

# **‘Treatment No Less Favourable’ and the Future of National Treatment Obligation in GATT Article III:4 after *EC – Seal Products***

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## **Abstract**

The national treatment (NT) obligation embodied in Article III:4 of the GATT 1994 has been long marked by legal indeterminacy. Recently, the WTO Appellate Body has shed some fresh light on how the NT obligation should be interpreted in *EC – Seal Products*. The Appellate Body’s report on *EC – Seal Products* and other recent developments in WTO case law have fundamentally reshaped our collective understanding of the NT obligation. The purpose of this article is to take stock of what we have known about the NT obligation in GATT Article III:4 after *EC – Seal Products*, as well as identifying some lingering uncertainties. This paper argues that the boundary of the NT obligation in GATT Article III:4 will be largely determined by how the Appellate Body deals with three big issues identified in this article in future disputes.

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## **1. Introduction**

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Although widely recognized as a core discipline in international economic law, the national treatment (NT) obligation embodied in GATT Article III:4 has been long marked by legal indeterminacy.<sup>1</sup> In different periods of time, the application of the NT obligation in GATT/WTO case law has oscillated between phases of varying severity and laxity. At the center of these interpretive cycles lies the fundamental tension between the liberal devotion to free trade and the sovereign's right to tax, legislate, and regulate according to domestically determined policy.<sup>2</sup> More recently, the WTO Appellate Body has shed some fresh light on how the NT provision should be interpreted in *EC – Seal Products*.<sup>3</sup> Reading the Appellate Body's report on *EC – Seal Products* together with the Appellate Body's earlier reports on *Dominican Republic – Import and Sale of Cigarettes*<sup>4</sup>, *Thailand – Cigarettes (Philippines)*<sup>5</sup>, *US – Clove Cigarettes*<sup>6</sup>, among others, it is safe to conclude that the recent developments in WTO case law have fundamentally reshaped our collective understanding of the NT obligation in GATT Article III:4.<sup>7</sup>

The purpose of this article is to critically review the recent WTO case law on GATT Article III:4, taking stock of what we have known about the NT obligation, as well as

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<sup>1</sup> Tomer Broude and Philip I. Levy, 'Do you Mind if I do not Smoke? Products, Purpose and Indeterminacy in *US – Measures Affecting the Production and Sale of Clove Cigarettes*', 13 (2) *World Trade Review* 357 (2014), at 368; Nicolas F. Diebold, 'Standards of Non-Discrimination in International Economic Law', 60 *International and Comparative Law Quarterly* 831 (2011), at 832-833; Simon Lester, 'Finding the Boundaries of International Economic Law', 17 (1) *Journal of International Economic Law* 3 (2014), at 9.

<sup>2</sup> Nicolas DiMascio and Joost Pauwelyn, 'Nondiscrimination in Trade and Investment Treaties: Worlds apart or Two Sides of the Same Coin', 102 *American Journal of International Law* 48 (2008), at 58-59.

<sup>3</sup> WTO Appellate Body Report, *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products (EC – Seal Products)*, WT/DS400/AB/R, adopted on 18 June 2014.

<sup>4</sup> WTO Appellate Body Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes (Dominican Republic – Import and Sale of Cigarettes)*, WT/DS302/AB/R, adopted 19 May 2005.

<sup>5</sup> WTO Appellate Body Report, *Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines (Thailand – Cigarettes)*, WT/DS371/AB/R, adopted 15 July 2011.

<sup>6</sup> WTO Appellate Body Report, *United States – Measures Affecting the Production and Sale of Clove Cigarettes (US – Clove Cigarettes)*, WT/DS406/AB/R, adopted 24 April 2012.

<sup>7</sup> Immediately after the Appellate Body Report on *EC – Seal Products* was released in May 2014, there was a lively discussion of the Appellate Body's interpretation of the national treatment obligation in the dispute at *International Economic Law and Policy Blog*. See Robert Howse, 'The WTO Appellate Body Ruling in Seals: National Treatment Article III:4', <http://worldtradelaw.typepad.com/ielpblog/2014/05/the-wto-appellate-body-ruling-in-seals-national-treatment-article-iii4.html> (23 May 2014); Simon Lester, 'Let's Put the AB's New Article III:4 Test to a Test', <http://worldtradelaw.typepad.com/ielpblog/2014/05/lets-put-the-abs-new-article-iii4-test-to-the-test.html> (25 May 2014).

identifying some lingering uncertainties. Based on this critical review, this article explores the future of the NT obligation in GATT Article III:4 after *EC – Seal Products*. The article concludes by suggesting that the WTO Appellate Body bring more clarity to three big issues in future WTO dispute settlements. The paper is organized as follows. Part II reviews the WTO Appellate Body’s interpretation of ‘treatment no less favorable’ in Article III:4, with a special emphasis on the evolving role of the regulatory purpose in the ‘treatment no less favorable’ analysis. Also in Part II is a critical examination of the WTO Appellate Body’s new approach to ‘treatment no less favorable’ analysis in *EC – Seal Products*. Part III identifies three big issues that are likely major battlefields in future disputes on the NT obligation in Article III:4. Part IV concludes the article.

## **2. What Constitutes ‘Treatment No Less Favourable’ in GATT Article III:4?**

With regard to the domestic non-fiscal regulation of goods, the NT obligation is embodied in Article III:4 of the GATT 1994. Article III:4 provides:

The products of ... any contracting party imported into ... any other contracting party shall be accorded *treatment no less favorable* than that accorded to *like products* of national origin in respect of all laws, regulations and requirements ...

Article III:4 should be read in light of Article III:1, which serves as a guiding principle of the whole Article III.<sup>8</sup> Article III:1 reads:

The Members recognize that ...internal laws, regulations and requirements ... should not be applied to imported or domestic products *so as to afford protection* to domestic production.

The interpretation of Article III:4 therefore hinges principally on three key terms: ‘like products’, ‘treatment no less favorable’ and ‘so as to afford protection’. This article is not intended to provide a comprehensive review of how WTO panels have interpreted these key

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<sup>8</sup> WTO Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products (EC – Asbestos)*, WT/DS135/AB/R, adopted 5 April 2001, para 93.

terms in GATT/WTO dispute settlement processes, as excellent scholarly work is readily available elsewhere.<sup>9</sup> In addition, the ‘like products’ analysis, the first prong of the NT obligation in Article III:4, including the recent important developments in *Philippines – Distilled Spirits*<sup>10</sup> and *US – Clove Cigarettes*, has also been the subject of numerous illuminating discussions.<sup>11</sup> Thus I will only focus on the second and third prong of the NT obligation analysis: the WTO Appellate Body’s evolving interpretation of ‘treatment no less favorable’ in Article III:4 and the role of the regulatory purpose in this evolving interpretation.

