2 and 6:3, it was not necessary to consider whether the date of application of the measure was also consistent (or not) with the WTO rules.⁵¹

The Panel in *US - Underwear* ruled that the restrictions could justifiably be imposed from the date on which the United States published the request for consultations.

Panel, US - Underwear

... [W]e conclude that the prevalent practice under the MFA of setting the initial date of a restraint period as the date of request for consultations cannot be maintained under the ATC. However, we note that if the importing country publishes the proposed restraint period and restraint level after the request for consultations, it can later set the initial date of the restraint period as the date of the publication of the proposed restraint. In the present case, the United States violated its obligations under Article X:2 of GATT 1994 and consequently under Article 6.10 of the ATC by setting the restraint period ... starting on 27 March 1995. ... Had it set the restraint period starting on 21 April 1995, which was the date of the publication of the information about the request for consultations, it would not have acted inconsistently with GATT 1994 or the ATC in respect of the restraint period.⁵²

On appeal by Costa Rica, the Appellate Body concluded that the Panel in *US - Underwear* erred in law and reversed its finding, ruling that the restriction could be applied only *after* the consultations provided for under Article 6. The Appellate Body ruling is extremely instructive in this regard.

Appellate Body, US - Underwear

It is essential to note that, under the express terms of Article 6.10, ATC, the restraint measure may be “applied” only “after the expiry of the period of 60 days” for consultations, without success, and only within the “window” of 30 days immediately following the 60-day period. Accordingly, we believe that, in the absence of an express authorization in Article 6.10, ATC, to backdate the effectivity of a safeguard restraint measure, a presumption arises from the very text of Article 6.10 that such a measure may be applied only prospectively.

⁵¹ Panel Report, *US – Wool Shirts and Blouses*, para. 7.58.

⁵² Panel Report, *US – Underwear*, para. 7.69.

...
It appears to the Appellate Body that to inject into Article 6.10 an authorization for backdating the effectivity of a restraint measure will encourage return to the practice of backdating restraint measures which appears to have been widespread under the regime of the MFA, a regime which has now ended, ... Such an introjection would moreover loosen up the carefully negotiated language of Article 6.10, which reflects an equally carefully drawn balance of rights and obligations of Members, by allowing the importing Member an enhanced ability to restrict the entry into its territory of goods in the exportation of which no unfair trade practice such as dumping or fraud or deception as to origin, is alleged or proven. For retroactive application of a restraint measure effectively enables the importing Member to exclude more goods by enforcing the quota measure earlier rather than later.⁵³

3.9 New Restrictions Only Under the ATC

Article 2:4 of the ATC provides that any new restrictions on textile and clothing products, that are not yet integrated into the GATT, can be applied only if justified under the ATC or relevant provisions of the GATT 1994 excluding however Article XIX thereof.

Article 2:4 of the ATC

... No new restrictions in terms of products or Members shall be introduced except under the provisions of this Agreement or relevant GATT 1994 provisions...

In many dispute cases involving textile and clothing products, the complaining Members alleged violation of this provision, in addition to violations of other provisions of the ATC (such as its Article 6) or other GATT provisions (such as Articles XI, XIII, etc.)

In such instances, the panels and the Appellate Body ruled that if a restriction on textile and clothing products were found to be violative of Article 6 of the ATC or Article XI and/or XIII of the GATT it should *ipso facto* be deemed to be violative of Article 2:4 of the ATC also.

Panel, US - Underwear

In our view, a finding that the United States violated Article 2.4 of the ATC would depend on a previous finding that the United States violated Article 6 of the ATC; conversely, a finding by the Panel that the United States acted consistently with its obligations under Article 6 of the ATC would automatically mean that Article 2.4 of the ATC was not violated.

We note our previous conclusion that the United States imposed the restriction in a manner inconsistent with its obligations under Articles 6.2, 6.4 and 6.6(d) of the ATC. In our view, the United States by violating its obligations under Article 6 of the ATC has ipso facto violated its obligations under Article 2.4 of the ATC as well.⁵⁴

⁵³ Appellate Body Report, US – Underwear, p. 22 and 23.

⁵⁴ Panel Report, US - Underwear, paras. 7.70 and 7.71.

In this regard, it is significant to note that Turkey applied restrictions on imports of textile and clothing products following the establishment of the customs union between Turkey and the European Communities.⁵⁵ It argued that these restrictions were necessary for the formation of the customs union. On a WTO challenge by India, the Panel concluded that Turkey's measure was inconsistent with the provisions of Article XI and XIII of GATT 1994 and *consequently* also with that of Article 2:4 of the ATC. The Panel in *Turkey - Textiles* rejected Turkey's claim that the subject measure was permitted by Article XXIV of GATT 1994 relating to the formation of customs union.⁵⁶

The Appellate Body upheld the Panel's conclusion stating that "...Article XXIV does not allow Turkey to adopt, upon the formation of a customs union with the European Union, quantitative restrictions on imports of 19 categories of textile and clothing products which were found to be inconsistent with Article XI and XIII of the GATT 1994 and *Article 2:4 of the ATC*."⁵⁷ [Emphasis added]

In another important finding, the Panel in *Turkey - Textiles* reasoned as follows:

**Panel, Turkey –
Textiles**

The prohibition on "new restrictions" must be interpreted taking into account the preceding sentence [of ATC Article 2:4]: "The restrictions notified under paragraph 1 shall be deemed to constitute the totality of such restrictions applied by the respective Members on the day before the entry into force of the WTO Agreement". The ordinary meaning of the words indicates that WTO Members intended that as of 1 January 1995, the incidence of restrictions under the ATC could only be reduced. We are of the view that any legal fiction whereby an existing restriction could simply be increased and not constitute a "new restriction", would defeat the clear purpose of the ATC which is to reduce the scope of such restrictions, starting from 1 January 1995 (but for the exceptional situations referred to in Article 2.4 of the ATC). Thus, we consider that, setting aside the possibility of exceptions and justifications mentioned in Article 2.4 of the ATC, any increase of an ATC compatible quantitative restriction notified under Article 2.1 of the ATC, constitutes a "new" restriction.⁵⁸

In the *Argentina – Textiles and Apparel* case too, the complainant, the United States, had claimed that because Argentina had violated Articles II and VIII of the GATT with respect to textiles and apparel, it had also consequently violated Article 7 of the ATC. The Panel however declined to rule on this claim, exercising the principle of judicial economy.

⁵⁵Turkey – Restrictions on Imports of Textile and Clothing Products, *complaint by India, WT/DS34/R* ("Turkey – Textiles").

⁵⁶ *Panel Report, Turkey – Textiles, para. 10.1.*

⁵⁷ *Appellate Body Report, Turkey - Textiles, para. 64.*

⁵⁸ *Panel Report, Turkey – Textiles, para. 9.71.*

**Panel, Argentina –
Textiles and Apparel**

The parties and third parties have entered into long and well-argued debates as to whether Article 7 covers only actions and obligations covered by the ATC, i.e., quantitative restrictions, or whether the purpose of Article 7 is [also] to ensure that measures other than quantitative restrictions such as tariffs, non-tariff barriers, licensing provisions and intellectual property provisions are not used in a manner which undermines market access in the textile and apparel sector for all WTO Members.

We have decided to exercise judicial economy and not address the US claim related to the ATC. Such decision is consistent with the findings of the Appellate Body report in the Shirts and Blouses case. We do not see how a finding on Article 7 of the ATC would help the parties to resolve their dispute.⁵⁹

⁵⁹ Panel Report, Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items (“Argentina – Textiles and Apparel”), WT/DS56/R, adopted 22 April 1998, as modified by the Appellate Body Report, WT/DS56/AB/R and Corr.1, DSR 1998:III, 1033, paras. 6.86 and 6.87.

4. SUMMARY OVERVIEW OF ATC DISPUTE CASES

The central purpose of the ATC was to secure the progressive phasing out of quota restrictions on textiles and clothing maintained by major developed countries on imports from developing countries under the MFA and its predecessor arrangements. Yet the Agreement also provided for the possibility of new restrictions in the interim, by means of a “transitional safeguard” on products that remained to be integrated.

Article 6 of the ATC lays down the conditions and procedures for “transitional safeguard” which an importing Member must follow to introduce any new restrictions. Paragraphs 1 - 4 of the Article set out the substantive requirements whereas the main procedural requirements are laid out in paragraphs 7 - 11. In brief, an importing Member may resort to a transitional safeguard action if it is demonstrated that the product subject to the action is being imported in such increased quantities as to cause serious damage, or actual threat thereof, to its domestic industry producing like and/or directly competitive products, and that such damage or threat is attributable to a sharp and substantial increase in imports from the Member to which the action is applied (Articles 6:1 to 6:4).

The importing Member proposing to take the safeguard action is required to seek consultations with the Member or Members which would be affected by such action (Article 6:7). In its request for consultations, it must provide specific information justifying the new restriction. If during consultations, there is mutual understanding between the importing and exporting Member, the restriction may be put into effect, with details of the agreed restraint measure communicated to the TMB. If there is no mutual understanding, the importing Member may apply a restriction and, at the same time, refer the matter to the TMB. In both cases, the TMB is required to examine the measure and determine whether it is justified in accordance with the provisions of Article 6. If after TMB examination, the matter remains unresolved, either Member may invoke the dispute settlement procedures of the DSU.

As noted earlier, to date, three cases of transitional safeguard action by the United States have been litigated in dispute settlement panels. In all three cases, certain findings of the panels were appealed to the Appellate Body. While key aspects of the Panel and Appellate Body rulings in these cases have been considered in Section 3 of this Module, the following account is designed to provide brief summaries of the cases. The various stages of the three cases are tabulated below:

Stage	Underwear	Wool Shirts and Blouses	Cotton Yarn
United States consultation request (Article 6.7)	27 March 1995	18 April 1995	24 Dec. 1998
Result of consultations	No agreement	No agreement	No agreement
Unilateral restraint introduced (Art. 6.10)	23 June 1995	14 July 1995	5 March 1999
Restraint effective from	27 March 1995 ⁶⁰	18 April 1995 ⁶¹	17 March 1999
After TMB process	Matter unresolved	Matter unresolved	Matter unresolved
Panel request	22 February 1996	14 March 1996	3 April 2000
Panel established	5 March 1996	17 April 1996	19 June 2000
Panel report	8 November 1996	6 January 1997	31 May 2001
Panel findings appealed	11 November 1996	24 february 1997	9 July 2001
Appellate Body report	10 February 1997	25 April 1997	8 October 2001

The issues in each case are summarized below.

4.1 US - Underwear

In this, the first case concerning a safeguard action under the ATC, the TMB ruled that the United States had failed to demonstrate that its domestic industry had been damaged due to increased imports. However, the TMB could not reach a consensus on whether a situation of actual threat of damage to the United States industry had been proven. It recommended further consultations between the parties which, Costa Rica believed, the TMB was not entitled to do under the ATC. Nevertheless, even following further consultations, the matter remained unresolved. The TMB again examined the case pursuant to

⁶⁰ In other words, the effectivity of the restraint back-dated to the date of request for consultation.

⁶¹ Idem.

Costa Rica's request under Article 8.10 and maintained its previous findings, prompting Costa Rica to request the establishment of a dispute settlement panel.

Costa Rica claimed before the Panel that the United States, by imposing a unilateral quantitative restriction, acted in violation of Articles 2, 6 and 8 of the ATC and requested that the Panel recommend that the United States withdraw the measure in question. Specifically, it claimed that the United States violated its obligations by:

- (a) imposing the restriction without having satisfied the conditions of Article 6.2 and 6.4 of the ATC, namely, by not having been able to demonstrate that serious damage or actual threat thereof resulted from imports from Costa Rica;
- (b) not granting, when applying the restriction, more favourable treatment to re-imports from Costa Rica in contravention of Article 6.6(d) of the ATC;
- (c) not consulting with Costa Rica on the issue of actual threat of serious damage contrary to its obligations under Article 6.7 and 6.10 of the ATC (because the United States request for consultations had only claimed damage to its industry, not actual threat thereof);
- (d) applying the restriction retroactively in contravention of Article 6.10 of the ATC;
- (e) violating Article 2.4 of the ATC, by introducing a new restriction which was not justified under Article 6; and
- (f) not respecting the TMB recommendation, contrary to Article 8 of the ATC.

The panel upheld Costa Rica's claims with the exception of the one at (f) above. It recommended the DSB to request that the United States bring the measure into compliance with its obligations under the ATC. It also suggested that "such compliance can best be achieved and further nullification and impairment of benefits accruing to Costa Rica under the ATC best be avoided by prompt removal of the measure..."

Costa Rica appealed the Panel findings with respect to the backdating of the restriction. In essence, the Panel had found that the United States was wrong in setting the start of the restraint period as from the date of the request for consultations with Costa Rica; but, that it would have been justified to set this date as from the day on which it had published its consultation request

The Appellate Body set aside this Panel finding and ruled, instead, that the restraint measure could not be back-dated even as implied from the Panel ruling. The Appellate Body ruled the restriction could be applied only "after the expiry of the period of 60 days" for consultations, and only within the "window" of 30 days immediately following the 60-day period.

4.2 US – Wool Shirts and Blouses

In this case, after exhausting the TMB process, India requested the Panel to rule that the restraint introduced by the United States was inconsistent with a number of substantive and procedural requirements of Articles 6, 8 and 2 of the ATC, thus nullifying or impairing benefits accruing to India. India further requested supplementary findings that, according to Article 6 of the ATC, the onus of demonstrating serious damage or its actual threat was on the United States and that it had to choose, at the beginning of the process, whether it claimed the existence of “serious damage” or “actual threat thereof”, these two situations not being interchangeable. India also claimed that there was nothing in the ATC under which the United States could impose a restraint with retrospective effect.

The Panel found that the restraint measure in question violated the substantive provisions of Articles 2 and 6 of the ATC. However, it declined to rule on India’s supplementary claims. Invoking the principle of judicial economy, the Panel held that as it had concluded that the United States measure did not respect the requirements of Articles 6.2 and 6.3 of the ATC and was, therefore, violative of the Agreement and that the Panel need not consider and rule on those supplementary issues.

Notwithstanding this Panel’s refusal to make all the findings requested by India, the Panel and the Appellate Body rulings in *US - Underwear* were instructive, at least in so far as the back-dating of the restraint measure and the separate requirements for determination of threat of damage (as opposed to damage) were concerned.

India appealed the Panel’s approach with regard to the issues of (i) the burden of proof, and (ii) the exercise of judicial economy. It also appealed the finding in which the Panel had ruled that the TMB was not limited to considering only the initial information submitted by the importing Member.

The Appellate Body upheld the Panel with respect to the first two issues. Regarding the third, it ruled that the Panel’s statement was only a gratuitous comment, and therefore, it was not to be considered as “a legal finding or conclusion”.

4.3 US – Cotton Yarn

As in the two previous cases, after going through the TMB process, Pakistan requested the Panel to find that the United States failed to demonstrate, before taking the safeguard action, that imports caused serious damage or actual threat thereof to its domestic industry and that such damage or threat was attributable to Pakistan because the United States:

- did not examine the state of the entire domestic industry producing combed cotton yarn, only the yarn produced by units selling to outsiders;
- based its determination on the state of the domestic industry on unverified, incorrect and incomplete data;
- based its determination on the causal link between imports and serious damage on changes in economic variables during an eight-month period only;
- did not conduct a prospective analysis of the effects of imports to determine whether they were causing a threat of serious damage; and
- attributed serious damage to imports from Pakistan without making a comparative assessment of the imports from Pakistan and Mexico (imports from whom had similarly increased) and their respective effects.