### ***2.1 The General Analytical Approach***

The basic rule of Article III:4 is that internal regulations must treat imports no less favorably than like domestic products. Previously the Appellate Body’s interpretation of ‘like products’ attracted by far the most attention in the NT obligation. More recently, the focus has shifted to ‘treatment no less favorable’.<sup>12</sup> The GATT panel in *US – Section 337 Tariff Act* stated that the term ‘treatment no less favorable’ does not require the identical treatment of imported and like domestic products, but the effective equality of competitive conditions between these like products in respect of the application of laws, regulations and requirements. The Panel stated:

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<sup>9</sup> See, for example, Gene M. Grossman, Henrik Horn and Petros C. Mavroidis, ‘Legal and Economic Principles of World Trade Law: National Treatment’, IFN Working Paper No. 917 (2012).

<sup>10</sup> WTO Appellate Body Report, *Philippines – Taxes on Distilled Spirits (Philippines – Distilled Spirits)*, WT/DS396/AB/R, adopted 20 January 2012.

<sup>11</sup> See generally Won-Mog Choi, ‘Like Products’ in *International Trade Law: Towards a Consistent GATT/WTO Jurisprudence* (Oxford University Press, 2003); Broude and Levy, above n 1, 378-381; Damien Neven and Joel P. Trachtman, ‘*Philippines – Taxes on Distilled Spirits: Like Products and Market Definition*’, 12 (2) *World Trade Review* 297 (2013), 297-326; Emily Barrett Lydgate, ‘Consumer Preferences and the National Treatment Principle: Emerging Environmental Regulations Prompt a New Look at an Old Problem’, 10 (2) *World Trade Review* 165 (2011); Marios C. Iacovides, ‘Minority Consumers, Marginalized Economics: Whose Tastes and Habits should the WTO Panels and the Appellate Body Consider when Assessing ‘Likeness’?’ 48 (2) *Journal of World Trade* 323 (2014).

<sup>12</sup> Joost Pauwelyn, ‘The Unbearable Lightness of Likeness’ in Marion Panizzon, Nicole Pohl and Pierre Sauve (eds), *GATS and the Regulation of International Trade in Services* (Cambridge: Cambridge University Press, 2008), at 366-67; Lothar Ehring, ‘De Facto Discrimination in World Trade Law: National and Most-Favored-Nation Treatment- or Equal Treatment?’ 36 (5) *Journal of World Trade* 921 (2002), at 944.

[The term ‘treatment no less favourable’] clearly sets a minimum permissible standard as a basis. On the one hand, contracting parties may apply to imported products different formal legal requirements if doing so would accord imported products more favorable treatment. On the other hand, there may be cases where application of formally identical legal provisions would in practice accord less favorable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is in fact no less favorable.<sup>13</sup>

In *Korea – Various Measures on Beef*, the panel had wrongfully assumed that any regulatory differences based exclusively on the nationality or the origin of the products is inconsistent with Article III:4.<sup>14</sup> The Appellate Body rejected the panel’s interpretation and made it clear that a formal difference in treatment between imported products and like domestic products, even if based exclusively on the origin of the products, is neither necessary, nor sufficient, to show a violation of Article III:4. Rather, what is relevant is whether such regulatory differences modified the conditions of competition to the detriment of imported products.<sup>15</sup> In other words, the ‘treatment no less favorable’ standard prohibits WTO Members from modifying the conditions of competition in the market place to the detriment of imported products vis-à-vis like domestic products.<sup>16</sup>

The examination of whether imported products are afforded less favourable treatment cannot rest on simple assertion, there must be further identification or elaboration of the implications of the measure for the conditions of competition in order properly to support a finding of less favourable treatment under Article III:4.<sup>17</sup> This is especially the case for origin-neutral measures.<sup>18</sup> On how to evaluate the implications of the contested measures for the equality of competitive conditions between imported and like domestic products, the

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<sup>13</sup> GATT Panel Report, *United States Section 337 of the Tariff Act of 1930*, L/6439, adopted 7 November 1989, BISD 36S/345, para 5.11.

<sup>14</sup> WTO Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, adopted 10 January 2001, as modified by Appellate Body Report WT/DS161/AB/R, para 627.

<sup>15</sup> WTO Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, adopted 10 January 2001, paras 137-144.

<sup>16</sup> *Ibid.*, para 137. .

<sup>17</sup> Appellate Body Report, *Thailand – Cigarettes*, above n 5, para 130.

<sup>18</sup> *Ibid.*, para 133.

Appellate Body has provided detailed guidance in *Thailand – Cigarettes*.

First, such an analysis must begin with careful scrutiny of the measure, including consideration of the design, structure, and expected operation of the measure.<sup>19</sup> Such an analysis may involve, but need not be based on, the actual effects of the contested measure in the market place, nor should the Panel anchor the analysis of less favorable treatment in an assessment of the degree of likelihood that an adverse impact on competitive conditions will materialize.<sup>20</sup> Second, if the regulation at issue indicates an origin-based, *de jure* discrimination, i.e., the sole difference in regulatory treatment consists of requirements applied only to imported products, there is a significant indication that imported products are accorded less favorable treatment.<sup>21</sup> In *Thailand – Cigarettes*, Thailand exempted three sets of VAT-related administrative requirements for resellers of domestic cigarettes, but imposed these administrative requirements on resellers of *imported* cigarettes. Without much difficulty, the Appellate Body ruled that less favorable treatment could be established in this case.<sup>22</sup> Third, in any event, there must be in every case a genuine relationship between the measure at issue and its adverse impact on competitive opportunities for imported versus like domestic products.<sup>23</sup> To identify the existence of a genuine relationship, the relevant question is whether it is the governmental measure at issue that affects the conditions under which like goods, domestic and imported, compete in the market within a Member's territory.<sup>24</sup> In other words, the detrimental impact on competitive opportunities for like imported products must be attributable to the contested measure at issue.

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<sup>19</sup> Ibid, para 130 and 134.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid, para 133.

<sup>22</sup> Ibid, paras 139-140.

<sup>23</sup> Ibid, para 134.

<sup>24</sup> Appellate Body Report, *EC – Seal Products*, above n 3, para 5.105.

Under Article III:4, less favorable treatment must affect the *group* of imported products, as compared to the *group* of domestic products. The NT obligation is breached only if imported products from the complaining party, *on the whole*, are treated less favorably than domestic like products. It is not enough that some like imported products from the complaining party receive worse treatment than some like domestic goods. This is because it is always possible to find a violation of Article III:4 as long as the disfavored type of products is imported and the favored type exists domestically.<sup>25</sup> The Appellate Body report on *US – Clove Cigarettes* has provided the best illustration of the correct approach to identify the scope of like products for ‘treatment no less favorable’ comparison in the NT provision. In this case, the Panel determined that the ‘treatment no less favorable’ requirement called for a comparison between treatment accorded to imported clove cigarettes and that accorded to domestically produced cigarettes that it had earlier found to be like products, menthol cigarettes.<sup>26</sup> The Appellate Body reversed the panel and held that a panel is required to compare, on the one hand, the treatment accorded to *all* like products imported from the complaining Member with, on the other hand, that accorded to *all* like domestic products. In determining what the scope of like imported and domestic product is, a panel is not limited to those products specifically identified by the complaining Member.<sup>27</sup> In addition, the NT obligation does not require Members to accord no less favorable treatment to each and every imported product as compared to each and every domestic like product. To put it another way, the ‘treatment no less favorable’ standard does not prohibit regulatory distinctions between products found to be like, provided that the group of like products imported from the complaining Member is treated no less favorably than the group of domestic like products.<sup>28</sup>

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<sup>25</sup> Ehring, above n 12, at 924.

<sup>26</sup> Appellate Body Report, *US – Clove Cigarettes*, above n 6, para 185.

<sup>27</sup> *Ibid*, para 191.

<sup>28</sup> *Ibid*, paras 193 and 194.

Based on this analytical framework, the Appellate Body in *US – Clove Cigarettes* held that the group of imported like products from Indonesia into the US included not only clove cigarettes but also non-clove cigarettes. Similarly, the group of like domestic products included not only menthol cigarettes but also domestically produced flavored cigarettes in the US.<sup>29</sup> Nevertheless, only a small percentage of non-clove cigarettes was imported from Indonesia into the US and US domestic flavored cigarettes other than menthol cigarettes at best represented a relatively small market share prior to the ban. Consequently, the inclusion of non-clove cigarettes imported from Indonesia and domestically produced flavored cigarettes in the comparison would not have altered the Panel’s conclusion that, essentially, the comparison was between imported clove cigarettes and domestic menthol cigarettes.<sup>30</sup>

## ***2.2 The Role of Regulatory Purpose in ‘Treatment No Less Favourable’ Analysis***

Similar to the interpretation of ‘like products’, there has been a long-standing debate on whether the regulatory purpose in Article III:1 should be considered in the interpretation of ‘treatment no less favorable’ in Article III:4.<sup>31</sup> In *EC – Bananas III*, the Panel considered it appropriate to discern the protective application of a measure from its design, architecture, and the revealing structure under Article III:4.<sup>32</sup> On appeal, the Appellate Body reversed the Panel and found that since Article III:4 does not specifically refer to Article III:1, a determination of whether there has been a violation of Article III:4 does not require a separate consideration of whether a measure ‘affords protection to domestic production’.<sup>33</sup> In other words, a determination that the imported and domestic products in question are ‘like

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<sup>29</sup> Ibid, paras 197-198.

<sup>30</sup> Ibid, para 200.

<sup>31</sup> Michael Ming Du, ‘The Rise of National Regulatory Autonomy in the GATT/WTO Regime’, 14 (3) *Journal of International Economic Law* 639 (2011), 655-664.

<sup>32</sup> Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas, Complaint by Ecuador*, WT/DS27/R/ECU, adopted 25 September 1997, as modified by Appellate Body Report WT/DS27/AB/R, para 7.249.

<sup>33</sup> Appellate Body Report, *EC – Bananas III*, WT/DS27/AB/R, adopted 25 September 1997, para 216.

products’ and that the regulatory measure in dispute provides less favorable treatment to imported products, is sufficient to establish a violation of Article III:4.<sup>34</sup>

In *EC – Asbestos*, the Appellate Body implicitly retreated from *EC – Bananas III* and reiterated its earlier holding in *Japan – Alcoholic Beverages II* that Article III:1 ‘informs’ Article III and should act as a guide to understanding and interpreting the specific obligations contained in Article III.<sup>35</sup> Setting aside the conventional wisdom of exploring the role of regulatory purpose in ‘like products’ analysis, the Appellate Body appeared to indicate that the regulatory purpose might be considered in connection with whether foreign products are accorded less favorable treatment compared with like domestic products. The Appellate Body stated:

The term ‘less favorable treatment’ expresses the general principle, in Article III:1: if there is ‘less favorable treatment’ of the group of like imported products, there is, conversely, protection of the group of like domestic products. However, A Member may draw distinctions between products which have been found to be ‘like’, without, for this reason alone, according to the group of like imported products less favorable treatment than that accorded to the group of like domestic products.<sup>36</sup>

Here the Appellate Body equated less favorable treatment in Article III:4 to protectionism in Article III:1. It is also clear from this paragraph that there is no separate and additional inquiry on the regulatory purpose of the measure under Article III:1. However, the Appellate Body did not address clearly the crucial question of how Article III:1 might inform the ‘treatment no less favorable’ analysis in Article III:4. As a result, after *EC – Asbestos*, there was a long-standing controversy of what message the Appellate Body meant to convey

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<sup>34</sup> Michael J. Trebilcock & Shiva K. Giri, ‘The National Treatment Principle in International Trade Law’ (2003) American Law & Economics Association Annual Meetings Papers, at 36.  
<http://econpapers.repec.org/paper/bepalecam/1007.htm>.

<sup>35</sup> Appellate Body Report, *EC – Asbestos*, above n 8, para 93.

<sup>36</sup> *Ibid*, para 100.

through the quoted paragraph above.<sup>37</sup> For example, will a finding of disparate impact to the detriment of imported products automatically lead to a finding of less favorable treatment? Should the consideration of regulatory purpose be *part of* the less favorable treatment analysis? What could the Appellate Body possibly have in mind when they use the tantalizing phrase whereby a Member may draw distinctions between like products without causing less favorable treatment? Is it because the purpose of the distinction is not trade protectionism?<sup>38</sup>

It was later clarified in *Thailand – Cigarettes* that the Appellate Body in *EC – Asbestos* did not mean to say that the panel should try to explore the regulatory purpose of a disputed measure, nor a non-protectionist explanation could render an otherwise discriminatory measure consistent with Article III:4. The correct understanding of the quoted paragraph in *EC – Asbestos* above is that it confirmed what the Appellate Body had stated in *Korea – Various Measures on Beef*, i.e., a formal regulatory distinction itself is not conclusive evidence of less favorable treatment. The investigative focus should be on whether *competition conditions* between like products were distorted to the detriment of imported products.<sup>39</sup> The Appellate Body in *EC – Seal Products* reiterated this interpretation.<sup>40</sup>

On the critical question of whether a finding of detrimental impact on imported products vis-à-vis like domestic products, without more, is sufficient to conclude a violation of NT obligation under Article III:4, the Appellate Body report on *Dominican Republic – Cigarettes* caused even more confusion. In this case, Honduras argued that Dominican Republic's requirement that importers and domestic producers post a bond of RD\$5 million to ensure

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<sup>37</sup> Donald H Regan, 'Regulatory Purpose and "Like Products" in Article III:4 of the GATT' in George A. Bermann and Petros C. Mavroidis (eds), *Trade and Human Health and Safety* (Cambridge: Cambridge University Press, 2006), at 214.