Furthermore, Pakistan requested the Panel:

- to rule, on the basis of the above findings, that the safeguard action was inconsistent with the United States' obligations under Article 6 of the ATC;
- to rule further that the United States had nullified or impaired benefits accruing to Pakistan under the ATC since, according to Article 3.8 of the DSU, the infringement of an obligation is considered to constitute a *prima facie* case of nullification or impairment;
- to recommend, in accordance with Article 19.1, first sentence, of the DSU, that the DSB request the United States to bring itself into conformity with its obligations under the ATC; and
- to suggest, in accordance with Article 19.1, second sentence, of the DSU, that the most appropriate way to implement the Panel's ruling would be to rescind the safeguard action forthwith.

This Panel decided not to exercise judicial economy and examined all claims submitted by Pakistan. It upheld all these claims with the exception of those pertaining to: (i) the data used by the United States to base its determination on; and (ii) the short time period of eight months in determining the causal link between imports and serious damage.

The United States appealed the Panel findings with regard to the issues of: (i) the standard of review; (ii) the definition of domestic industry in which the United States had excluded the portion of yarn produced by the so-called vertical producers for their own use; and (iii) the attribution of serious damage (in which the Panel had faulted the United States for not examining the imports from Mexico and possibly some other Members *individually* and attributing, instead, the entire alleged damage to imports from Pakistan).

The Appellate Body rejected the United States contention and upheld the Panel with respect to the latter two issues. However, it concluded that the Panel exceeded its mandate by considering data which was not available to the importing Member, the United States, when it had made its determination concerning the damage caused to its industry by increased imports.

5. TEST YOUR UNDERSTANDING

After having studied this Module, can you answer the following questions? The answers should not be simple yes or no. Consider brief explanations.

1. The textile and clothing sector is not yet integrated into the GATT. In this situation, how is the DSU relevant for dispute settlement under the ATC?
2. The ATC replaced the MFA that had long regulated trade in textiles and clothing. In what respect is the MFA still relevant? Does it also have relevance in cases of disputes under the ATC?
3. Why is it that a dispute case involving imposition of anti-dumping measures on wearing apparel cannot be raised under the ATC?
4. A WTO Member is considering requesting consultations with another WTO Member to take issue with changes made by the latter in its rules of origin for textile products. What is the correct process and procedure for the requesting Member to follow?
5. A WTO Member has imposed a quota restriction on import of a clothing product from another WTO Member without requesting or undertaking any consultations pursuant to Article 6 of the ATC. Is the measure justified under the ATC?
6. The TMB has recommended that an importing Member should withdraw a restriction imposed by it under transitional safeguard of the ATC. The Member insists on the justification of its measure and declines to accept the TMB recommendation. Can this Member do so? What recourse is available to the exporting Member under the WTO? Cite the relevant provisions in support of the approach you suggest.
7. What did the TMB say with respect to the issue of triple deduction of quotas due to repeated instances of trans-shipments?
8. Two WTO Members have agreed to establish a quota restriction for a period of three years as of May 15 2002, pursuant to Article 6 of the ATC. Will this restriction be consistent with the ATC and the WTO Agreement after 1 January 2005?

6. CASE STUDY

This section identifies a hypothetical case with reference to certain provisions of the ATC. It is proposed that readers of this Module try to develop detailed arguments and reasoning regarding the case, assuming it is to be litigated under the WTO.

It may be recalled from Section 1.4.4 of this Module that Article 2.13 and 2.14 of the ATC stipulated that quota levels for products that are not yet integrated into GATT 1994 shall be increased during the transitional period in accordance with the following formulae:

As of 1 January 1995: All annual quota growth rates, which existed in respective bilateral agreements prior to the ATC, be increased by a factor of at least 16 per cent⁶².

Thus an annual growth rate of 6 per cent should be increased to 6.96 per cent; 5 per cent to 5.80 per cent; 4 per cent to 4.64 per cent; 3 per cent to 3.48 per cent; 2 per cent to 2.32 per cent; 1 per cent to 1.16 per cent.

As of 1 January 1998: The annual growth rates resulting from the above formula shall be increased further by at least 25 per cent.⁶³

As of 1 January 2002: The rates resulting from the above (i.e. 1998) shall be increased by another at least 27%.⁶⁴

However, for exporting countries considered small suppliers, the ATC provided for preferential treatment for such increases in quotas. Thus Article 1.2 of the ATC stipulated:

*Members agree to use the provisions of paragraph 18 of Article 2... in such a way as to permit meaningful increases in access possibilities for small suppliers ...*⁶⁵ [Emphasis added]

Furthermore, Article 2.18 of the ATC provided:

As regards those Members whose exports are subject to restrictions on the day before the entry into force of the WTO Agreement and whose restrictions

⁶² Article 2:13 of the ATC.

⁶³ Article 2:14(a) of the ATC.

⁶⁴ Article 2:14(b) of the ATC.

⁶⁵ To the extent possible, exports from a least-developed country Member may also benefit from this provision.

represent 1.2 per cent or less of the total volume of the restrictions applied by an importing Member as of 31 December 1991 ... , meaningful improvement in access for their exports shall be provided, at the entry into force of the WTO Agreement and for the duration of this Agreement, through advancement by one stage of the growth rates set out in paragraphs 13 and 14 [brought out above], or through at least equivalent changes as may be mutually agreed with respect to a different mix of base levels, growth and flexibility provisions. Such improvements shall be notified to the TMB. [Emphasis added]

In giving effect to the preferential treatment for small suppliers however, the importing countries maintaining quota restrictions (“restraining countries”) gave varying interpretations of the provisions cited above.

Thus, at the first stage from January 1995, restraining country ‘A’ increased the rates existing prior to the ATC first by 16 per cent and, then, by 25 per cent, i.e., cumulatively. Consequently, the pre-ATC growth rate of 6 per cent was increased to 8.7 per cent. Subsequently, in the second stage from 1998, the resulting rate was increased by 27 per cent to 11.05 per cent. The rate was then again raised by 27 per cent to 14.03 per cent in the third stage starting from 2002.

But restraining country ‘B’ simply brought forward the growth factors prescribed for subsequent stages. Thus, for stage 1, it applied 25 per cent; for stage 2, 27 per cent; and for stage 3, another 27 per cent. Consequently, the pre-ATC growth rate of 6 per cent was increased to 7.5 per cent, 9.53 per cent, and 12.10%, respectively.

It may be noticed that the rates allowed by restraining country ‘B’ produced lower market access increases to the small suppliers concerned than that allowed by restraining country ‘A’.

	Country A	Country B
As of 1 January 1995	8.7 %	7.5 %
As of 1 January 1998	11.05 %	9.53 %
As of 1 January 2002	14.03 %	12.10 %

In the light of the principles of interpretation applied by panels and the Appellate Body to cases reviewed in this Module, readers are invited to develop arguments with regard to the justification or otherwise of the two approaches. They may also specify the process under the ATC and the DSU, where a dispute case is to be pursued by a small exporting country, Member of the WTO.

7. FURTHER READING

7.1 Books and Articles

- **Bagchi, S.**, *International Trade Policy in Textiles: Fifty Years of Protectionism* (Geneva, ITCB, 2001)
- **Baughman, L., et al.**, “Of Tyre Cords, Tyres and Tents: Window-Dressing in the ATC?”, *The World Economy*, Vol. 20, No. 4
- **Raffaelli, M. and Jenkins, T.**, *The Drafting History of the Agreement on Textiles and Clothing* (Geneva, ITCB, 1995)
- **Tang, Xiaobing**, “The Integration of Textiles and Clothing into GATT and WTO Dispute Settlement”, in *Dispute Resolution in the World Trade Organization* (Cameron May, London)

7.2 Panel and Appellate Body Reports

- Panel Report, *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear (“US – Underwear”)*, WT/DS24/R, adopted 25 February 1997, as modified by the Appellate Body Report, WT/DS24/AB/R, DSR 1997:I, 31.
- Appellate Body Report, *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear (“US – Underwear”)*, WT/DS24/AB/R, adopted 25 February 1997, DSR 1997:I, 11.
- Panel Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India (“US – Wool Shirts and Blouses”)*, WT/DS33/R, adopted 23 May 1997, as upheld by the Appellate Body Report, WT/DS33/AB/R and Corr.1, DSR 1997:I, 343.
- Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India (“US – Wool Shirts and Blouses”)*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323.
- Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products (“Turkey – Textiles”)*, WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R.
- Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products (“Turkey – Textiles”)*, WT/DS34/AB/R, adopted 19 November 1999.
- Panel Report, *United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan (“US – Cotton Yarn”)*, WT/DS192/R, adopted 5 November 2001, as modified by the Appellate Body Report, WT/DS192/AB/R.
- Appellate Body Report, *United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan (“US – Cotton Yarn”)*, WT/DS192/AB/R, adopted 5 November 2001.

7.3 Documents and Information

- International Textiles and Clothing Bureau (ITCB) “Conduct of Textile Trade Relations under GATT/WTO – A Chronological Account” (www.itcb.org)
- WTO, *Reports of the Textiles Monitoring Body* (G/TMB/R/-) and (G/L/459).

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

COURSE ON DISPUTE SETTLEMENT

WORLD TRADE ORGANIZATION

3.14 TRIPS



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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WHAT YOU WILL LEARN

The *Agreement on Trade-Related Aspects of Intellectual Property Rights* (“TRIPS Agreement”) is the first WTO agreement requiring Members to establish a relatively detailed set of substantive norms within their national legal systems, as well as requiring them to establish enforcement measures and procedures meeting minimum standards. The *TRIPS Agreement* is sometimes referred to as the first WTO agreement that prescribes “positive law”. This factor alone might account for a more than typical level of controversy as Members deal, in many cases, with adopting rather far-reaching changes to their national legal systems.

However, added to the uniquely “positive” aspect of the *TRIPS Agreement* is a negotiating history that for a long time was highly contentious, particularly as between developed and developing Members, and the fact that the *TRIPS Agreement* touches upon sensitive and important social issues. In the final analysis, it should not be surprising that the TRIPS Agreement has generated a considerable amount of controversy among WTO Members, even if to date much of that controversy has not resulted in formal dispute settlement proceedings.

The TRIPS Agreement addresses a wide range of intellectual property subject matter areas (copyright, trademark, patent, and so forth). It also covers competitive markets, enforcement measures, dispute settlement, and transitional arrangements. This Module provides an introduction to these various aspects of the TRIPS Agreement, and seeks to focus on the kinds of questions that should be asked when approaching dispute settlement. In some areas, the questions are answered, but the entire field of intellectual property rights protection, including enforcement measures, cannot be covered in a single Module or short course. Moreover, the questions will change along with the technologies that form the subject matter of intellectual property rights protection. The objective of this Module is to provide sufficient background so that as specific issues arise, the diplomat or lawyer understands how to approach them.

This Module begins by discussing some general principles or concepts applicable to the field of TRIPS dispute settlement. It then deals with the various substantive subject matter areas covered by the agreement. It turns to enforcement measures, and afterwards to specific aspects of the WTO dispute settlement process. Finally, the existing WTO jurisprudence is described.

1. GENERAL PRINCIPLES OF THE TRIPS AGREEMENT

Objectives

On completion of this section, the reader will be able:

- **to identify the basic concepts and principles of the TRIPS Agreement.**
- **to recognize the flexibility inherent in its rules, the prescription of minimum substantive standards of protection, and the possibility of direct application in national law.**
- **to discuss the concept of exhaustion of intellectual property right that underlies parallel trade, and the principles of national and most favoured nation treatment as they apply to TRIPS.**
- **to review the objectives and principles of the TRIPS Agreement and understand its relationship to the WIPO Conventions.**

1.1 Rights and Obligations

The TRIPS Agreement does not only impose obligations or duties on WTO Members, but also grants them an important set of rights. In approaching a dispute, a diplomat or lawyer should ask, “What are my government’s rights under the Agreement”? This is critically important because a dispute settlement claim under the TRIPS Agreement will usually be framed in terms of obligations that a Member is failing to fulfil.

The TRIPS Agreement and incorporated WIPO Conventions are often drafted in general terms. Members are not bound to follow a rigid set of rules in implementing them. Members have the right to implement the TRIPS Agreement in the manner they consider appropriate. Intellectual property (“IP”) law contains much inherent flexibility. Members have the “right” to use the flexibility inherent in the Agreement, as well the “obligation” to meet its minimum requirements.

1.1.1 Structure of the Agreement

The TRIPS Agreement consists of seven Parts. The first two parts are concerned with substantive rules that WTO Members are expected to implement and apply in their national (or regional) legal systems.¹ The third Part establishes the enforcement obligations of Members, and the fourth addresses the means for acquiring and maintaining intellectual property rights (“IPRs”). The fifth Part is directed specifically to dispute settlement under the TRIPS Agreement, though of course the other Parts of the Agreement will form the subject matter of disputes. The sixth Part concerns transitional arrangements, and the seventh concerns various institutional and other matters.

¹ *The European Communities are a Member of the WTO and TRIPS Agreement, and have developed an extensive body of IP laws and court decisions. Other regional groups, such as the Andean Pact and Mercosul/r, also have adopted or contemplate the adoption of regional IP law. In this Module, reference to national rights and obligations should be understood to include regional rights and obligations, except where the context expressly indicates otherwise.*

On 14 November 2001, the WTO Ministerial Conference in Doha adopted a Ministerial Declaration on the TRIPS Agreement and Public Health. This Declaration is important to interpretation of the Agreement, and has relevance beyond the field of public health.

The TRIPS Agreement establishes the Council for Trade-Related Aspects of Intellectual Property Rights (“TRIPS Council”) that plays an important role in the review of national legislation and in ongoing negotiations under its “built-in agenda”, as well as in other negotiations.

Preamble TRIPS

The TRIPS Agreement obligates WTO Members to establish a set of minimum standards that will permit parties to obtain and enforce certain rights in IP. The preamble of the TRIPS Agreement recognizes that IPRs are “private rights”. This means that “holders” of IPRs, not government authorities, are generally responsible for pursuing the enforcement of IPRs. On the other hand, governments may be (and often are) “holders” of IPRs, and the reference to IPRs as private rights should not be understood as a limitation on government ownership.

The preamble of the TRIPS Agreement was heavily negotiated during the Uruguay Round, and forms an important part of the context of its interpretation.²

1.1.2 Discretion and Flexibility

Article 1.1 TRIPS

Article 1:1 of the TRIPS Agreement obligates Members to “give effect” to the provisions of the Agreement. It also provides that Members “shall be free to determine the appropriate method of implementing the provisions of this Agreement within their own legal system and practice.”

Article 1:1 provides flexibility for Members to implement the TRIPS Agreement in the manner of their own choosing, provided that the specific requirements of the Agreement are met. This is an extremely important principle for the purposes of dispute settlement because the implementation of IP law in national legal systems involves choosing between different approaches.

For example, copyright law typically allows the “fair use” of authors’ and artists’ works for certain categories of acts, such as for criticism or parody. Rights of fair use are acknowledged under the terms of the Berne Convention on Literary and Artistic Works (see Berne Convention, Articles 9(2), 10 & 10*bis*) that are incorporated in the TRIPS Agreement (see TRIPS Agreement, Article 9:1), as well as by Article 13 of the TRIPS Agreement. The approaches that Members take to the scope of fair use rights differ, and often depend on how courts choose to interpret local rules in specific cases. When a government is challenged regarding the scope of its fair use provisions in dispute settlement, it may rely on the flexibility inherent in Article 1:1 of the TRIPS Agreement, as well as the relevant provisions of the Berne Convention and other parts of

² See Chapter 1.5, *UNCTAD TRIPS and Development: Resource Book*.

the TRIPS Agreement. The Panel Report in *US – Section 110(5) Copyright Act*³ shows that there are limits to this flexibility or discretion

1.1.3 Implementation into National Law and the Question of Direct Effect

As noted above, Members are obligated to “give effect” to the TRIPS Agreement in national law. The question of “giving effect” is more complex than might first appear. Members may, of course, choose to give effect to the rules of the TRIPS Agreement by the adoption of national legislation or administrative rules that specifically implement its provisions. However, not all legal systems require that the rules of treaties (or international agreements) be transformed into national law by the adoption of specific legislation. In some national legal systems, the constitution provides that treaties may be given “direct effect” by the regulatory authorities and courts.⁴

The question whether a particular national legal system recognizes the possibility of direct effect may be important in WTO dispute settlement. Consider the case in which a Member is challenged for an alleged failure to “give effect” to a provision of the TRIPS Agreement in national law. If the constitution of that Member allows for the possibility of direct effect, that Member may defend against the claim of non-implementation by pointing out that its national legal system does not require that TRIPS provisions be transformed by a separate legislative act into national law, but rather the Agreement itself becomes part of national law. There is thus no failure in implementation.