<sup>38</sup> Henrik Horm and Joseph H. H. Weiler, 'European Communities- Measuring Affecting Asbestos and Asbestos-Containing Products', 3(1)World Trade Review 129 (2004), at 147; Amelia Porges and Joel P. Trachman, 'Robert Hudec and Domestic Regulation: The Resurrection of Aim and Effects', 37 (4) Journal of World Trade 783 (2003), at 796-797.

<sup>39</sup> Appellate Body Report, *Thailand – Cigarettes*, above n 5, para 128.

<sup>40</sup> Appellate Body Report, *EC – Seal Products*, above n 3, paras 5.106- 5.110.

payment of taxes has a detrimental impact on the class of imported cigarettes compared with the class of domestic cigarettes. This was because importers sold fewer cigarettes in the Dominican Republic than domestic cigarette producers did. In the view of the Appellate Body, this detrimental effect on imported cigarettes was not enough to find a violation of national treatment:

[T]he existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favorable treatment to imports *if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product...*<sup>41</sup> (emphasis added)

After *Dominican Republic – Cigarettes*, almost all panels and WTO experts understood the Appellate Body as saying that a modification of the conditions of competition to the disadvantage of imported products, without more, is not sufficient to find a violation of Article III:4. The complainant must also show that those adverse effects are related to the foreign origin of the products. In other words, a non-protectionist explanation, that is, an explanation unrelated to the foreign origin of the product, may be evidence that there is no less favorable treatment to imported products. For example, in *EC – Biotech Products*, Argentina, the US and Canada complained that the EC had accorded less favorable treatment to biotech products than to non-biotech products, despite the fact that they are ‘like products’.

The Panel stated:

Argentina is not alleging that the treatment of products has differed depending on their origin. In these circumstances, it is not self-evident that the alleged less favorable treatment of imported biotech products is explained by the foreign origin of these products rather than, for instance, a perceived difference between biotech products and non-biotech products in terms of their safety, etc. In our view, *Argentina has not adduced argument and evidence sufficient to raise a presumption that the alleged less favorable treatment is*

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<sup>41</sup> Appellate Body Report, *Dominican Republic – Cigarettes*, above n 4, para 96.

*explained by the foreign origin of the relevant biotech products.*<sup>42</sup> (emphasis added)

Similarly, in *US – Tuna II*, the Panel found that Mexico failed to demonstrate that the US ‘dolphin-safe’ labelling provisions had afforded less favorable treatment to Mexican tuna products. The Panel reasoned:

The impact of the US dolphin-safe provisions on different operators on the market and on tuna products of various origins depends on a number of *factors that are not related to the nationality of the product*, but to the fishing and purchasing practices, geographical location, relative integration of different segments of production, and economic and marketing choices.<sup>43</sup> (emphasis added)

Clearly, in these cases, the panels interpreted the WTO Appellate Body report on *Dominican Republic – Cigarettes* as requiring a separate and additional step of inquiry on whether the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, before any conclusion on ‘treatment no less favorable’ may be drawn. This is also the most sensible and straightforward reading of the Appellate Body’s message.

In *US – Clove Cigarettes*, however, the Appellate Body has started to move away from its own interpretation of less favorable treatment in *Dominican Republic – Cigarettes*. In footnote 372 of the Appellate Body report, the Appellate Body clarified that there is no additional inquiry of whether the detrimental impact is related to the foreign origin of the products or whether there are any non-protectionist policy justifications for such a disparate impact under Article III:4. The intriguing statement in the Appellate Body report on *Dominican Republic – Cigarettes* simply stresses the fact that the sales of domestic cigarettes were greater than those of imported cigarettes on the Dominican Republic market. Consequently, per unit cost of the bond requirement for imported cigarettes was higher than

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<sup>42</sup> WTO Panel Report, *European Communities – Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, adopted 21 November 2006, para 7.2514.

<sup>43</sup> Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WT/DS381/AB/R, adopted 13 June 2012, para 224.

domestic products.<sup>44</sup> In other words, the higher per unit costs of the bond requirement for imported cigarettes was *not attributable to* the specific measure at issue but was a function of sales volumes.<sup>45</sup> It is now settled that what the Appellate Body meant to establish in *Dominican Republic – Cigarettes* was a test of ‘causation’ under which a panel needs to consider whether any alleged disparate impact is caused by the challenged measure.<sup>46</sup> If some other factors, rather than the disputed measure, are accountable to the disparate impact, then the measure in dispute has not modified conditions of competition, hence no less favorable treatment.

After refuting the popular misinterpretation of its report on *Dominican Republic – Cigarettes*, the Appellate Body in footnote 372 of its *US – Clove Cigarettes* report also hinted that it would not examine the *rationale* for the detrimental impact on imported products under Article III:4 in future disputes:

In *Thailand – Cigarettes*, the Appellate Body *eschewed* an additional inquiry as to whether such detrimental impact was related to foreign origin of the products or explained by other factors or circumstances’.<sup>47</sup>

Undoubtedly, the Appellate Body’s interpretation in footnote 372 of the *US – Clove Cigarettes* Appellate Body report represents a sharp deviation from its loud and clear message in *Dominican Republic – Cigarettes* that a separate and additional step of inquiry on whether the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product should be conducted before any conclusion on ‘treatment no less favorable’ may be drawn. Instead, the Appellate Body inserted an ‘attribution’ test, which later morphed into a ‘genuine relationship’ test between the measure at issue and the

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<sup>44</sup> Appellate Body Report, *Dominican Republic – Cigarettes*, above n 4, para. 96.

<sup>45</sup> *Ibid*, footnote 372.

<sup>46</sup> Weihuan Zhou, ‘*US – Clove Cigarettes* and *US – Tuna II (Mexico)*: Implications for the Role of Regulatory Purpose under Article III:4 of the GATT’, 15 (4) *Journal of International Economic Law* 1075 (2012), at 1115.

<sup>47</sup> Appellate Body Report, *US – Clove Cigarettes*, above n 6, footnote 372.

disparate impact in *Thailand – Cigarettes*, into the ‘treatment no less favorable’ analysis.<sup>48</sup> The Appellate Body did not offer any explanation as to why it ditched the origin test outlined in *Dominican Republic – Cigarettes*. In essence, what the Appellate Body stated in footnote 372 was that everybody misinterpreted its ruling in *Dominican Republic – Cigarettes*. As I will explain in part 2.3 below, the real reason for the Appellate Body’s move is its reluctance to transpose an Article XX-style justification analysis to Article III:4 and its preference for a clear division of labor between Article III:4 and Article XX of the GATT 1994.

It was not until *EC – Seal Products* that the Appellate Body finally stated unequivocally its position on the role of regulatory purpose in interpreting ‘treatment no less favorable’. In this case, the EU argued that for the purpose of establishing a violation of Article III:4, a finding that a measure has a detrimental impact on competitive opportunities for imported products, compared to like domestic products, is not dispositive. The EU submitted that a panel must conduct an additional inquiry into whether the detrimental impact on competitive opportunities for like imported products stems exclusively from a legitimate regulatory distinction.<sup>49</sup> In essence, the EU requested the Appellate Body to transpose the legal standard for the ‘treatment no less favorable’ under Article 2.1 of the TBT Agreement to Article III:4.<sup>50</sup> Under Article 2.1 of the TBT Agreement, the analysis of ‘treatment no less favorable’ goes beyond a consideration of the detrimental effects of the measure on the competitive opportunities for like imported products, and necessarily involves a consideration of possible policy rationale for such detrimental effect on trade.<sup>51</sup>

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<sup>48</sup> Appellate Body Report, *Thailand – Cigarettes*, above n 5, para 134. See Part 3 below for further analysis on the genuine relationship test in the ‘treatment no less favorable’ analysis.

<sup>49</sup> Appellate Body Report, *EC – Seal Products*, above n 3, para. 5.100.

<sup>50</sup> Gabrielle Marceau, ‘The New TBT Jurisprudence in *US – Clove Cigarettes*, *US – Tuna II*, and *US – COOL*’, 8 (1) *Asian Journal of WTO and International Health Law and Policy* 1 (2014), 1-39; Petros C. Mavroidis, ‘Driftin’ Too Far from Shore- Why the Test for Compliance with the TBT Agreement Developed by the WTO Appellate Body is Wrong, and what should the AB have Done Instead’, 12 (3) *World Trade Review* 509 (2013), 509-531.

<sup>51</sup> *Ibid.*

The EU's arguments actually represent a very popular view among WTO commentators.<sup>52</sup> Indeed, from a regulatory perspective, the EU's position is rather appealing. Article 2.1 of the TBT and Article III:4 of the GATT overlap in their scope of application in respect of technical regulations. The NT obligation in both provisions is built around the same core terms 'like products' and 'treatment no less favorable'.<sup>53</sup> The TBT Agreement and the GATT 1994 also share the same objective and purpose: to strike a balance between trade liberalization and regulatory autonomy.<sup>54</sup> One uniform approach to 'treatment no less favorable' will not only clarify the scope of the NT obligation in the WTO law, but also help to make the case law more coherent across WTO Agreements with regard to domestic regulations.

However, the Appellate Body categorically rejected the EU's position. To the disappointment of many WTO commentators, the Appellate Body took a strictly textualist approach to solve the long-standing controversy over the role of regulatory purpose in interpreting the NT obligation. Since Article III:4 does not explicitly refer to Article III:1, the Appellate Body considered that this omission of a textual reference to Article III:1 must be given meaning.<sup>55</sup> Then the Appellate Body held that Article III:4 is, itself, an expression of the principle set forth in Article III:1. Consequently, if there is less favorable treatment of the group of like imported products, there is, conversely, protection of the group of like domestic products. In other words, the Appellate Body in *EC – Seal Products* supported the position that less favorable treatment is equal to a detrimental impact on the competitive opportunities for imported products. There is no need to consider the regulatory purpose of the measure in

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<sup>52</sup> James Flett, 'WTO Space for National Regulation: Requiem for a Diagonal Vector Test', 16 (1) *Journal of International Economic Law* 37 (2013), at 64 and 73; Meredith A. Crowley and Robert Howse, '*Tuna – Dolphin II*: A Legal and Economic Analysis of the Appellate Body Report', 13 (2) *World Trade Review* 321 (2014). Gaetan Verhoosel, *National Treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (Hart Publishing, 2002).

<sup>53</sup> Appellate Body Report, *US – Clove Cigarettes*, above n 6, para 100.

<sup>54</sup> *Ibid*, paras 92-96.

<sup>55</sup> Appellate Body Report, *EC – Seal Products*, above n 3, at 5.115.

the ‘treatment no less favorable’ analysis, and a finding of a detrimental impact, without more, will automatically send the measure to be justified under Article XX.

### ***2.3 An Analysis of the Appellate Body’s Interpretation of ‘Treatment No Less Favorable’ in EC – Seal Products***

As the Appellate Body has illustrated in *US – Clove Cigarettes*, the detrimental impact on imported products vis-à-vis domestic like products, by itself, is *not* sufficient to constitute less favorable treatment in Article 2.1 of the TBT Agreement. This is because a *legitimate* regulatory distinction can rectify detrimental effects of the measure on trade.<sup>56</sup> This is in sharp contrast to the Appellate Body’s interpretation of the identical ‘treatment no less favorable’ phrase in Article III:4 of the GATT 1994.

The Appellate Body’s interpretation of ‘treatment no less favorable’ in *EC – Seal Products* reminds the readers of its earlier position in *EC – Bananas III* in 1997. Admittedly, this interpretation has the advantage of a clear division of labor between Article III:4 and Article XX. Although the TBT Agreement and the GATT 1994 share the same objective of striking a delicate balance between the pursuit of trade liberalization and member states’ right to regulate, this balance is expressed in different ways. In the GATT 1994, this balance is expressed by the NT obligation in Article III:4 as qualified by the general exception clause in Article XX. The WTO Appellate Body in *EC – Seal Products* made it clear that only the trade impact of the contested measure will be considered under Article III:4. Any possible policy justifications for the detrimental trade impact, which delineate the scope of a Member’s right to regulate, will be considered under Article XX only. After *EC – Seal Products*, the long-standing controversy on whether Article III:4 itself affords policy space for a WTO Member to consider Article XX-like policy rationale is over.

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<sup>56</sup> Appellate Body Report, *US – Clove Cigarettes*, above n 6, para 182.