The recognition of “direct effect” for the TRIPS Agreement is a potential “two-edged sword” however, and this is one of the reasons that the European Communities and the United States have each taken steps to deny direct effect, even though the constitutional systems of both the EC and the United States allow for its possibility. If a Member allows the TRIPS Agreement direct effect, this generally means that private parties may directly rely on its terms before national courts. If the parliament or the executive of a Member prefers to implement the TRIPS Agreement in a particular way – taking advantage of the flexibility referred to earlier – it may lose some of its options in turning the task of interpreting the Agreement over to the courts.

1.1.4 Mandatory and Discretionary Rules

One of the critical questions to ask in any WTO dispute settlement context is whether a law or regulation being challenged has a mandatory or discretionary character. In the TRIPS context, a mandatory rule is one that implementing authorities “must” apply with regard to IPRs holders or those challenging

³ Panel Report, *United States – Section 110(5) of the US Copyright Act* (“*US – Section 110(5) Copyright Act*”), WT/DS160/R, adopted 27 July 2000.

⁴ In the United States, treaties that are given direct effect are referred to as “self-executing” treaties, but this terminology is specific to the United States.

them. A discretionary rule is one that executive authorities or courts “may” apply in these settings. Although there may be certain limits on this principle, it has long been recognized under GATT-WTO dispute settlement practice that only mandatory rules may be challenged in dispute settlement, and that discretionary rules may not be challenged until a Member uses discretionary authority in a way inconsistent with WTO obligations.⁵

If a Member adopts an IP law or regulation that allows its executive authorities or courts to exercise broad discretion with regard to a particular subject matter, the grant of discretion alone is unlikely to be inconsistent with TRIPS obligations until it is abused in practice.

1.2 General Principles

1.2.1 National and Most Favoured Nation Treatment

Part I of the TRIPS Agreement also incorporates certain general principles, including national and most favoured nation (MFN) treatment.

Article 3 TRIPS

The national and MFN treatment principles should be familiar from the study of GATT 1994 and GATS. While these principles have their own special characteristics in application to IPRs, the general idea is the same. Pursuant to the national treatment principle, a Member should treat foreign nationals in a manner equivalent to local nationals for the purpose of obtaining and enforcing rights in IPRs, as well as in defending against allegations of abuse. Pursuant to the MFN principle, a Member should treat nationals of different Members in the same manner, and should not grant special privileges to nationals of particular Members. Both the national and MFN principles are subject to certain limitations and exceptions.

Article 4 TRIPS

For example, under the national treatment principle, rules with regard to securing protection may vary to take into account the foreign character of a registrant, provided that the formal difference does not result in discrimination. Perhaps the major exception for MFN treatment is one that applies to international agreements regarding intellectual property existing prior to entry into force of the TRIPS Agreement. This exception may arguably be understood to refer to the intellectual property regimes of certain regional arrangements, such as the European Communities.

⁵ *The Panel in the US – Section 301 Trade Act case identified a discretionary rule it considered to obligate the United States to act in manner that created uncertainty regarding its WTO obligations, and found that in such circumstance even a discretionary rule might violate WTO obligations. This panel report was not appealed (see Panel Report, United States – Sections 301-310 of the Trade Act of 1974 (“US – Section 301 Trade Act”), WT/DS152/R, adopted 27 January 2000.) In a subsequent ruling, the Appellate Body affirmed that the mandatory-discretionary distinction forms part of WTO jurisprudence noting, without expressing an opinion on the matter, that the Panel in the US – Section 301 case had “found that even discretionary obligations may violate certain WTO obligations” (Appellate Body Report, United States – Anti-Dumping Act of 1916, WT/DS136/AB/R, DS162/AB/R, adopted 26 September 2000, at footnote 59).*

1.2.2 Exhaustion of Rights

Article 4 TRIPS

Article 6 of the TRIPS Agreement provides that nothing in the Agreement will be considered to address the subject of exhaustion of IPRs for purposes of dispute settlement. Although virtually all Members understood Article 6 to allow each of them to adopt its own policies and rules on the subject of national and international exhaustion, there was sufficient concern over interpretative questions raised by certain Members that the Doha Declaration on the TRIPS Agreement and Public Health made clear that each Member is allowed to adopt its own policies with respect to exhaustion, without being subject to dispute settlement.

Doha Declaration

The concept of “exhaustion” of IPRs may not be well known to those who are not familiar with IP law. The concept exists because of a fundamental difference between intellectual “property” and tangible (or physical) property. That is, IP is embodied in goods and services, but it is not the goods and services themselves. Generally speaking, when a tangible product (such as a can of soda) is sold and transferred, the seller has no further claim on the product, and the buyer can dispose of it as he or she wishes. The holder of an IP right (such as a trademark), on the other hand, generally does not give up his or her right to the IP when a product that embodies it is sold and transferred. The IP holder continues to hold the IP right. The “exhaustion” question concerns whether that right can be used to control the further disposition of the product.

Consider the famous “Coca-Cola” trademark displayed on a can of soda. When you purchase a can of Coca-Cola, you do not buy the Coca-Cola trademark itself. You buy the can with the soda inside it. That soda has been identified by the trademark as the product of a particular enterprise. The Coca-Cola Company has not given up its interest in its trademark such that you can begin to produce your own Coca-Cola. Conversely, the fact that the Coca-Cola trademark remains on the can after you have purchased the soda does not give the Coca-Cola Company the right to prevent you from selling the can you have purchased to someone else, or the right to prevent you from drinking the soda. When Coca-Cola sells the can of soda to you, it “exhausts” its rights in the trademark such that it may no longer control the subsequent disposition of the product. All national IPRs regimes recognize some doctrine of exhaustion; otherwise, IPRs holders would control virtually all aspects of economic activity by maintaining control over goods and services after they had been “first sold” and transferred.

WTO Members have not agreed on uniform rules regarding whether exhaustion of IPRs should have a “national” or “international” character. Under a doctrine of international exhaustion, if a product is lawfully placed on the market in one WTO Member, the holder of a “parallel” IP right in another Member is not able to control its importation or resale based on that parallel IPR. Under a doctrine of national exhaustion, the lawful marketing of the product in one WTO Member does not affect the rights of a “parallel” IP holder in another Member, and the IP holder in the other Member may use its parallel IPR to

block the importation and further disposition of the product. Some WTO Members follow a rule of international exhaustion, and some a rule of national exhaustion. It is not uncommon for Members to have different exhaustion rules with respect to different types of IPR.

While Article 6 and the Doha Declaration establish beyond doubt that each Member is entitled to allow international exhaustion and so-called “parallel importation” of IPRs protected goods, this does not mean that an exhaustion policy will never be challenged in WTO dispute settlement. This is because the term “exhaustion” is not self-defining, and a Member might bring a claim against another Member asserting that it has adopted an unreasonable definition of the concept of exhaustion. Thus a panel and the Appellate Body (AB) might be called upon at some point to determine what the limits on the scope of the exhaustion principle are.

1.2.3 Objectives and Principles

Article 7 TRIPS

Articles 7 and 8 of the TRIPS Agreement refer to the objectives of the Agreement and to principles that generally apply to its interpretation and application. Article 7 confirms that the IPRs are intended to reflect a balance between the interests of private stakeholders that are relying on IP protection to provide an incentive for creativity and invention (and investment in those activities), and society that is expected to benefit from access to creations and the transfer and dissemination of technology. Article 8:1 indicates that Members may adopt, *inter alia*, measures necessary to protect public health and nutrition, provided that those measures are consistent with the Agreement. The Article 8:1 formulation may assist in the defence of so-called non-violation nullification or impairment claims, if these are eventually permitted under the Agreement. In more general terms, the usefulness of Article 8:1 in dispute settlement is limited by the requirement that measures be consistent with the Agreement, in contrast to the formulation of Article XX of GATT 1994 and Article XIV of GATS, each of which makes provision for measures that are necessary and otherwise “inconsistent” with the Agreement. The formula set forth in Article 8:1 is controversial.

Article 8:1 TRIPS

Article 8:2 TRIPS

Article 8:2 acknowledges the *right* of Members to take action against anticompetitive practices relating to IP, also with the proviso that such action must be consistent with the Agreement.

The role of Articles 7 and 8 in dispute settlement has so far been limited. These provisions have been invoked as an aid in interpretation, but have not exercised an identifiable influence on the outcome of cases.

1.2.4 *The Relationship of the TRIPS Agreement to the WIPO Conventions and Treaties*

Article 2 TRIPS

The TRIPS Agreement is unique among the WTO agreements in that it incorporates provisions of various pre-existing Conventions into its body of rules, the most important of which are the *Paris Convention on the Protection of Industrial Property* and the *Berne Convention on Literary and Artistic Works*.⁶ Article 2 of the TRIPS Agreement generally defines the relationship with the WIPO Conventions. It requires Members to comply with the relevant provisions of the Conventions, and also provides that nothing in the TRIPS Agreement will be deemed to derogate from the obligations of parties to the Conventions. In the latter respect, it should be noted that while the TRIPS Agreement may not interfere with “obligations” under the Paris and Berne Conventions, it is theoretically capable of modifying “rights” that Members may have under those Conventions.

Because the WIPO Conventions have been in force far longer than the TRIPS Agreement, some interesting issues of international treaty law are raised regarding the relationship of state practice under the Conventions with interpretation of the TRIPS Agreement. Assume, for example, that a question arises in TRIPS dispute settlement regarding the interpretation of a provision of the TRIPS Agreement that is established by incorporation of a provision of the Berne Convention. Assume further that over the course of the Berne Convention’s history, a number of national courts have interpreted that provision to have a particular meaning. Is a WTO panel bound by the interpretation derived from prior state practice under the Berne Convention? What if one of the Members party to the TRIPS Agreement was not party to the Berne Convention at the time the earlier national court decisions were adopted?

We have already seen the Appellate Body and panels relying on documents produced by the WIPO Secretariat (the “International Bureau”) as a source for interpreting the relevant Conventions.

1.2.5 *The Doha Declaration on the TRIPS Agreement and Public Health*

Doha Declaration

On 14 November 2001, the WTO Ministerial Conference in Doha adopted the *Ministerial Declaration on the TRIPS Agreement and Public Health*. Though there is some debate about the precise legal character of this Declaration, it is clear that it will be used as a source of interpretation of the *TRIPS Agreement* in future dispute settlement.⁷ The Doha Declaration will have very specific application in the field of public health later. In a more

⁶Also incorporated are the *Rome Convention and Treaty on Intellectual Property in Respect of Integrated Circuits*

⁷This author is inclined to view the Declaration as a “decision” of WTO Members on the interpretation of the Agreement since it is framed in terms of “We agree” (see para. 4). Some view the declaration as a “statement” of the Ministers.

general sense, the Doha Declaration affirms the right of Members to take advantage of the flexibility inherent in the *TRIPS Agreement*, and affirms and clarifies the meaning of provisions relating to compulsory licensing and parallel importation. The Doha Declaration authorizes an extension to least developed Members regarding the implementation and enforcement of pharmaceutical patent protection, the scope of which may well become the subject of dispute settlement. Pursuant to paragraph 6 of the Doha Declaration, by the end of 2002 there should be a recommendation from the TRIPS Council to deal with the issue of compulsory licensing predominantly to meet export demand in the field of medicines.

1.3 Approaching WTO Dispute Settlement

The general provisions of the *TRIPS Agreement* referred to above suggest certain questions that should be asked by diplomats and lawyers when facing a claim of non-compliance with its terms.

- Does the complaint involve a very precise rule, or is it one where there is substantial flexibility? If the latter, have other WTO Members implemented the rule in a way that is similar to the practice being challenged?
- Is the challenge based on an alleged failure to adopt or implement a TRIPS rule? If it is, does the Member being challenged recognize a doctrine of direct effect of treaties so that the *TRIPS Agreement* may itself be considered as part of national law.
- Is the challenged rule mandatory or discretionary? Has the government actually acted in a way inconsistent with TRIPS obligations, or has it only been granted powers wide enough to allow it to do so?

1.4 Test Your Understanding

1. **What is the doctrine of “direct effect” of treaties in international law? How might this doctrine be important in the TRIPS dispute settlement context?**
2. **What is the doctrine of exhaustion of intellectual property rights and how does it affect so-called “parallel importation”?**
3. **Does the *TRIPS Agreement* include a general exemption provision similar to Article XX of the GATT 1994? If there are differences between the approach of these two agreements to the question of exceptions, what do you think might account for this?**

2. THE TRIPS AGREEMENT AS A BODY OF SUBSTANTIVE RULES

Objectives

On completion of this section, the reader will be able:

- to identify the forms of intellectual property addressed by the *TRIPS Agreement*, and the basic rules that are generally applicable to them. This includes copyright, trademark, geographical indication of origin, industrial design, patent, layout-design of integrated circuits and protection of undisclosed information.
- to explain that the *TRIPS Agreement* incorporates rules of WIPO Conventions which address its subject matter.
- to appreciate that obligations to protect IPRs are subject to important exceptions.

2.1 The Establishment of Substantive Norms

2.1.1 Express Provision and Incorporation

One of the principal motivations for negotiation of the *TRIPS Agreement* was the perception among developed country contracting parties of GATT 1947 that the substantive standards for IP protection established in the WIPO Conventions were inadequate to address the needs of their business sectors in the “post-industrial era” or “information age”. The perception of weakness on substantive protection grounds was mainly directed to the Paris Convention rules on patents, though other areas of concern were raised. Because the legal regimes established by the WIPO Conventions embody a high level of technical detail, and had evolved over the course of a century through implementation in national legislation, court decision and so forth, it was considered unnecessary and inefficient to attempt to entirely replace the WIPO Conventions with a new body of international legal rules.

The *TRIPS Agreement* thus frames its substantive rules both by expressly stating applicable rules in certain subject matter areas, and by incorporating provisions of the WIPO Conventions with modifications and supplementary provisions in other areas. In many instances, the *TRIPS Agreement* may only be understood when read in conjunction with a related WIPO Convention.

2.1.2 Scope of Subject Matter Coverage

Article 1:2 TRIPS

The *TRIPS Agreement* provides in Article 1:2 that “[f]or the purposes of this Agreement, the term ‘intellectual property’ refers to all categories of intellectual property that are the subject of Sections 1 through 7 of Part II”. This definition appears to constitute a deliberate effort on the part of the negotiators to limit the applicability of *TRIPS Agreement* rules to specific forms of IP addressed in the Agreement. New forms of IP, or “marginal” forms of IP (such as sui

generis “database” protection), would not automatically be brought within the scope of the Agreement. However, as with most aspects of the *TRIPS Agreement*, matters are not so clear cut. For example, the Appellate Body decided in the *US – Section 211 Appropriations Act* case that “trade names” are within the scope of the Agreement even though not expressly addressed, principally on grounds that trade names are the subject of a provision of the Paris Convention (Article 8) that is incorporated by reference in Article 2:1 of the TRIPS. This is not to suggest disagreement with the Appellate Body on this account, but rather to indicate that what is within and outside the scope of the *TRIPS Agreement* may not always be easily determined.