Indeed, one major difficulty with the EU's argument in *EC – Seal Products* with regard to Article III:4 is that it is likely to disrupt the delicate balance between Article III:4 and Article XX and risk rendering Article XX inutile. Like it or not, WTO Members have agreed on a rule-exception structure in the GATT 1994. All non-economic policy justifications are supposed to be considered under Article XX. Bearing in mind the contextual discrepancies between Article III:4 of the GATT 1994 and Article 2.1 of the TBT, it is challenging to introduce the concepts such as 'legitimate regulatory distinction' and 'even-handedness' in Article 2.1 of the TBT to Article III:4<sup>57</sup>, nor is it possible to consider adequately all possible non-protectionist policy justifications under Article III:1. One may dismiss such concerns as misguided because if the jurisprudence under Article 2.1 of the TBT Agreement only applies to origin-neutral measures under Article III:4, then doing so could at most imply a less frequent recourse to Article XX. Article XX will still have a role to play in cases where the violation of Article III:4 is established by origin-based discrimination or in cases coming from Article XI or other Articles.<sup>58</sup> But this argument represents a radical deviation from the WTO case law precedents. In view of the Appellate Body's formalist approach to the interpretation of WTO texts, arguably out of legitimacy concerns<sup>59</sup>, it is unlikely for the Appellate Body to adopt such an approach in practice.

Of course, the Appellate Body's interpretation of 'treatment no less favorable' in *EC – Seal Products* is not free from doubts and concerns. It is submitted that there are at least four problems with regard to the Appellate Body's interpretive approach. First, the Appellate

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<sup>57</sup> Ibid. Neither are these concepts part of the text of Article 2.1 of the TBT Agreement. The Appellate Body used a contextual approach to tease out the meaning of 'treatment no less favorable' in Article 2.1 in *US – Clove Cigarettes*. However, no Article XX-like exception clause in the TBT Agreement weighs heavily in the Appellate Body's reasoning to introduce these concepts to Article 2.1. The TBT case law also demonstrated that the second step of 'treatment no less favorable' in Article 2.1 is almost identical to the chapeau test of Article XX.

<sup>58</sup> Robert Howse and Donald H. Regan, 'The Product-Process Distinction: An Illusory Basis for Disciplining Unilateralism in Trade Policy', 11(2) *European Journal of International Law* 249 (2000), at 266.

<sup>59</sup> Sol Picciotto, 'The WTO's Appellate Body: Legal Formalism as a Legitimation of Global Governance', 18 (3) *Governance* 477 (2005), at 478.

Body's interpretation almost deprives Article III:1 of any meaning. It is well settled that the purpose of the NT obligation is to avoid protectionism and that Article III:1 informs Article III:4. The negotiating record of the NT obligation also suggests that the specific intention of incorporating Article III:1 was to mandate purpose inquiries in dealing with origin-neutral measures under Articles III:2 and III:4.<sup>60</sup> In other words, Article III:4 of the GATT 1994 itself affords some policy space for WTO members to regulate for non-protectionist policy goals. If this is true, then origin-neutral internal measures that genuinely serve non-protectionist purposes with only incidental negative trade effects should not be found in violation of the NT obligation in the first place, let alone the necessity to seek justification under Article XX. That being said, the negotiating history of the role of Article III:1 in interpreting Article III:4 is not entirely unambiguous.<sup>61</sup> Indeed, if all negotiating parties have shared a common understanding on this issue, we would not see the rise and fall of the 'aims and effects' test in the first place.<sup>62</sup> In any case, the Appellate Body seldom resorts to *travaux préparatoires* because they are only a supplementary means of interpretation.<sup>63</sup>

Second, the Appellate Body's interpretation of 'treatment no less favorable' in *EC – Seal Products* may cause inconsistent rulings between Article III:2, the second sentence and Article III:4, leading to a curious result of internal fiscal measure may enjoy wider policy space than internal non-fiscal measures under the NT obligation. The second sentence of Article III:2 specifies a NT obligation for internal taxation on directly competitive or substitutable products (DCS products). The Appellate Body reasoned that since the second sentence specially refers to Article III:1, a separate finding that the 'so as to afford protection' requirement in Article III:1 has been violated is necessary to establish a violation under the

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<sup>60</sup> Weihuan Zhou, 'The Role of Regulatory Purpose under Article III:2 and 4- Toward Consistency between Negotiating History and WTO Jurisprudence', 11 (1) World Trade Review 81 (2012), at 100-102.

<sup>61</sup> *Ibid*, at 106.

<sup>62</sup> Du, above n 31, at 656-664.

<sup>63</sup> Enrico Partiti, 'The Appellate Body Report in US- Tuna II and Its Impact on Eco-Labeling and Standardization', 40 (1) Legal Issues of Economic Integration 73 (2013), at 79.

second sentence of Article III:2.<sup>64</sup> The Appellate Body further illustrated in *Chile – Alcoholic Beverages* that the regulatory purpose of the measure at issue and, more specifically, whether the structure of measure relates to the asserted purpose is the key to determine whether the measure has the effect of ‘so as to afford protection’ to domestic products.<sup>65</sup> Other than an explicit reference to Article III:1 in the second sentence of Article III:2, there does not seem to be a valid policy rationale to explain why the Appellate Body should reject any regulatory purpose analysis in Article III:4. That said, it is difficult to fault the Appellate Body for adopting a strict textualist approach to Article III:4. The Appellate Body has adopted the same strict textualist approach in its interpretation of Article III:2, the first sentence since the establishment of the WTO in 1995.<sup>66</sup>

Third, the Appellate Body’s interpretation of ‘treatment no less favorable’ may create inconsistent rulings between the GATT 1994 and the TBT Agreement in the future. Article XX provides a closed list of legitimate objectives for government intervention. It is questionable whether this closed list written sixty years ago is adequate to rescue various legitimate government regulations in the 21<sup>st</sup> century.<sup>67</sup> Some suggested that Article XX may not be available in the realm of culture, consumer protection (beyond life and health) and socio-economic policies in general.<sup>68</sup> By contrast, under Article 2.1 of the TBT Agreement, the list of possible legitimate objectives that may factor into the ‘treatment no less favorable’ analysis is open. Thus, a technical regulation that has a detrimental impact on imports would be permitted if such detrimental impact stems from a legitimate regulatory distinction, while,

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<sup>64</sup> WTO Appellate Body Report, *Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages II)*, WT/DS8/AB/R, adopted 1 November 1996, at 24.

<sup>65</sup> WTO Appellate Body Report, *Chile – Taxes on Alcoholic Beverages (Chile – Alcoholic Beverages)*, WT/DS87/AB/R, adopted 12 January 2000, paras 71-72.