2.1.3 Subject Matter Areas

Part II of the *TRIPS Agreement* expressly addresses the fields of copyright, trademark, geographical indication, industrial design, patent, lay-out design of integrated circuits, undisclosed information and control of anticompetitive practices. For each subject matter area, the *TRIPS Agreement* elaborates the basic substantive standards that Members are expected to implement and apply within their legal systems.

2.2 Copyright and Related Rights

2.2.1 Incorporation of Berne

Article 9:1 TRIPS

The *TRIPS Agreement* substantive provisions on copyright primarily involve incorporated provisions of the Berne Convention (Articles 1 through 21, and the Appendix). As such, in a dispute settlement proceeding, a panel or the Appellate Body will be called upon to interpret the relevant provisions of the Berne Convention within the framework of the *TRIPS Agreement*.

2.2.2 Idea-expression Dichotomy

Article 9:2 TRIPS

Copyright protects the interests of authors and artists in their literary and artistic works and concerns the “expression” of the author or artist, in contrast to his or her “idea”. Article 9:2 of the *TRIPS Agreement* acknowledges the so-called “idea-expression dichotomy” that has evolved through a long history of legislative and judicial interpretation of the Berne Convention and national copyright law.

To illustrate the distinction, the idea of writing a book about wizards and witches probably is as old as book writing itself. Yet in the past several years, an author has earned a great deal of money by writing a popular series of children’s books concerning a young man’s coming of age in a school for wizards and witches. The author of this series cannot through copyright protection of her books prevent other authors from writing new books about wizards and witches. That would represent an attempt to control the use of an idea. What the author may be able to prevent is the use by others of a particular

way of expressing an idea, such as describing specific individuals or the details in a storyline.

2.2.3 *Supplements to Berne*

Article 11 and 14 **TRIPS**

The *TRIPS Agreement* adds certain new elements to the rules of the Berne Convention (as well as to rules of the Rome Convention on Performances, Phonograms and Broadcasts) in areas such as rental rights, and performance and broadcast rights. Therefore, WTO Members that are parties to the Berne Convention and that implemented its requirements in national law must still adopt new rules to take into account the TRIPS copyright provisions that supplement the Berne Convention.

2.2.4 *Specificity*

The Berne Convention contains rules of varying levels of specificity. Some rules, such as those describing the subject matter of copyright, are rather detailed. Even then, there is substantial room for interpretation because technology is rapidly evolving, and this outmodes the terminology of the Convention. Other rules, such as those establishing permissible exceptions that may be accorded to copyright protection, are drafted very generally, and are therefore capable of flexible implementation.

2.2.5 *Options, Including Fair Use*

The Berne Convention by its express terms provides Members with choices as to whether to apply protection and what form of protection to apply. For example, Article 2(4) of the Berne Convention authorizes each Member to decide whether it will provide copyright protection “to official texts of a legislative, administrative and legal nature”, and to what extent. Since there is a substantial publishing industry built around supplying legislative texts to the public, it is easy to imagine a complaint from that industry that a Member is failing to adequately protect legislative texts against copying. But neither the *TRIPS Agreement* nor the Berne Convention requires such protection, and this is part of the flexibility reserved to Members. This illustrates the importance of recognizing that the *TRIPS Agreement* provides rights to Members, and not only obligations.

The most controversial copyright provisions of the *TRIPS Agreement* and Berne Convention are likely to be those addressing the “fair use” of copyrighted works, principally Article 13 of the *TRIPS Agreement* and Articles 9(2), 10 and 10*bis* of the Berne Convention, incorporated by reference in the *TRIPS Agreement*. This hypothesis is based on the fact that the rights of fair use are among the most heavily litigated within national legal systems, including within the OECD countries.⁸

⁸ For example, the well-known “Napster” case involving the provision of digital recordings over the Internet involved a “fair use” defence by Napster.

2.2.6 The National Constitution and Copyright

Another important set of questions that may provoke WTO dispute settlement involves the relationship between “free speech” and copyright as a matter of national constitutional law. Many countries recognize freedom of speech in their national constitutions (and this right is reflected in various human rights instruments). Copyright protection almost by definition operates as a constraint on free speech. The *TRIPS Agreement* does not address the extent to which freedom of speech as a constitutionally protected right may take precedence over the interests of copyright holders. It is not so difficult to foresee a Member defending a TRIPS copyright claim by invoking its constitution and the freedom of speech. In the *India – Patents (US)* case the Panel and Appellate Body addressed certain questions of Indian constitutional law as they affected the administration of patents, and indicated that the substance of national constitutional rules might be a question of fact in WTO dispute settlement.⁹ The question of the range of constitutional protections a Member might offer its citizens is of a different character, and it remains to be seen whether the WTO dispute settlement system might attempt to constrain a Member’s basic constitutional choices.

2.3 Trademark

2.3.1 Incorporation of Paris Convention

The Paris Convention addresses the subject of trademark. Relevant provisions of that convention are incorporated in the *TRIPS Agreement* (noting that several Paris Convention provisions are common to patent and trademark). *TRIPS Agreement* provisions on trademark, however, expand considerably on the rules of the Paris Convention that were primarily (though not exclusively) directed at the procedures for securing registrations, rather than at substantive aspects of trademark protection. As noted earlier, the incorporation of Article 8 of the Paris Convention in the *TRIPS Agreement* has led the Appellate Body to conclude (in the *US – Section 211 Appropriations Act* case) that trade names are regulated by the *TRIPS Agreement*.

2.3.2 The Subject Matter of Trademark Protection

Article 15:1 TRIPS

Article 15 of the *TRIPS Agreement* is the first multilateral effort to define the nature of the trademark; that is, any sign capable of distinguishing the goods or services of one enterprise from another. Article 15:1 includes a non-exhaustive listing of such signs, including letters, numbers, figurative elements and combinations of colours. When such signs are not inherently distinctive, a Member may make registrability dependent on use.

Article 15:3 TRIPS

Traditionally, a broad range of signs and symbols has been accepted for registration and protection by national governments, though there are borderline

⁹ *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products, complaint by the United States*, WT/DS50/AB/R (“*India – Patents (US)*”).

areas such as single colours and fragrances that continue to draw different results.

**Article 15 and 16
TRIPS**

Articles 15 and 16 of the *TRIPS Agreement* provide that “service marks” and trademarks will essentially be given equivalent regulatory treatment, which was not required by the Paris Convention. “Service marks” have long been in common use, for example, in connexion with banking and financial services, tourism and transport, professional services and so forth.

Article 15:5 TRIPS

Article 15:5 of the *TRIPS Agreement* requires that Members provide for publication and the availability of procedures for the cancellation of trademark registration.

2.3.3 Trademark ownership

Article 15:2 TRIPS

Article 15:2 of the *TRIPS Agreement* provides that Members may deny trademark registration on other grounds than those of failure to meet the criteria of constituting a distinctive sign, so long as those grounds are not precluded by the Paris Convention. This provision was interpreted in the context of the *Section 211 Appropriations Act* case, in which the Appellate Body decided that the United States could deny the registration of a trademark when it determined that the party asserting a right to registration was not the legitimate owner of the mark. This case establishes a very important principle for the implementation of the *TRIPS Agreement* that is, it is up to Members to decide who are the legitimate owners of IPRs. In *US – Section 211 Appropriations Act* the United States had denied ownership of an IPR on public policy grounds.

2.3.4 The Scope of Trademark Protection

Article 15:2 TRIPS

Article 16 of the *TRIPS Agreement* defines the scope of protection, to allow the holder to oppose the use without its consent in the course of trade of an identical or similar sign on identical or similar goods or services, where such use would result in a likelihood of confusion. The use of an identical sign on identical goods or services raises a presumption of likelihood of confusion.

The definition of the scope of trademark protection in Article 16 allows Members a considerable degree of flexibility regarding the level of protection that will be provided. For example, the basic requirement is that a “similar” sign may not be used on “similar” goods. This might be construed strictly, such that signs and goods must be nearly identical to justify protection, or this might be construed liberally, such that signs and goods need only be within a category or class to justify protection. In fact, different legal systems, and different courts within the same legal system, may differ on the way these concepts are applied. There are other flexibilities built into Article 16.

Article 16 of the *TRIPS Agreement* supplements Paris Convention rules on “well known” marks, essentially limiting the class of persons to whom a trademark or service mark must be well known in order to qualify for protection.

2.3.5 Exceptions and Fair Use

Article 17 TRIPS

There are a variety of circumstances under which it may be necessary or useful to permit the use of a trademark or service mark outside the specific context of the marketing of the particular good or service on which it is used by its holder. These circumstances are addressed in a broad way by Article 17 of the *TRIPS Agreement* which permits limited exceptions, such as the fair use of descriptive terms.

The writer of a news story regarding a company and its products may refer to the products by their trademark since there is a public interest in this type of reference. The writer of a satire or parody might refer to a trademarked product in the interests of promoting freedom of expression. There are important public health issues in fair use of trademarks. For example, generic drug producers may consider it important to mimic the colour of branded medicines so as to avoid confusion among consumers. The flexible character of Article 17 would appear to permit each WTO Member the scope to decide whether a limited exception for this type of use should be provided, though there is debate over the extent to which fair use of such colours is permitted. By restricting the extent to which a single colour may constitute a trademark, Members might provide a basic flexibility for generic drug manufacturers.

2.3.6 Duration and Other Aspects

Article 18 TRIPS

Article 18, *TRIPS Agreement*, establishes that trademark protection is not limited in duration, provided the relevant criteria for maintaining rights in a mark are met, although Members may require that registrations be renewed not more frequently than each seven (7) years. Articles 19 through 21 of the *TRIPS Agreement* provide rules on the requirement of use and other special requirements that might affect the grant and maintenance of trademark protection, and the limitations that might be imposed on the assignment of marks.

2.4 Geographical Indications

2.4.1 Subject Matter

Article 22 TRIPS

Although Article 10*bis* of the Paris Convention (on unfair competition) may deal with the protection of geographical indications in a general sense, the *TRIPS Agreement* is the first multilateral agreement to expressly address this subject matter. Article 22 of the *TRIPS Agreement* defines geographical indication as the name of a territory or locality that identifies a good as coming from that place and where the “quality, reputation or other characteristic of the good is essentially attributable to its geographical origin”.

The legitimacy of a geographical indication is not dependent on an objective demonstration that a good in fact is different or better because it comes from a particular place, though such a demonstration may well be useful in

establishing entitlement to a geographic indication. Instead, the legitimacy of a claim may derive from the “reputation” or “goodwill” that a place has built up for making a good.

To give a well-known illustration, the makers of sparkling wine in the Champagne region of France depend on the name of their region to distinguish their product from those of sparkling wine makers in other places. The makers of German “sekt” may use the same fermentation process, and an expert panel of wine tasters in a “blind test” might not be able to accurately distinguish between the product of the Champagne region and that of Germany. Nonetheless, because the wine producers in Champagne have built up an international reputation for their products, the term “Champagne” has been protected as a geographical indication.

A geographical indication is distinguished from an indication of origin – such as “Made in China” – that only connotes the place of production of a good, and is not intended to denote any particular characteristic of the good. The indication of origin is used by customs and other trade regulatory authorities for various purposes.

2.4.2 Wines and Spirits

Article 23 TRIPS

The *TRIPS Agreement* includes specific rules regarding geographical indications for wine, and to a lesser extent, spirits. This includes a limitation on using terms such as “like” and “type” to distinguish products from outside the place ordinarily attributed to the geographical indication. The rules on wines provide for the establishment of a registry of indications. There are rules regarding the “grandfathering” of pre-existing identical uses of the names of wines as well.

2.4.3 Negotiations

Outside the area of wines and spirits, the *TRIPS Agreement* put off the negotiation of rules for additional subject matter areas until a later date. These negotiations have been commenced in the TRIPS Council, and will continue pursuant to the Doha mandate.

2.4.4 Potential Disputes

The field of geographical indications is one which might reasonably be foreseen to lead to disputes among developing WTO Members. There are competing claims to entitlement to the names of strains of rice and varieties of tea that are popular among consumers around the world, and which originated in particular geographic regions. One of the objectives of the ongoing TRIPS Council negotiations is to develop more precise rules to sort out these competing claims.

2.5 Industrial Designs

2.5.1 *Subject Matter*

Article 25 TRIPS

Industrial design has long been one of the most problematic areas of IP law. Countries have differed regarding how such design should be protected, and the scope of protection that should be accorded.

Article 25 of the *TRIPS Agreement* defines industrial design by reference to “independent” creation and “new or original” character, but allows for exclusion if such designs are essentially dictated by technical or functional considerations. If the design of an aircraft wing, for example, is dictated by the need for an aircraft to stay aloft, the design can be excluded from industrial design protection, though it might be protected by patent if the relevant criteria are met.

2.5.2 *Methods of Protection*

Countries have protected designs through copyright, design patent and design registration, or through a combination of these methods. An industrial design might be protected by copyright because it is an expressive work. Yet copyright does not protect function, and it may be difficult to differentiate between the expressive and functional elements of a design. Design patent is distinguished from the patent on invention (or “utility patent”) by the requirement that a new design should be aesthetic, and not useful or functional. As with copyright, it is often difficult to separate the aesthetic characteristics of a product from its usefulness. Registration systems are typically characterized by the relative ease by which parties can list their designs, though the registration creates only a presumption in favour of the registrant that may be challenged in administrative or court proceedings.

Article 25:2, *TRIPS Agreement*, obligates Members to facilitate the protection of textile designs.

2.5.3 *Scope and Duration*

Article 26 TRIPS

Article 26:1 of the *TRIPS Agreement* requires that design right holders have the right to prevent others without consent from making, selling or importing articles bearing copied or substantially copied designs, for commercial purposes. Article 26:2 allows for limited exceptions, along the lines of the provisions regulating exceptions in copyright, trademark and patent. This again provides substantial flexibility.

Members must provide a minimum ten (10) years protection for industrial designs.

2.6 Patent

2.6.1 *The Paris Convention*

The Paris Convention was adopted in 1893 to establish a potentially worldwide mechanism for allowing patents to be obtained, and prescribing the basic requirements for registration systems, including the rule of national treatment for patent applicants. However, the Paris Convention did not prescribe substantive rules for many aspects of patenting, such as the scope of subject matter protection, the criterion for entitlement to protection, or the duration of protection. When the Uruguay Round and TRIPS negotiations began in 1986, there was wide variation among nations regarding the nature and scope of patent protection.

The *TRIPS Agreement* incorporates the provisions of the Paris Convention regulating patents, and supplements those provisions with substantive and procedural rules. As noted earlier, Article 2:1 of the *TRIPS Agreement* obligates compliance with relevant provisions of the Paris Convention, while Article 2:2 precludes derogation from existing obligations under that agreement.

2.6.2 *Differences in Perspective*

The TRIPS negotiations on patents were the most contentious, with developing Members for the most part taking a decidedly different view from the developed Members regarding the merits of extending high levels of patent protection to economies with limited resources to purchase higher priced goods, and with more limited research and development capacity. Despite an agreement on patent protection in the *TRIPS Agreement*, there remain important differences in perspective on the benefits of extensive patent protection. These differences were evident in the negotiations that led to adoption of the *Doha Declaration on the TRIPS Agreement and Public Health*, and continue to be discussed in the TRIPS Council.

2.6.3 *Subject Matter Scope*

Article 27:1 TRIPS

Article 27:1 of the *TRIPS Agreement* provides broad subject matter scope for patent protection, extending it to products and processes in all fields of technology. It also provides that Members will not “discriminate” with respect to the enjoyment of patent rights based on the place of invention, field of technology, or whether products are imported or locally produced. The non-discrimination provisions in Article 27:1 are the subject of a WTO panel report in the *Canada – Pharmaceutical Patents* case that is discussed in more detail later on.¹⁰ However, it might be noted here that the Panel in that case made clear that “discrimination” in Article 27:1 is a pejorative or negative term that means something other than “differentiation”. Members may treat different

¹⁰ *Canada – Patent Protection of Pharmaceutical Products, complaint by the European Communities, WT/DS114 (“Canada – Pharmaceutical Patents”).*

fields of patent protection differently if they do so for a legitimate regulatory purpose.

The question whether Members may impose “local working” requirements for patents depends to a certain extent on how Article 27:1 is interpreted. That is, while requiring patent holders to produce their products within a particular territory, a Member may create a distinction between imported products and locally produced products. There is debate, however, as to whether that distinction amounts to discrimination, or whether it may be justified on policy grounds. The local working question also ties in to Article 5.A of the Paris Convention that regulates compulsory licensing. The United States initiated a complaint in WTO dispute settlement against Brazil alleging a violation of the patent provisions of the *TRIPS Agreement* based on a local working requirement, but the United States later withdrew its complaint. Since other Members maintain or are adopting local working requirements, it is likely that this issue will be raised again in dispute settlement.

Article 27:1 of the *TRIPS Agreement* also sets out the basic criteria for the grant of patents; that is, inventions must be new, capable of industrial application, and involve an inventive step. These criteria were common to the major patent systems prior to the *TRIPS Agreement*, but the meaning of each of the criterion is the subject of extensive administrative rule-making, judicial decision and scholarly debate. Inherent in any decision whether to grant or deny patent protection to a claimed invention are numerous judgments by patent examiners. This feature of patent protection provides considerable flexibility to national legal systems.

Article 27:2 TRIPS

Article 27:2 and 27:3 permit exclusions from the subject matter scope of patent protection. Article 27:2 speaks broadly in the context of exclusions necessary to protect ordre public, public health and the environment, arising out of commercialization of the invention. Although there are commentators that suggest these exclusions are to be construed narrowly, it is not clear from the text that this is required. There is the potential for dispute inherent in these broadly formulated grounds for exclusion.

Article 27:3 TRIPS

The exclusions in Article 27:3 are framed more narrowly, yet again leave substantial room for interpretation. For example, Article 27:3(a) permits the exclusion of “therapeutic methods” for the treatment of humans. The use of pharmaceuticals is a method of therapy for treating human health conditions, and so arguably (and no doubt controversially) a Member could exclude the use of drugs for medical treatment from patent protection. Article 27:3(b) allows for the exclusion of animals and plants from patent protection, but does not allow this exclusion for certain “microbiological” products and processes. This language is highly ambiguous. Article 27:3(b) requires Members to provide plant variety protection either through patent or a sui generis form of protection. This provision is subject to further negotiations in the TRIPS Council.

2.6.4 Scope of Protection

Article 28 TRIPS

Article 28:1 of the *TRIPS Agreement* establishes basic rights of the patent holder, which is to preclude others without consent from the acts of making, using, selling, offering for sale or importing the patented product, or using the patented process (including importing products made with the process). Article 28:1 is cross-referenced by footnote to Article 6 of the *TRIPS Agreement* that precludes *TRIPS Agreement* dispute settlement on the question of exhaustion of rights.

The rights to preclude others from making, using, selling, offering for sale and importing are commonly referred to as the “enumerated” rights of patent holders since they are expressly provided for in Article 28. By way of contrast, Article 28 does not expressly confer a right to “export” patented products, though since a product may need to be “made” or “sold” to be exported, it might be difficult to undertake export of a patented product without contravening one of the enumerated rights.

Within each of the enumerated patent holder rights there are interpretative questions. For example, at what point is a patented invention “made”? If a person builds the various component parts of an invention, but does not assemble them, does that constitute “making”?

2.6.5 Disclosure

Article 29 TRIPS

Part of the bargain between the patent holder and society is that the patent applicant undertakes to disclose the invention in a manner that will allow others to carry out the invention. Article 29 of the *TRIPS Agreement* requires that patent applicants undertake sufficient disclosure.

2.6.6 Exceptions

Article 30 TRIPS

In light of the intensive debate concerning the appropriate scope of patent protection, it should not be surprising that the scope of permitted exceptions to such protection under Article 30 would likewise be the subject of controversy. The Paris Convention did not prescribe the scope of patent subject matter coverage, and in that context a provision on permitted exceptions was not required. After failing to agree on a list of permitted exceptions, the negotiators of the *TRIPS Agreement* borrowed the exceptions formula used in the Berne Convention, with some modifications. The Article 30 text leaves considerable scope for interpretation, and while a WTO panel in the *Canada – Pharmaceutical Patents* case provided one such interpretation, it certainly did not resolve the many questions surrounding the meaning of Article 30.

Article 30 employs a three-pronged test for evaluating exceptions. The exceptions should be “limited”, they should not unreasonably interfere with the normal exploitation of the patent, and they should not unreasonably prejudice the rights of the patent holder, taking into account the legitimate interests of third parties.

The ordinary meaning of the terms in Article 30 would appear to allow considerable flexibility to Members in adopting exceptions to the rights of patent holders. In the discussion of the *Canada –Pharmaceuticals Patents* case the text of Article 30 will be explored.

2.6.7 Other Uses

Article 31 TRIPS

Article 31 of the *TRIPS Agreement* addresses authorization of third parties to use patents without the consent of patent holders. This authorization is ordinarily understood to refer to the practice of “compulsory licensing”. However, since Article 31 also covers government use of patents for non-commercial purposes, the terminology of Article 31 is not specifically addressed to compulsory licensing.

Article 31 does not limit the grounds upon which compulsory licenses may be granted. It provides procedures that should be followed in granting such licenses, and requires that certain minimum obligations be fulfilled:

- each licence should be considered on its own merits (Article 31(a));
- there should be prior negotiations for a reasonable commercial licence with the patent holder, except in the case of national emergency, extreme urgency, or public non-commercial use (Article 31(b));
- the patent holder is entitled to adequate remuneration in the circumstances of the case (Article 31(h));
- the licence should be granted predominantly for the supply of the local market (Article 31(f))
- the licence should be non-exclusive (Article 31(d)); and
- there should be opportunity for review by independent authority of the grant of the licence and the terms of remuneration (Articles 31(i) & (j)).

When a compulsory license is granted to remedy anticompetitive practices, the restriction on predominant supply of the domestic market does not apply, and remuneration may take into account the remedial nature of the licence (Article 31(k)).

The instrument of compulsory licensing provides a critical tool for Members in seeking to balance the interests of the public and those of patent holders. There are a variety of circumstances in which allowing a patent monopoly to persist would injure the public interest to the extent that providing exclusive market access to the patent holder cannot be justified. A maker of electronic equipment might find itself unable to compete in international markets if its access to a single technological component is denied by patent protection, and it might be in a Member’s interest to grant a licence assuring access to the protected technology in order to ensure the survival of local industry. In the public health sector, patent protection may restrict access to medicines among a large segment of the population by preventing competition from generic

medicines, and it may be antithetical to a wide public interest to permit such a situation to persist. In these cases, compulsory licensing is available to provide an effective remedy. Often, the mere threat of a compulsory licence will cause a patent holder to re-evaluate its access or pricing strategy.

Doha Declaration

The *Doha Declaration on the TRIPS Agreement and Public Health* expressly recognized that the *TRIPS Agreement* does not limit the grounds on which compulsory licences may be granted, and acknowledged the right of each Member to determine when a national emergency or circumstance of extreme urgency exists. It also directed the TRIPS Council to seek an expeditious solution to the problem facing Members with insufficient or no manufacturing capacity for pharmaceuticals. The TRIPS Council is to provide a recommendation to the General Council on this subject before the end of 2002. This is a critical issue for developing Members since the world supply of low price generic medicines will undergo a significant contraction after January 1, 2005 when developing countries are required to implement pharmaceutical patent protection, and when drugs within the so-called “mailbox pipeline” are brought under patent protection.

Although developing Members have so far rarely granted compulsory licences, as they gain experience in the implementation of patent laws this practice will almost certainly become more prevalent. It may reasonably be anticipated that the laws and practices surrounding compulsory licensing will be the subject of TRIPS dispute settlement. In this regard, it is essential to attend to the facts that many developed country Members of the WTO have very broad compulsory licensing powers, and that the terms of Article 31 of the *TRIPS Agreement* and Article 5 of the Paris Convention provide a great deal of flexibility in the way these systems are administered.

2.6.8 Term of Protection and Other Aspects

Articles 32 – 34 TRIPS

The *TRIPS Agreement* provides for a minimum patent term of 20 years from the filing date of a patent application (Article 33). It also provides for judicial review of forfeiture and revocation decisions (Article 32) and regulates the burden of proof in process patent proceedings (Article 34).

2.7 Lay-out Design of Integrated Circuits

Article 35 TRIPS

The subject of the lay-out design of integrated circuits was proposed to be addressed in a WIPO Treaty on Intellectual Property in Respect of Integrated Circuits. However, certain provisions of that agreement did not satisfy the interests of the United States and Japan, in particular. The approach taken in the *TRIPS Agreement* was to incorporate most of the provisions of the Treaty by reference, but to alter and supplement the rules that were deemed inadequate by some Members.

Article 36 TRIPS

The lay-out design of an integrated circuit (IC) or computer chip is typically embodied in a “mask work” that essentially provides a map to guide the

sophisticated computerized equipment that etches circuits on silicon wafers to create the various types of chips used in computers. The *TRIPS Agreement* allows the right holder to prevent the unauthorized reproduction of a protected lay-out design, and the selling or importation of an IC in which that design is incorporated. In order to qualify for protection, a lay-out design must be “original”, that is, different from prior designs, and need not be “novel” in the patent sense of not having been anticipated by prior art. Most Members grant lay-out protection on the basis of registration, but registration is not required by the *TRIPS Agreement* or the WIPO Treaty. The minimum duration for lay-out design protection is ten (10) years from the filing date for registration or the first commercial exploitation wherever in the world it occurs.

Article 38 TRIPS

2.8 Undisclosed Information

2.8.1 Relationship to Paris Convention

Article 39:1 TRIPS

Prior to the *TRIPS Agreement*, there was no multilateral agreement specifically addressing “trade secret” and other protected undisclosed information, although the Paris Convention provision on unfair competition generally encompassed this subject matter. Article 39:1 of the *TRIPS Agreement* acknowledges the applicability of Article 10*bis* of the Paris Convention on unfair competition, and provides specific guidance for its application.

2.8.2 Trade Secret

Article 39:2 TRIPS

Although not referred to by this term, Article 39:2 establishes the requirements for protection of what is commonly referred to as “trade secret”, that is, commercially valuable confidential information. Members are to provide protection against such information being obtained “contrary to honest commercial practices”. Information will be protected if it is not generally known in its precise configuration by those in the relevant sector, if it has commercial value because it is secret, and if the holder has taken reasonable steps to keep it secret. So far, the subject of trade secret protection has not been especially controversial, particularly in light of the fact that most legal systems provided some form of trade secret protection well prior to entry into force of the *TRIPS Agreement*.

2.8.3 Test and Regulatory Data

Article 39:3 TRIPS

Article 39:3 of the *TRIPS Agreement* is among the most controversial provisions of the agreement. It provides that, when Members require the submission for marketing approval of test data regarding new pharmaceutical or agricultural chemical entities that involved considerable effort, Members will take steps to protect such data against “unfair commercial use”. Since generic pharmaceutical manufacturers and compulsory licensees may rely on prior regulatory approval of new chemical entities as the basis for their own regulatory submissions, it would significantly restrict public access to generic medicines if such producers could not rely on these approvals as the basis for their own submissions. There

is an ongoing struggle between research-based pharmaceutical companies and generic producers over the issue of access to and use of test data, and that struggle carries over into the intergovernmental TRIPS arena. The debate over the scope of application of Article 39:3 of the *TRIPS Agreement* is likely to be the subject of dispute settlement, presumably addressing the question of what constitutes “unfair commercial use”.

2.9 Competition Rules

Article 40 TRIPS

IPRs by their nature inhibit competition by according holders the right to exclude others from the market. Developed Members with experience in the implementation of IPRs have long used competition (or antitrust) laws to address problems associated with uses of IPRs that unreasonably restrain competition. Article 40:2 of the *TRIPS Agreement* acknowledges the legitimate interest of Members in addressing “licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market”. A non-exhaustive illustrative list of such practices includes “for example exclusive grantback conditions, conditions preventing challenges to validity and coercive package licensing, in the light of the relevant laws and regulations of that Member”.

Article 40 does not obligate Members to address conditions affecting competition. It provides for sympathetic consideration to consultation requests among Members intended to secure cooperation in investigating alleged anticompetitive practices. The only obligation imposed on a Member from which cooperation is sought is to provide publicly available non-confidential information, and other information subject to the conclusion of mutually satisfactory agreements to safeguard confidentiality.

While most developed Members maintain vigorous competition law agencies with broad and effective enforcement powers, this type of enforcement agency is not common in developing Members. This creates the possibility of an imbalance between the market power of IPRs holders in developing Members and the interests of the general public in those Members in the maintenance of competitive markets.

Competition laws are an extremely powerful tool for correcting market failures, and as developing Members increase their capacity to use these tools conflicts may arise over the extent to which Members may use competition laws to address IPRs-related market failures. It is again important to stress that the *TRIPS Agreement* provides only general guidance regarding the application of competition law, leaving to the discretion of each Member the level at which it will choose to intervene to protect the public interest in competitive markets. Ongoing negotiations regarding the relationship between trade and competition rules may result in further WTO agreements or decisions regarding implementation and application of Article 40.

2.10 Approaching WTO Dispute Settlement

The *TRIPS Agreement* establishes minimum substantive standards for the establishment of rights to IP. However, it is addressing a subject matter of very broad scope with rules that are deliberately designed to provide Members with substantial flexibility in their implementation. Predicting the specific issues that will be raised in dispute settlement would be rather difficult in light of the broad scope of potential subject matter. However, based on experience under the *TRIPS Agreement* so far, a few basic points are worth making:

- Some industries are very aggressive about asserting rights in IPRs, and also exercise substantial influence over external commercial relations agencies in their home countries. Claims are made by some Members regarding inadequate IPRs protection that are not well-founded under the terms of the *TRIPS Agreement*. However, the lack of experience in many Members in addressing IPRs issues leads to a high level of concern regarding the potential for being drawn into a WTO dispute settlement proceeding. When a claim is brought to the attention of government, it should be examined very carefully to determine whether it does in fact involve a potential violation of substantive TRIPS standards. If there are doubts on this question, the advice of independent IPRs experts should be sought. It is critical to recognize that even among legal systems in the technologically most advanced Members, there are substantial differences in approach to substantive regulation of IPRs. There is rarely a single correct answer to an IPRs question.
- It is always useful to look for precedents among Members that is, how other Members have implemented and applied rules. In addition to examining statutes and regulations, it is important to review judicial decisions that provide insight into the subtleties of statutory language. There is a very substantial body of academic texts that explain the nature of IPRs and address the different approaches that may be taken in applying them.
- Legal regimes are typically framed in terms of rules and exceptions to them, and the *TRIPS Agreement* is typical in this respect. The *TRIPS Agreement* rules on copyright, trademark and patent each include an exception provision that permits Members to carve out certain practices from the scope of protection. Since the exception provisions in trademark and patent are without precedent in the Paris Convention, the scope of permissible exceptions is not well settled. It is important to recognize that merely because a certain kind of exception has not traditionally been used by particular Members, this does not mean that the WTO Dispute Settlement Body would refuse to accept it as legitimate.

2.11 Test Your Understanding

- 1. What kinds of subject matter are protected by copyright? What kinds of subject matter are excluded from copyright protection?**
- 2. What is the function of a trademark? Is the “fair use” of a trademark permitted?**
- 3. What is a geographical indication of origin? How is it distinguished from a trademark?**
- 4. What exceptions to the rights of patent holder’s does the *TRIPS Agreement* allow? Under what articles are these exceptions found?**

3. TRIPS AGREEMENT RULES ON ENFORCEMENT

Objectives

On completion of this section, the reader will:

- be able to recognize the *TRIPS Agreement* is minimum standards for the enforcement of IPRs that generally allow right holders to protect their legitimate interests through civil court or administrative proceedings. Those who are challenged also are to enjoy the protection of due process of law.
- To appreciate that the *TRIPS Agreement* does not require a WTO Member to establish special or separate courts for IPRs, and that Members are not required to specially allocate resources to IPRs enforcement.