<sup>66</sup> Appellate Body Report, *Japan – Alcoholic Beverages II* (n 66), at 18-9;

<sup>67</sup> Frieder Roessler, ‘Beyond the Ostensible: A Tribute to Professor Robert Hudec’s Insights on the Determination of the Likeness of Products under the National Treatment Provisions of the General Agreement on Tariffs and Trade’, 37 (4) *Journal of World Trade* 771 (2003), at 777.

<sup>68</sup> See Ehring, above n 12, at 955.

under Article III:4 of the GATT 1994, the same technical regulation would be prohibited if the objective that it pursues does not fall within the subparagraphs of Article XX.<sup>69</sup> Therefore, if WTO Panels were to confine purpose inquiries to Article XX, the policy space that WTO members would like to retain with regard to the use of domestic measures in GATT 1994 may be severely restricted and the legitimacy of the multilateral trading system may be undermined.<sup>70</sup>

However, the Appellate Body does not share such concerns. The Appellate Body argued in *EC – Seal Products*:

[T]he European Union has not pointed to any concrete examples of a legitimate objective that could factor into analysis under Article 2.1 of the TBT Agreement, but would not fall within the scope of Article XX of the GATT 1994... [Even] If there is a perceived imbalance in the existing rights and obligations under the TBT Agreement and the GATT 1994, the authority rests with the Members of the WTO to address that imbalance.<sup>71</sup>

As the defending party, the EU was understandably reluctant to point out any example in which a legitimate objective would not fall within the scope of Article XX because such a move will prevent itself from invoking Article XX in certain disputes in the future.<sup>72</sup> On the other hand, the Appellate Body seemed to imply that WTO Members should not worry about the alleged inconsistency between Article III:4 of the GATT 1994 and Article 2.1 of the TBT Agreement going forward. To begin with, the Appellate Body emphasized that the balance between trade liberalization and Members' right to regulate in the TBT Agreement is not, in principle, different from the balance set out in the GATT 1994.<sup>73</sup> If so, then the fact that this balance is expressed in different forms should not result in inconsistent rulings. Furthermore, by challenging the EU to point out a concrete example, the Appellate Body seemed to hint that

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<sup>69</sup> Appellate Body Report, *EC – Seal Products*, above n 3, at 5.118.

<sup>70</sup> Grossman, Horn and Mavroidis, above n 9, at 129.

<sup>71</sup> Appellate Body Report, *EC – Seal Products*, above n 3, paras 5.128- 5.129.

<sup>72</sup> Robert Howse, above n 7.

<sup>73</sup> Appellate Body Report, *EC – Seal Products*, above n 3, at 5.127.

the scope of legitimate objectives that could be invoked under Article XX of the GATT is largely the same as the TBT Agreement. If this were true, then the Appellate Body would necessarily interpret the ten subparagraphs of Article XX more flexibly in order to cover all possible legitimate objectives that a WTO Member may pursue in future disputes. The Appellate Body's liberal interpretation of 'public morals' in Article XX (a) in *EC – Seal Products* may have already pointed to this direction.<sup>74</sup>

Finally, the Appellate Body's interpretation of 'treatment no less favorable' does not help to alleviate the rule-exception dichotomy embedded in the GATT 1994. The normative hierarchy whereby the default norm is liberalized trade, and non-economic competing values, such as human health and safety and protection of the environment, have to be *justified* is simply unacceptable to many people.<sup>75</sup> However, to be fair, the WTO Appellate Body should not be blamed for the rule-exception dichotomy embedded in the WTO text. It is difficult to imagine an aggressive role for the Appellate Body to respond to such sensitivity. The role of the Appellate Body is to interpret the WTO text as it was written by the negotiators. The institutional constraints of the WTO also militate against the Appellate Body's ability to play such a progressive role.<sup>76</sup>

Ultimately, the debate on the merit of the Appellate Body's interpretive approach to 'treatment no less favorable' analysis in *EC – Seal Products* boils down to this question: where should a panel consider the regulatory purpose of the measure at issue, under the less favorable treatment analysis in Article III:4 itself or under Article XX? I submit that, with regard to the outcome of a dispute, there is not really much difference. This point could be

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<sup>74</sup> Joost Pauwelyn, 'The Public Morals Exception after Seals- How to Keep it under Check?' <http://worldtradelaw.typepad.com/ielpblog/2014/05/the-public-morals-exception-after-seals-how-to-keep-it-in-check.html> (27 May 2014).

<sup>75</sup> Henrik Horn and J.H.H. Weiler, 'EC- Asbestos' in Henrik Horn and Petros C. Mavroidis (eds), *The WTO Case Law of 2001* (Cambridge: Cambridge University Press, 2003), at 31.

<sup>76</sup> Richard H. Steinberg, 'Judicial Lawmaking at the WTO: Discursive, Constitutional, and Political Constraints', 98 *American Journal of International Law* 247 (2004), 257-67.

illustrated by the Appellate Body's interpretation of Article 2.1 of the TBT Agreement. For Article 2.1, the first step in the Appellate Body's 'treatment no less favorable' analysis is the same disparate impact test in Article III:4; the second step of determining whether the detrimental impact stems exclusively from a legitimate regulatory distinction, sort of the 'regulatory purpose' test favored by many leading WTO commentators, is very similar to the chapeau test of Article XX of the GATT 1994.<sup>77</sup>

As the TBT case law shows, the second step of the analysis in Article 2.1 has been interpreted expansively by the WTO Appellate Body,<sup>78</sup> and sometimes so expansively that intentionally or unintentionally, the Appellate Body may do under Article 2.1 what it is supposed to do under the necessity test in Article 2.2.<sup>79</sup> This is of course not surprising because no facts are *per se* excluded from the assessment of whether or not the measure is implemented even-handedly under the chapeau test in Article XX. Such facts may include the objective of the measure, whether it is legitimate, how is the measure applied, the extent to which the measure contributes to the objective at the chosen level, the existence of less trade restrictive alternatives, whether the restrictiveness of the measure is somewhat disproportionate, and even the consistent treatment of similar situations.<sup>80</sup>

Then, we may wonder what purpose does it really serve to transpose the essentially Article XX case law to the 'treatment no less favourable' analysis in Article III:4? As my analysis has shown, despite some reasonable concerns, the Appellate Body has valid reasons to

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<sup>77</sup> Johannes Norpoth, 'Mysteries of the TBT Agreement Resolved? Lessons to Learn from Climate Policies and Developing Country Exporters from Recent TBT Disputes', 47(3) *Journal of World Trade* (2013) 575, at 594; Joshua Meltzer, 'The WTO Ruling on U.S. Country of Origin Labeling' ("COOL"), 16 (23) *ASIL Insight* (2012).