3.1 General Provisions

Part III TRIPS

The proponents of the *TRIPS Agreement* in the Uruguay Round were concerned not only that minimum substantive IPRs standards be adopted, but also that they be capable of application. As noted earlier, the *TRIPS Agreement* preamble characterizes IPRs as private rights, and this implies that private right holders are responsible for seeking the enforcement of those rights. The *TRIPS Agreement* Part III on Enforcement of IPRs takes the approach of obligating Members to establish administrative and judicial mechanisms through which private IPRs holders can seek effective protection of their interests.

It is implicit in all international agreements that their parties will undertake to implement them in good faith.¹¹ The Paris Convention includes obligations regarding the enforcement, among others, of trademark rights with respect to infringing imports (Articles 9-10). The *TRIPS Agreement* may nonetheless be characterized as the first multilateral effort to regulate the internal administrative and judicial mechanisms that countries are obligated to maintain with respect to the application of a set of agreed upon legal rules. Because of the novelty of this endeavour, there are few readily available answers regarding how the requirements of *TRIPS Agreement* Part III will be interpreted or applied.

Article 41 TRIPS

The general obligation of Members to provide enforcement mechanisms requires that enforcement procedures “are available under their law so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements”.¹² Members are obligated to ensure that enforcement procedures are “fair and equitable”, and “not unnecessarily complicated or costly, or entail unreasonable time limits or unwarranted delays”. There is additional provision on written decisions, opportunities to present evidence, and obligation to provide judicial review for administrative decision in particular

¹¹ Vienna Convention on the Law of Treaties, Article 26.

¹² Article 41:1 of the *TRIPS Agreement*.

contexts.¹³ Article 41:5 establishes two important principles. First, Members are not required to establish separate judicial systems for the enforcement of IPRs, as distinct from general law enforcement. Second, there is no “obligation with respect to the distribution of resources as between enforcement of intellectual property rights and the enforcement of law generally”. The latter point is relevant to the question under what conditions a Member may be subject to dispute settlement, not for failing to adopt adequate enforcement rules, but rather for failing to “effectively” apply them. If a Member generally does not have adequate resources or capacity in the administration of its civil legal system, it should be under no special obligation to focus its attention on TRIPS enforcement matters.

3.2 Civil and Administrative Procedures and Remedies

Article 42 - 49 TRIPS

Articles 42 through 49 of the *TRIPS Agreement* establish basic principles for the conduct of civil proceedings to enforce IPRs, such as through actions brought by right holders to enjoin infringement. The rules are largely common among developed legal systems, and include rights in favour of defendants as well as complaining parties. The rules provide that parties should have the opportunity to present and contest evidence, and that adequate remedial measures should be available. There is flexibility inherent in these civil enforcement rules, such as in the area of calculating damages for infringement, as to which there is substantial existing jurisprudence that does not follow a uniform line.

It is of particular interest to note that Article 44:2 of the *TRIPS Agreement* permits Members to exclude the grant of injunctions in circumstances involving compulsory licenses and “other uses”. This provision was adopted to take account of the United States government use provision (28 U.S.C. § 1498) that excludes the possibility of obtaining a civil injunction against government use of a patent, and should be taken into account in the drafting and implementation of compulsory licensing and government use measures in other Members.

3.3 Provisional Measures

Article 50 TRIPS

Article 50:1 of the *TRIPS Agreement* obligates Members to make provision for the ordering of “prompt and effective provisional measures” to prevent entry of infringing goods into channels of commerce and preserve evidence. Article 50:2 requires that judicial authorities have the power to adopt provisional measures “*inaudita altera parte*” (outside the hearing of the other party) where delay may cause irreparable harm. This means that the IPRs holder should be entitled to seek a prompt order whether or not the party alleged to be acting in an infringing manner can be notified and given opportunity to be heard. In this event, the affected party should be notified promptly, and be given an opportunity to be heard and contest the measures that have been taken.

¹³ Articles 41:2 – 41:4 of the *TRIPS Agreement*.

Judicial authorities may require complaining parties to post security in the event that their actions are without merit and damage defendants.

Article 50:6 of the *TRIPS Agreement* requires that, if requested by a defendant, a proceeding on the merits of the action be initiated within a reasonable period, with time limits set forth if not decided by a judge under the law of the Member. The question whether this provision is directly applicable in European Community law was the subject of a referral from the Netherlands to the *European Court of Justice* in *Parfums Christian Dior v. Tuk Consultancy*.¹⁴ The ECJ put the question in the hands of the Netherlands courts since the procedural rule was not within the competence of the EC.

3.4 Special Requirements Related to Border Measures

Articles 51 - 60 TRIPS

Articles 51 through 60, *TRIPS Agreement*, address measures that a Member must adopt to allow certain right holders to prevent release by customs authorities of infringing goods into circulation. Pursuant to Article 51:1 of the *TRIPS Agreement* these procedures need only be established in respect to suspected “counterfeit trademark or pirated copyright goods”, and specifically excludes parallel import goods (that is, according to footnote 13, “imports of goods put on the market in another country by or with the consent of the right holder”). Article 58 provides that equivalent rules should be followed when customs authorities are granted the authority to act against suspected infringing goods on their own initiative.

Generally, the specified right holder should be permitted to lodge an application with the relevant authorities that describes with sufficient particularity the allegedly infringing goods, along with information sufficient to establish a prima facie case of infringement. The applicant may be required to post security sufficient to compensate for potential injury to the importer for abuse, and the importer must also have a right to be compensated in cases of abuse of process. There is provision for notification of the suspension to the importer, and provision for the release of suspended goods by the relevant authorities if a suspension has not been followed by appropriate legal action. The right holder is to be granted a right to inspect allegedly infringing goods, although the authorities may protect confidential information. Competent authorities are to have the power to order destruction or disposal of infringing goods, and a presumption against allowing re-exportation is established.

3.5 Criminal Procedures

Article 61 TRIPS

Article 61 of the *TRIPS Agreement* obligates Members to provide criminal penalties for trademark counterfeiting and copyright piracy on a commercial scale, allowing for the possibility of imprisonment and/or fines “sufficient to provide a deterrent, consistently with the level of penalties applied for crimes of corresponding gravity”.

¹⁴ ECJ *Joined Cases C-300/98 and C-392/98, Dec. 14, 2000.*

3.6 Acquisition and Maintenance

Article 62 TRIPS

The *TRIPS Agreement* includes a separate Part IV regarding the “Acquisition and Maintenance of Intellectual Property Rights and Related Inter-Partes Procedures”. This Part consists solely of Article 62. It provides that Members may apply reasonable procedures and formalities in connexion with the grant or maintenance of IPRs, that registrations will be undertaken within a reasonable period of time, and that service mark registrations will be subject to the same basic Paris Convention procedures as trademark registrations. It also provides that administrative and *inter partes* (that is, between parties) proceedings relating to the grant or revocation of rights will be subject to similar due process protections as those applicable to enforcement proceedings. Finally, there is provision for judicial or “quasi-judicial” review of grant and revocation proceedings, except in cases of unsuccessful opposition claims.

The procedures by which IPRs are granted or denied are of great interest to applicants, those opposing applications and the public. The *TRIPS Agreement* provides limited guidance in this area, leaving Members with considerable discretion with respect to the manner in which their grant and revocation systems are designed. However, this must be understood within the context of the various WIPO treaties that address these types of procedures and proceedings in more detail than the substantive rules that were the primary focus of the TRIPS negotiations.

3.7 Issues for Dispute Settlement

There are two basic types of claims regarding the enforcement provisions of the *TRIPS Agreement* that are foreseeable. The first are claims that Members have failed to adopt laws and establish administrative mechanisms that satisfy the basic requirements of Part III of the Agreement. The second are claims that while Members may have adopted the relevant laws and mechanisms, they are failing to operate them in a manner that is “effective”.

Because the enforcement rules of the *TRIPS Agreement* are unique in the multilateral context, there is little prior international experience to rely on for guidance regarding how these two basic types of claims will be addressed by panels and/or the Appellate Body. The characteristics of legal systems around the world as regards procedure in civil enforcement matters are rather different, stemming from various cultural and legal traditions. In this sense, uniform methods of implementing the enforcement provisions should not be expected. One of the principal questions that panels and/or the Appellate Body will face is how much discretion will be accorded to each Member to follow its own traditions in matters of enforcement.

Even more difficult to predict is how panels and/or the Appellate Body will evaluate claims that Members are failing to “effectively” implement their civil IPRs enforcement systems. The requirement of providing an effective system of enforcement would not appear to be directed at the process or outcome in a single case or controversy, but rather to be more concerned with repeated or

systematic deficiencies. The question is, what quantum of deficiency would constitute TRIPS-inconsistent conduct, and how would this be measured? Also, since Article 41:5 expressly acknowledges that Members need not provide special attention to IPRs enforcement as compared with their general civil legal enforcement regime, there is by definition more leeway in TRIPS enforcement matters allowable to Members with less capacity within their general legal systems.

There have as yet been no TRIPS dispute settlement decisions involving Part III of the agreement.

3.8 Approaching Dispute Settlement

As with the substantive subject matter of the *TRIPS Agreement*, a claim involving the enforcement provisions should be approached with the flexible nature of the relevant provisions in view. A Member is clearly permitted to approach civil enforcement within its own legal traditions, and to implement the enforcement provisions in a way compatible with its existing constitutional and regulatory framework. Throughout their histories, the most technologically advanced countries have gone through periods in which legal attitudes towards intellectual property regimes have differed. As recently as the 1970s, in the United States there was substantial judicial scepticism concerning IPRs and their market restricting characteristics. In the late 1990s, the pendulum had swung towards viewing the market restricting characteristics of IPRs with less concern. As this pendulum swings back and forth, IPRs holders have had less and more success with pursuing civil enforcement claims in the courts. In sum, the legal system and judiciary are entitled to strike an appropriate balance among the various national stakeholders regarding the enforcement of IPRs, provided that basic protections are effectively provided within the provisions of the *TRIPS Agreement*.

- IPRs holders are required to have access to courts or appropriate administrative authorities, and to be afforded basic due process protections. It is not required that right holders be placed in a special category outside the normal civil legal channels. While certain specific requirements must be met, e.g., in respect to the availability of provisional measures, these measures may be those applicable in all civil proceedings. It is mainly in the case of border measures (and customs authorities) that special measures may be required that are distinct from the treatment of other subject matters.
- Developing Members with limited enforcement capacity need not specially allocate resources to IPRs enforcement compared to general law enforcement.

3.9 Test Your Understanding

- 1. Are WTO Members obligated to establish courts or administrative tribunals that specialize in the enforcement of IPRs, such as patent courts?**
- 2. What are “provisional measures” in the context of IPRs enforcement?**
- 3. Are WTO Members obliged to provide for injunctive relief when a compulsory licence is successfully challenged?**

4. THE DISPUTE SETTLEMENT SYSTEM OF THE TRIPS AGREEMENT

Objectives

On completion of this section, the reader will be able:

- to appreciate that the *TRIPS Agreement* dispute settlement system generally relies on the rules of the WTO Dispute Settlement Understanding.
- to explain that non-violation nullification or impairment causes of action were not permitted during the first five years of the *TRIPS Agreement*, and the explicit limitation on such actions was extended by Ministers at least until the Cancun Ministerial in 2003.
- to realize that WIPO has routinely been requested by dispute settlement panels to provide factual information concerning the negotiating history of the WIPO Conventions.
- To appreciate national court decisions interpreting the various WIPO Conventions may be relevant in TRIPS dispute settlement.

4.1 Transparency

Article 63 TRIPS

Article 63 of the *TRIPS Agreement* establishes transparency requirements, which include obligations to publish or otherwise make available legal texts such as laws and judicial decisions. This article establishes an obligation to notify laws and regulations to the TRIPS Council or to WIPO for the common register should that be decided upon. Members are obligated to furnish applicable rules or decisions, or sufficient details about them, at the request of Members who reasonably believe their rights may be affected. Confidential information is entitled to protection.

Absence of transparency is a common problem affecting legal systems, not only in countries with limited capacity. The *India – Patents (US)* case, included a claim of lack of transparency for India's alleged failure to publish the details of its system for receiving and holding patent applications. The Panel found that India failed to meet its transparency obligations, though this finding was reversed by the Appellate Body on DSU procedural grounds.

4.2 Dispute Settlement

Article 64:1 TRIPS

Article 64:1 of the *TRIPS Agreement* provides that the rules of Articles XXII and XIII of GATT 1994, as elaborated by the Dispute Settlement Understanding (DSU), will apply to consultations and dispute settlement under the *TRIPS Agreement*, except as expressly provided in the Agreement. Before turning to the general applicability of the DSU, it is notable that Articles 64:2 and 64:3 address the subject of non-violation nullification or impairment and situation complaints.

4.3 Non-violation in TRIPS

Article XXIII of the GATT 1994 provides for three types of causes of action in GATT dispute settlement: “violation”, “non-violation” and “situation”. The “violation” cause of action is that which is familiar to most lawyers and diplomats. A complained against Member is alleged to have violated a rule set forth in the agreement, resulting in some harm (nullification or impairment of benefits) to a complaining Member. However, since its outset GATT dispute settlement also has included a less typical kind of action based on an allegation that, although a complained against Member has not violated a specific rule, it has acted in a way that deprives the complaining Member of benefits it expected to obtain when it entered into the agreement. This kind of complaint involves a “non-violation” that nonetheless has resulted in a “nullification or impairment of benefits”. The so-called “situation” cause of action has rarely been argued, and has never formed the basis of a decision.

Article 26 DSU

The DSU limits the remedies available in non-violation causes of action such that a Member may not be required to amend or withdraw a non-conforming measure, but may instead face the withdrawal of concessions.¹⁵ Special rules apply to situation complaints that include making adoption of panel reports subject to a rule of consensus.¹⁶

The non-violation cause of action was developed to take into account the circumstance in which a first Member granted a tariff concession to a second Member that presumably would make it easier for the second Member to undertake exports to the first Member. However, after the tariff concession was granted, the first Member grants a subsidy to its local producers that lowers the effective cost and price of their product, and thereby makes it difficult again for exporters to penetrate the local market. Although the first (concession-granting) Member may not have violated the GATT by providing a domestic subsidy, by doing so it deprived the second Member of the benefits of the original concession. Since the GATT was based on reciprocal bargaining and concessions between Members, there was a belief that remedies against indirectly tampering with concessions was needed.

Article 64:2 TRIPS

Article 64:3 TRIPS

Article 64:2 of the *TRIPS Agreement* provided that non-violation and situation complaints could not be brought for five years following entry into force of the Agreement. Article 64:3 directed the TRIPS Council to examine these types of action and make a recommendation to the Ministerial Conference. It provided that acceptance of a recommendation or extension of the five-year moratorium would only be done by consensus. In the Doha Ministerial Decision on Implementation and Related Concerns adopted on 14 November 2001, Ministers directed the TRIPS Council to continue work on a recommendation to be considered at the Fifth Ministerial Conference, and agreed that non-violation and situation complaints could not be initiated prior to that meeting.

¹⁵ Article 26.1(b) of the DSU.

¹⁶ Article 26.2 of the DSU.

During the Uruguay Round negotiations, incorporation of non-violation causes of action in TRIPS dispute settlement was resisted not only by many developing Members, but also by the European Communities. EC negotiators were concerned that the United States might attempt to challenge certain of its market access restrictions in the audio-visual sector using non-violation complaints. Today, many developing Members continue to be concerned that introducing non-violation causes of action into TRIPS dispute settlement will expand the range of complaints that may be brought against them, and they have largely opposed this extension. If non-violation causes of action are introduced in TRIPS dispute settlement, the range of potential complaints will certainly expand, and complex new questions will be brought into the dispute settlement arena.

IPRs are typically framed as negative rights; that is, they grant the holder the right to exclude others from undertaking certain acts. An IPR is not a positive “market access” right in the sense that granting an IPR does not authorize its holder to enter a market. The fact that a person has a copyright in a book or newspaper, and may thereby prevent another person from reproducing or distributing it, does not give the copyright holder the right to sell the book or newspaper in any market.

IPRs holders may attempt to argue that “property” rights are meaningless unless they are accompanied by rights to use them. So, for example, what is the benefit of holding a patent on an invention if the holder is not permitted to sell it? To frame this in the context of a hypothetical non-violation complaint, the patent holder’s rights in the invention are nullified or impaired by the failure to grant market access, even if the patent holder maintains its right to exclude others from the market.

To put this kind of claim into more concrete perspective, consider price controls in the area of patented pharmaceuticals. If a Member recognizes pharmaceutical patents, but imposes regulations that severely limit the price at which patent holders may sell their products, could this theoretically deprive patent holders of benefits they (or their governments) expected when entering into the *TRIPS Agreement*? Since many governments imposed pharmaceutical price controls when the *TRIPS Agreement* was negotiated, and since the Agreement does not address such controls, it seems very unlikely that such a claim might succeed if non-violation causes of action are permitted. That is, no Member could reasonably have expected that price controls would not be used in respect to patented pharmaceuticals. Nonetheless, there are other areas that raise similar questions, and where answers may not be so clear.

In the Panel and Appellate Body Reports in the *EC – Asbestos* case, and in the Panel Report in the *Japan – Film* case, legal and evidentiary issues involving the establishment of a non-violation claim were considered (though these cases were outside the TRIPS context).¹⁷ Yet the law in this area remains unsettled,

¹⁷ *Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel, WT/DS44/R, 31 Mar. 1998, at Section X.E.1-2, and European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, AB-2000-11, WT/DS135/AB/R, 12 Mar. 2001, at paras. 182 et seq.*

and Members would benefit from a clear decision by the Ministerial Conference as to the scope and modalities of non-violation (or situation) complaints in TRIPS dispute settlement.

4.4 Proceedings

4.4.1 *General application of DSU*

The *TRIPS Agreement* incorporates the general consultation and dispute settlement mechanism of Articles XXII and XIII of the GATT 1994, and the DSU, and from that standpoint the same procedural considerations apply in the TRIPS context as in the GATT and GATS contexts. There are familiar procedures for initiation of consultations, consultations, request for the establishment of a panel, third party participation, establishment of a panel, establishment of terms of reference, submission of pleadings and evidence, proceedings before the panels, possibilities for expert consultation, and so forth.¹⁸

4.4.2 *Expert Consultation and Negotiating History*

Some features of TRIPS dispute settlement procedure that are relatively distinct to the TRIPS context are emerging as more or less common, based on experience so far.

First, either at the request of a party or on the panel's own initiative, the WIPO International Bureau is likely to be consulted regarding the negotiating history and other factual information regarding WIPO Conventions that are incorporated in the *TRIPS Agreement*. WIPO provided information to the Panel in the *US – Section 110(5) Copyright Act* and *US – Section 211 Appropriations Act* cases.

Second, the negotiating history of the *TRIPS Agreement* and the WIPO Conventions appear to play perhaps a more substantial role in TRIPS dispute settlement than in other subject matter areas. Negotiating history played a prominent role in the decisions of the panels in the *Canada - Pharmaceutical Patents*, *US – Section 110(5) Copyright Act* and *US – Section 211 Appropriations Act* cases, and a somewhat lesser role in the *India – Patents (US)* and *Canada – Patent Term* cases.¹⁹

Third, even in the absence of direct consultation of the WIPO International Bureau, panels and the Appellate Body have made consistent reference to the work product of WIPO in the form of guides to the implementation of the Conventions and related works. The influence of WIPO in this respect has been more substantial than that of national courts in interpreting the Conventions, although that may be the result of the particular subject matter of the disputes rather than a preference regarding sources.

¹⁸ See Modules 3.2, 3.3 and 3.4 of this Course.

¹⁹ *Canada – Term of Patent Protection, complaint by the United States, WT/DS170* (“Canada – Patent Term”).

The foregoing observations suggest that Members preparing for TRIPS dispute settlement will be well-advised to look into the negotiating history of the *TRIPS Agreement* and the WIPO Conventions, as well as the guidance regarding the Conventions furnished by the International Bureau.

4.4.3 *Claim and counterclaim*

A particularly interesting feature of Brazil's response to the United States request for consultations and statement of claims regarding Brazil's compulsory licensing law was Brazil's counterclaims. Essentially, Brazil prepared to argue that features of United States patent law involving licenses granted with respect to government-funded patents included some of the same elements that the United States alleged to represent TRIPS-inconsistencies in the Brazilian legislation. Since the United States claim was withdrawn, it is difficult to draw conclusions regarding the usefulness of Brazil's approach. Yet the very act of withdrawal by the United States might suggest that there is some value in seeking to identify TRIPS-inconsistent provisions of the law of a complaining Member as a responsive tactic.

4.4.4 *Customary International Law and TRIPS*

The Appellate Body has indicated that the rules on interpretation of the *Vienna Convention on the Law of Treaties* apply in WTO dispute settlement. This is an unremarkable proposition in light of the text of the DSU and the role of the Vienna Convention as mainly an effort to codify customary international law rules.

There is however, another aspect of customary law that may play a different role, and for which it may be useful to be prepared. In quite a number of areas involving IPRs, courts in developed countries have rendered numerous decisions that interpret and apply national IP laws. There is an evident tendency among trade negotiators from the developed countries to refer to the results of these decisions as the accepted rules governing IPRs. Yet these references may not accurately capture the nature of customary international law and the establishment of rules outside the boundaries of treaty or conventional law. Customary international law represents the practice of states combined with their belief that such practice is required as a matter of law or obligation (the latter being referred to as *opinio juris*). It is long understood that states are bound to customary international law rules only to the extent that they have implicitly or explicitly accepted them. A state is not bound by a customary rule to which it has objected. Only in the relatively rare circumstance of a rule of *jus cogens* (or a peremptory norm of international law) (e.g., the norms prohibiting slavery and torture) is a state bound without its consent. Developed Members may well argue before panels and the Appellate Body that a particular IPR norm should be implemented and applied in a certain way because that is "customary practice" as evidenced by decisions of their own courts or legislatures. These types of claims must be examined with great care. In some cases, it may be that the practice is interpreting a WIPO Convention to which

all or virtually all WTO Members are party, and this may in fact shed some authoritative light on the interpretation of the Convention (as a matter of state practice under the Convention). In other cases, however, the decisions of developed Member courts and legislatures may merely represent wishful thinking in regard to developing WTO Members. What may be a customary practice among some Members, may not have been followed by a second group of Members, and may not have been given systematic attention by a third group of Members.

In short, developing Members of the WTO should be prepared to stake their own claims regarding accepted or customary practices that need not mirror those practices followed by developed Members with different economic and social interests. The *TRIPS Agreement* provides considerable flexibility in this regard.

4.5 Approaching Dispute Settlement

TRIPS dispute settlement claims may of course take many forms. They may involve an alleged failure to implement a substantive norm or rule for the grant of an IPR, or they may involve an allegation of failure to provide adequate enforcement.

- If the allegation is that the Member has failed to adopt a substantive standard, does the *TRIPS Agreement* explicitly lay out the precise contours of the rule that is required, or is the requirement framed in a more general way? If the requirement is framed more generally, on what basis is the complaining party demanding adoption of a specific norm?
- What do the incorporated WIPO Conventions provide? What is the negotiating history of the relevant provisions in the WIPO context, and in the WTO Uruguay Round?
- Does the complaining Member have rules on the same subject matter? What do those rules look like? How have their courts interpreted those rules? Are there other areas of TRIPS in which the complaining Member may be out of compliance? Is there a potential counterclaim?
- Is the alleged non-compliance potentially within the range of permissible exceptions?
- If the question relates to enforcement, is it directed to a particular case or controversy, or is a more systematic deficiency in the legal system alleged? If the former, is this symptomatic of a larger problem? If the latter, is the deficiency one relating to the amount of resources available for the national legal system as a whole?

4.6 Test Your Understanding

- 1. What does the “transparency” obligation in the *TRIPS Agreement* entail?**
- 2. What is the difference between a “violation” complaint and a “non violation” complaint? What are the differences in the potential remedies?**
- 3. If non-violation nullification or impairment complaints are eventually allowed under the *TRIPS Agreement*, what types of claims might be brought?**

5. JURISPRUDENCE UNDER THE TRIPS AGREEMENT

Objectives

Upon completion of this section, the reader will be able:

- to discuss the decisions that have been rendered by panels and the Appellate Body under the *TRIPS Agreement*.
- To appreciate that a substantial body of jurisprudence has been developed on issues such as the extent of a Member's obligation to demonstrate implementation of TRIPS obligations, the scope of exceptions to patent and copyright protection, and the nature of the national and most favoured nation treatment obligations.

There have been a number of cases decided by WTO panels and the Appellate Body under the terms of the *TRIPS Agreement*, and other dispute settlement claims initiated and withdrawn. Below is a summary of the cases decided so far, and a summary of one important claim that was withdrawn.

5.1 India – Patents (US)

India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50 (“*India – Patents (US)*”) was the first WTO dispute under the *TRIPS Agreement* that resulted in a decision by a panel, and subsequently by the Appellate Body. The complaining party was the United States, which alleged that India had failed to adequately implement *TRIPS Agreement* requirements under Articles 70:8 and 70:9 to establish a so-called “mailbox” to receive and preserve patent applications, and to adopt legislation authorizing the grant of exclusive marketing rights (EMRs).

The first part of the decision of the Appellate Body in this dispute concerned a difference over jurisprudence with the panel. The panel said that the United States and its patent holders had “legitimate expectations” concerning the implementation by India of a mailbox system that would eliminate “any reasonable doubts” concerning the future grant of patents. The Appellate Body said that that panel had mistakenly applied the doctrine of non-violation nullification or impairment in formulating its approach to interpretation, and pointed out that non-violation complaints could not yet be brought under the *TRIPS Agreement*. The Appellate Body said that the proper means for interpreting the *TRIPS Agreement* was by application of the rules of the *Vienna Convention on the Law of Treaties*, which provides that treaties shall be interpreted based on their express terms and context, in light of their object and purpose. India was required to comply with the terms of the *TRIPS Agreement*, no more, no less. This meant that India would be required to provide a “sound legal basis” for the treatment of mailbox applications.

The Appellate Body went on to examine India's claim that an administrative order allegedly given by the executive to the patent office was an adequate means to implement the mailbox requirement. India had not furnished the text

of such an order to the Panel or Appellate Body. The Indian Patents Act required the patent office to reject applications that concerned subject matter for which patent protection could not be granted, including for pharmaceutical products. There was substantial evidence that under the Indian Constitution, the statutory Patents Act requirement to reject a patent application on subject matter grounds could not be modified by an executive administrative order. The Appellate Body agreed with the Panel that India had in fact failed to provide a sound legal basis for receiving and preserving mailbox applications.

Another aspect of the case involved India's alleged failure to adopt legislation authorizing the grant of EMRs. India argued that since no party had yet to qualify for the grant of EMRs, it had no need for legislative authority which could be provided as the circumstances warranted. The Appellate Body disagreed on the basis of the express text of the *TRIPS Agreement* which it held to require the adoption of legislation authorizing the grant of EMRs from the entry into force of the agreement.

The Appellate Body also rejected a Panel determination under Article 63 of the *TRIPS Agreement* that India also had failed to comply with transparency obligations. The Appellate Body's rejection was based solely on grounds that the Panel had permitted the United States to add a cause of action to its complaint outside the Panel's terms of reference.

5.2 Canada – Pharmaceutical Patents

Canada – Patent Protection of Pharmaceutical Products, WT/DS114 (“*Canada – Pharmaceutical Patents*”) involved a complaint brought by the European Communities (EC) against Canada alleging that provisions of Canadian patent law that allowed the stockpiling of products prior to the expiration of a patent term, and that authorized the use of patented inventions for the purposes of preparing and pursuing regulatory submissions prior to the expiration of a patent term, violated TRIPS obligations. The focus of the EC's complaint was the generic pharmaceutical sector. The EC claimed that the relevant provisions of Canada's Patent Act, when read in connexion with its drug regulatory rules, allowed generic producers to obtain approval for and stockpile patented medicines contrary to TRIPS patent rules.

Canada conceded that the relevant provision of its Patent Act contravened the rights of patent holders under Article 28:1 of the *TRIPS Agreement*. It invoked Article 30, asserting that it was providing limited exceptions to the rights of patent holders within the scope of that provision.

The Panel devoted a considerable portion of its decision to interpreting the meaning of the three elements of Article 30; that is, “limited exception”, not unreasonably interfering with the normal exploitation of the patent, and not unreasonably prejudicing the interests of the patent holder, taking into account the legitimate interests of third parties. In the Panel's view, a “limited exception” refers to a narrow derogation, with reference to the range of rights provided

to the patent holder. The element of “normal exploitation” is used to address the way that patents are ordinarily used. The test of the patent holder’s interests is used to consider the potential economic impact on the patent holder. The legitimate interests of third parties are not limited to legal interests in the patent relation, but include public social interests.

The Panel determined that Canada’s stockpiling exception was not sufficiently “limited” because it potentially allowed an unlimited quantity of patented products to be made during the patent term. It therefore did not qualify as a limited exception under Article 30. Having made this determination, the panel did not address the other two elements that must be satisfied to support an Article 30 exception.

Canada’s regulatory review exception allows third parties to use patented inventions during the term of the patent to develop submissions for approval, such as in the case of marketing approval for a generic pharmaceutical product. Canada does not extend the term of patents to take into account the period of time during which an invention is subject to regulatory review.

Regarding the first criteria under Article 30, that an exception must be limited, the Panel determined that Canada’s regulatory review exception was limited because it addressed only a small part of the patent right, and was reasonably closely circumscribed.

Regarding the second criteria, that there is not unreasonable interference with normal patent exploitation, the Panel found it was not generally accepted that patent rights must be exploited without being subject to limited exceptions, such as use by third parties for regulatory review purposes. It was not an unreasonable interference with the normal exploitation of patents to subject them to this type of exception.

Regarding the third criteria, that there not be unreasonable prejudice to the patent holder (taking into account third party interests), the Panel considered the EC’s argument that Canada’s regulatory review exception should have been combined with a “patent term extension” to take into account the period during which the patent holder awaited marketing approval for its drug. In the EC’s view, the failure to provide an extension meant that the patent holder suffered economically because its patent term was effectively reduced by the period during which it awaited marketing approval, while the generic producer was enabled to begin marketing promptly upon the expiration of the patent. The Panel rejected the EC contention, finding that governments took account of the interests of the patent holder in adopting their regulatory review procedures, and that there was no requirement that the patent holder effectively be compensated because it had to subject its product to regulatory review.

The Panel finally considered whether Canada’s regulatory review exception was inconsistent with Article 27:1 of the *TRIPS Agreement* in the sense of discriminating with respect to field of technology. The Panel began by holding that Article 30 exceptions are subject to Article 27:1, even though there is no

language in Article 30 suggesting that exceptions that may be granted are restricted to a certain kind or class. However, it pointed out that Article 27:1 refers to “discrimination” regarding field of technology, which is a pejorative term. The fact that Members may not “discriminate” regarding a field of technology does not imply that they may not “differentiate” among fields of technology for legitimate purposes. Having made these determinations, the Panel found that Canada’s patent legislation neither differentiated nor discriminated since it was, by its terms and application, neutral as to field of technology.

5.3 US – Section 110(5) Copyright Act

United States – Section 110(5) of the US Copyright Act, WT/DS160/ (“US – Section 110(5) Copyright Act”) involved a claim by the EC against the United States alleging that exceptions in the U.S. Copyright Act that permitted commercial establishments to provide radio and television entertainment to customers without payment of remuneration to copyright holders was TRIPS-inconsistent. The EC’s claims were based on Articles 11bis and 11 of the Berne Convention that establish rights in favour of authors and artists with respect to the broadcast and communication to the public of their works. The United States defended its exemptions on the basis of Article 13 of the *TRIPS Agreement*, that largely incorporates the exception provision found in Article 9(2) of the Berne Convention.

The United States copyright exemptions basically covered two situations. The first (“homestyle exemption”) allowed broadcasts to be received and transmitted to the public by a single apparatus of a kind ordinarily used in private homes, and was not directed to a specific category of establishment. The second (“business exemption”) allowed general commercial establishments of a limited size, and bars and restaurants also of a limited (though larger) size, to receive and broadcast to the public through a specified range of equipment.

The Panel found that the United States business exemption did not fall within the exception for “certain special cases” within the meaning of Article 13 of the *TRIPS Agreement*. The range of establishments was too large, and the commercial significance to copyright holders was too great for this to be considered a minor exemption. Although it might have stopped here, the Panel went on to complete its analysis of the other exception factors in Article 13 of the *TRIPS Agreement* so as to provide a factually complete record for the Appellate Body. The Panel found that copyright holders had a normal expectation of compensation for broadcast to the public of their works, and that commercial establishments of a substantial size would reasonably be expected to bear the burden of furnishing compensation to them. Since the business exemption covered a broad range of United States commercial establishments, the lack of compensation unreasonably prejudiced the legitimate interests of the copyright holders.

The Panel found that the “homestyle exemption” was in fact of limited scope, because among other things it had been construed narrowly by United States courts. In respect to the normal exploitation of copyrighted works, the Panel found that there was a minimal market for single private receiver broadcasts, in particular since most small shop owners would not be willing to pay for a copyright licence. On similar grounds, the Panel found that the legitimate interests of copyright holders were not unreasonably prejudiced.

5.4 Canada – Patent Term

Canada – Term of Patent Protection, WT/DS170 (“*Canada – Patent Term*”) involved a complaint by the United States against Canada for an alleged failure to apply the minimum twenty (20) year patent term requirement of Article 33 of the *TRIPS Agreement* to patents that were granted under pre-*TRIPS Agreement* patent legislation. This decision involved the interpretation of Articles 70:1 and 70:2 of the *TRIPS Agreement* that deal with application of the agreement to subject matter that existed prior to its entry into force.

Canada argued that it was not required to extend the term of patents that had been granted under an act that applied to patents granted up until 1989 (and remained in force when Article 33 became applicable), because Article 70:1 excluded application of the *TRIPS Agreement* to “acts” which occurred before the date of application. In Canada’s view, the grant of a patent was an “act” that occurred before Article 33 became applicable. Canada argued that Article 70:2, which establishes obligations regarding “subject matter existing at the date of application . . . and which is protected in that Member on the said date” referred to patents granted prior to application of the agreement, but did not require Canada specifically to undertake the act of extending the patent term, which was excluded under Article 70:1.

The decision of the Panel and Appellate Body in this case focused on the plain meaning of Articles 70:1 and 70:2. Neither the Panel nor the Appellate Body found Canada’s attempt to distinguish the act of setting out a patent term (as within Article 70:1), and the general “existing” nature of the patented invention under Article 70:2, persuasive. The Appellate Body found that Article 70:2 required the application of Article 33 to the term of existing patents based on the express language of the *TRIPS Agreement*.

5.5 US – Section 211 Appropriations Act

United States – Section 211 Omnibus Appropriations Act of 1998 (“*US – Section 211 Appropriations Act*”), WT/DS176, involved a claim by the EC against the United States alleging *TRIPS Agreement* inconsistency of United States legislation denying holders of trademarks confiscated by the government of Cuba without compensation the right to enforce those marks in United States courts, and denying permission to register those marks at the United States Patent and Trademark Office. The case involved a trademark (“Havana Club” for rum) that the government of Cuba took from Cuban national owners

following the revolution, and that became the subject of a Cuban-French joint venture some 40 years later. Federal courts in the United States had upheld the validity of the United States legislation and its application to the Cuban-French joint venture prior to the EC's initiation of the dispute at the WTO. The EC argued that the United States legislation was inconsistent with rules concerning trademark registration of the Paris Convention, interfered with the basic rights of trademark holders under the *TRIPS Agreement*, and was inconsistent with *TRIPS Agreement* national and most favoured nation treatment rules.

The Appellate Body decided (confirming the Panel's view) that the obligation in the Paris Convention Article 6 *quinquies telle quelle* (or "as is") rule is addressed to accepting trademarks for registration in the same form, and not to eliminating Member discretion to apply rules concerning other rights in marks. It found that Articles 15 and 16 of the *TRIPS Agreement* do not prevent each Member from making its own determination regarding the ownership of marks within the boundaries established by the Paris Convention. It decided that Article 42 regarding procedural rights does not obligate a Member to permit adjudication of each substantive claim regarding trade mark rights a party might assert, if that party is fairly determined *ab initio* not to be the holder of an interest in the subject mark. In sum, the Appellate Body confirmed the right of the United States to refuse registration and enforcement of trademarks it determines to have been confiscated in violation of strong public policy of the forum state.

The Appellate Body analyzed United States law relating to Cuba's alleged confiscation of trademarks in regard to national and most favored nation treatment obligations. It observed that as a matter of WTO law, these obligations are fundamental. It rejected the Panel's determination that, although certain minor discriminatory aspects of the United States legislation could be identified, those aspects were unlikely to have a practical effect, and so are not WTO-inconsistent. The Appellate Body, in a somewhat strained reliance on an earlier GATT panel report (*US - Section 337*),²⁰ found that even discriminatory aspects unlikely to have effect in practice were nonetheless inconsistent with the United States national treatment and MFN obligations.

The Appellate Body further held, contrary to the panel, that trade names are within the subject matter scope of the *TRIPS Agreement*.

Although the Appellate Body identified what it considered to be a minor procedural defect in the mechanism adopted by the United States Congress to effectuate its decision regarding the confiscated trademark, the Appellate Body

²⁰ Panel Report, *United States – Section 337 of the Tariff Act of 1930* ("US – Section 337"), adopted 7 November 1989, BISD 36S/345. The Appellate Body's reliance is strained because the Panel in the US – Section 337 case identified a number of differences between rules applicable to patent proceedings involving domestically-produced and imported goods, and found only a limited number inconsistent with United States national treatment obligations. Those found to constitute discrimination (such as the incapacity of an import-related patent holder to assert counterclaims in a 337 proceeding) were matters that in intellectual property rights enforcement had significant consequences.

affirmed in its entirety the authority of the Congress and Executive Branch to deny validity to a Cuban-French claim of trademark ownership.

5.6 United States Claims Regarding Brazil's Compulsory Licensing Legislation

On May 30, 2000, the United States requested consultations with Brazil under the WTO Dispute Settlement Understanding, stating:

[The United States] request[s] consultations with the Government of Brazil ... concerning those provisions of Brazil's 1996 industrial property law (Law No. 9,279 of 14 May 1996; effective May 1997) and other related measures, which establish a 'local working' requirement for the enjoyability of exclusive patent rights that can only be satisfied by the local production – and not the importation – of the patented subject matter.

Specifically, Brazil's 'local working' requirement stipulates that a patent shall be subject to compulsory licensing if the subject matter of the patent is not 'worked' in the territory of Brazil. Brazil then explicitly defines 'failure to be worked' as 'failure to manufacture or incomplete manufacture of the product', or 'failure to make full use of the patented process'. The United States considers that such a requirement is inconsistent with Brazil's obligations under Articles 27 and 28 of the TRIPS Agreement, and Article III of the GATT 1994.

The request for consultations was followed by a United States request for the establishment of a panel. The United States withdrew its complaint in this matter prior to the submission of written pleadings by either party. However, the request for consultations illustrates that provisions authorizing compulsory licensing for “non-work” may be subject to challenge under Article 27 of the TRIPS Agreement.

The Paris Convention authorizes the grant of compulsory licences for failure to work a patent. A major issue in a case such as that brought by the United States against Brazil is whether Article 27:1 of the *TRIPS Agreement* was intended to prohibit WTO Members from adopting and implementing local working requirements, and effectively to supersede the Paris Convention rule. The negotiating history of the *TRIPS Agreement* indicates that Members differed strongly on the issue of local working. Several delegations favoured a direct prohibition of local working requirements, but the *TRIPS Agreement* did not incorporate a direct prohibition. Instead, it says that patent rights shall be enjoyable without “discrimination” as to whether goods are locally produced or imported. Under the jurisprudence of the *Canada- Pharmaceutical Patents* case, this leaves room for local working requirements adopted for *bona fide* (i.e., non-discriminatory) purposes. A WTO Member might well argue that requiring production of certain defence-related inventions within the national territory is essential to national security, and therefore justifies a local working requirement. There are no doubt other justifiable grounds for requiring local working of a patent.

5.7 Approaching WTO Dispute Settlement

- When confronted with a *TRIPS Agreement* claim, it is certainly important to refer to the prior decisions of panels and the Appellate Body as a potential source of interpretative guidance. However, it is important to dissect these decisions with care, since small changes in the facts may result in a different outcome before the DSB.
- The Ministerial Conference and General Council are exclusively empowered to render interpretations of the WTO agreements, including the *TRIPS Agreement*. A decision of a panel or the Appellate Body does not constitute an interpretation that is binding in subsequent disputes.
- The Appellate Body has frequently disagreed with panels as to the proper interpretation of the WTO agreements. If the only decision regarding a particular subject matter is by a panel, it would not be prudent to strictly rely on the panel's interpretation of the legal rules.

5.8 Test Your Understanding

1. **What did the Appellate Body decide about the doctrine of “legitimate expectations” in the *India – Patents (US)* case?**
2. **What significance did the Panel in the *Canada – Pharmaceutical Patents* case ascribe to the term “discrimination” in Article 27:1 of the *TRIPS Agreement*?**
3. **Did the Appellate Body in the *US – Section 211 Appropriations Act* allow the United States to make determinations regarding ownership of trademarks rights and, if so, with what basic constraint?**

6. CASE STUDY

WTO Member “Alpha” has a large number of individuals who are HIV-positive. Without effective medical treatment, these individuals will die of AIDS and its complications within the next ten years. The government of Alpha has aggressively addressed its HIV-AIDS crisis by providing free access to antiretroviral drugs to all citizens who need them.

Alpha has adopted a new Industrial Property Law to implement its *TRIPS Agreement* obligations. It includes a section on compulsory licensing that provides, inter alia:

“Article 7. The titleholder shall be subject to having the patent licensed on a compulsory basis if he exercises his rights derived therefrom in an abusive manner, or by means thereof engages in abuse of economic power, proven pursuant to law in an administrative or judicial decision.

Paragraph 1. The following also occasion a compulsory licence:

I – non-exploitation of the object of the patent within the Alpha territory for failure to manufacture or incomplete manufacture of the product, or also failure to make full use of the patented process, except cases where this is not economically feasible, when importation shall be permitted; or

II – commercialization that does not satisfy the needs of the market.

Paragraph 5. The compulsory licence that is the subject of Paragraph 1 shall only be required when 3 (three) years have elapsed since the patent was granted.

Article 8. A compulsory licence shall not be granted if, on the date of the application, the titleholder:

I – justifies the non-use based on legitimate reasons;

II – proves that serious and effective preparations for exploitation have been made;

III – justifies the failure to manufacture or to market on grounds of an obstacle of legal nature;

Article 9. In cases of national emergency or of public interest, as declared in an act of the Federal Executive Power, and provided the patentholder or his licensee does not fulfill such need, a temporary and non-exclusive compulsory licence for exploiting the patent may be granted, ex officio, without prejudice to the rights of the respective titleholder.

Sole Paragraph. The act of granting the licence shall establish its term and the possibility of extension.

Article 10. Compulsory licenses shall always be granted on a non-exclusive basis, and sublicensing shall not be permitted.

Article 11. The application for a compulsory licence shall be formulated upon indication of the conditions offered to the patentholder.”

The Alpha government has made perfectly clear that it intends to address the HIV-AIDS crisis in that country by whatever means are necessary, while abiding by its international legal obligations. If a patented drug is more expensive than

the government considers warranted, it will not hesitate to grant a compulsory licence for local production of the drug.

WTO Member Beta has initiated a dispute settlement action in the WTO charging that Alpha's compulsory licensing legislation "establish[es] a 'local working' requirement for the enjoyability of exclusive patent rights that can only be satisfied by the local production – and not the importation – of the patented subject matter." According to Beta, Alpha's compulsory licensing legislation is inconsistent with Alpha's obligations under the *TRIPS Agreement*.

Alpha asks you to assist in defending against the WTO action initiated by Beta. Alpha observes that in the initial phase of WTO dispute settlement, the complaining party need only state its cause of action in a brief summary manner. Beta has provided very limited information concerning the basis for its action.

- 1. What legal arguments do you expect Beta to advance against Alpha's compulsory licensing legislation?**
- 2. How should Alpha respond to Beta's legal arguments?**
- 3. Given the relative strength of the two side's arguments, would you recommend that Alpha settle this dispute by agreeing to amend its legislation and, if so, with what changes?**

7. FURTHER READING

7.1 Books and Articles

- **UNCTAD**, *TRIPS and Development: Resource Book* (forthcoming)
- **Abbott, F., Cottier, T. and Gurry, F.**, *The International Intellectual Property System: Commentary and Materials* (1999) (Kluwer Law International)
- **Abbott, F.**, “The Doha Declaration on the *TRIPS Agreement* and Public Health: Lighting a Dark Corner at the WTO”, *Journal of International Economic Law L.* 2002, 469
- **Abbott, F.**, Technology and State Enterprise in the WTO, in Cottier, T. and Mavroidis P., *World Trade Forum: State Trading in the Twenty-First Century* (U. Mich. Press, 1998), 121
- **Correa, C.**, *Integrating Public Health Concerns into Patent Legislation in Developing Countries* (South Centre 2000)
- **Maskus, K.**, *Intellectual Property Rights in the Global Economy* (IIE 2000)
- **Reichman, J.**, “Securing Compliance with the *TRIPS Agreement* After U.S. v. India”, *Journal of International Economic Law.* 1998, 585

7.2 Dispute Settlement Reports

- Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* (“*India – Patents (US)*”), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9.
- Panel Report, *Canada – Patent Protection of Pharmaceutical Products* (“*Canada – Pharmaceutical Patents*”), WT/DS114/R, adopted 7 April 2000.
- Panel Report, *United States – Section 110(5) of the US Copyright Act* (“*US – Section 110(5) Copyright Act*”), WT/DS160/R, adopted 27 July 2000.
- Appellate Body Report, *Canada – Term of Patent Protection* (“*Canada – Patent Term*”), WT/DS170/AB/R, adopted 12 October 2000.
- Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998* (“*US – Section 211 Appropriations Act*”), WT/DS176/AB/R, adopted 1 February 2002.

7.3 Documents and Information

- The World Intellectual Property Organization maintains a website with extensive documentation and research on IPRs, at <http://wipo.int>. This includes an electronic collection of national laws that have been notified

to WIPO (at the CLEA database). The WIPO website also maintains a list of links to national patent and copyright offices

- All WTO dispute settlement reports can be found at <http://wto.org>. There is also a section of the WTO website devoted to TRIPS matters.

There are many other Internet sites devoted to TRIPS and intellectual property rights matters.