<sup>78</sup> Jonathan Carlone, 'An Added Exception to the TBT Agreement after Clove, Tuna II and Cool', 37 *Boston College International & Comparative Law Review* 103 (2014), at 136.

<sup>79</sup> Joost Pauwelyn, 'Cool...but what is Left now for TBT Art. 2.2?', <http://worldtradelaw.typepad.com/ielpblog/2012/07/cool-but-what-is-left-now-of-tbt-art-22.html> (03 July 2012).

<sup>80</sup> Flett, above n 53, at 63; Benn McGrady, *Trade and Public Health: The WTO, Tobacco, Alcohol, and Diet* (Cambridge University Press, 2011), at 167; Zhou, above n 47, at 1120.

choose a bright line ‘disparate impact’ test for the ‘treatment no less favourable’ analysis. It has the benefits of a clear division of labour between Article III and Article XX; acute awareness of the textural differences among WTO Agreements and the avoidance of depriving Article XX of *effect utile*. Moreover, given that the WTO Appellate Body has established a long and increasingly stabilised jurisprudence under Article III:4 and Article XX, the cost of trying to reinvent the wheel is simply too heavy and the benefits do not obviously outweigh the costs incurred.

### **3. The Future of the National Treatment Obligation in GATT Article III:4**

In *EC – Seal Products*, the Appellate Body ruled that every regulation that results in different market opportunities for domestic products vis-à-vis imported like products, regardless of any possible policy rationale, is a *prima facie* violation of Article III:4. This holding shows that the Appellate body has attached great importance to the *effects* of the measure and defined protectionism solely by disparate impact on imported products. As a consequence, the regulatory space left for WTO Members under Article III:4 is much narrower than conventionally assumed. The full implication of the Appellate Body’s ruling remains to be seen. As Howse pointed out, the Appellate Body seems to have imposed a ‘strict liability’ on importing countries and many legislative or regulatory distinctions between products would fail this test.<sup>81</sup> This is potentially very problematic because national safety, environmental and health rules, for example, are quite likely to have a different impact on goods produced in different countries. The logical implication is that a large universe of laws and regulations is now *prima facie* illegal under WTO law. The outcome seems extreme and hard to reconcile with the intent and text of the GATT.<sup>82</sup>

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<sup>81</sup> Rob Howse, Joanna Langille and Katie Sykes, ‘Sealing the Deal: the WTO Appellate Body’s Report in *EC – Seal Products*’, 18 (12) ASIL Insights, June 2014.

<sup>82</sup> Ibid.

To be fair, there are still a few possible buffers in Article III:4 despite the Appellate Body's stringent interpretation in *EC – Seal Products*. Interpreted properly, these buffers may suggest some regulatory space for non-protectionist regulations to pass muster under Article III:4. I submit that, going forward, the scope of national regulatory autonomy under Article III:4 will be largely dependent on the Appellate Body's handling of the following three issues.

### **3.1 The 'Genuine Relationship' Requirement**

The first issue is the Appellate Body's interpretation of the 'genuine relationship' requirement between the measure at issue and its adverse impact on competitive opportunities for imported products vis-à-vis like domestic products. To be clear, after *EC – Seal Products*, there is still room to argue that even if the measure at issue has a disparate impact on imported products compared to like domestic products, there is nevertheless no less favorable treatment. The key argument will be that a 'genuine relationship' between the measure and the disparate impact on competitive opportunities does not exist. In *Thailand – Cigarettes*, the Appellate Body required that in every case such a genuine relationship must exist.<sup>83</sup> A genuine relationship means that it is the *governmental measure at issue* that affects the conditions under which like products, domestic and imported, compete in the market within a Member's territory.<sup>84</sup> In *Dominican Republic – Cigarettes*, a fixed expense, such as the annual fee for the bond, led to different per-unit costs among supplier firms, to the extent that these firms had different volumes of production or volumes of sales.<sup>85</sup> Because imported cigarettes had a smaller market share, per unit costs of the bond requirement for imported cigarettes were higher than domestic cigarettes. The Appellate Body held that there was no less favorable treatment essentially because the disparate impact on imported products was not attributable to the measures at issue, but because of greater market shares of domestic

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<sup>83</sup> Appellate Body Report, *Thailand – Cigarettes*, above n 5, para 134.

<sup>84</sup> Appellate Body Report, *EC – Seal Products*, above n 3, para 5.105.

<sup>85</sup> Appellate Body Report, *Dominican Republic – Cigarettes*, above n 4, para 98.

cigarettes than those of imported cigarettes in the Dominican Republic market. In *EC – Seal Products*, the Appellate Body identified a second possible scenario where the disparate market impact was caused not by the governmental measure but *entirely* by private choices.<sup>86</sup> It is not clear how the Appellate Body could make such a determination. Governments routinely make normative regulations that affect private choices.<sup>87</sup> In reality, a disparate market impact can hardly be caused *entirely* by private choice and the measure at issue does not play any role in causing such an adverse impact.<sup>88</sup> It is quite possible that the Appellate Body may loosen this seemingly insurmountable test in future cases.

Interesting questions may arise as to how to determine the causal link between the governmental measure at issue and the detrimental impact on imported products. It is well known that the ‘but-for’ test is commonly used to determine a defendant’s responsibility in tort and criminal law. It states that causation exists only when the result would not have occurred without the accused party’s conduct. The ‘but-for’ test simply asks the question: ‘but for the existence of X, would Y have occurred?’ If the answer is yes, then factor X is an actual course of result Y.<sup>89</sup> Applying the ‘but-for’ test to *Dominican Republic – Cigarette*, the uniform 5M bond requirement is surely a causal factor because without the bond requirement, the disparate impact would not arise in the first instance. This reasoning is of course not what the Appellate Body wanted as the Appellate Body looked at *other* contributing factors and made the determination that market share, rather than the measures at issue, was accountable for the disparate impact on trade. This means that identification of a genuine relationship entails examining and dismissing *other* factors to which the detrimental impact might be attributable: climatic or geographical or demographic factors, changing consumer tastes or

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<sup>86</sup> Appellate Body Report, *EC- Seal Products*, above n 3, para 5.336.

<sup>87</sup> Lydgate, above n 11, at 185.

<sup>88</sup> I thank one anonymous reviewer for pointing out this point.

<sup>89</sup> *R v White* [1910] 2 KB 124.

ethical values, policies of the governments of the exporting countries that could affect how the market is structured, etc.<sup>90</sup> To establish the attribution, or a genuine relationship to the measure, a Panel must arguably be sure that the detrimental competitive impact in question is not due to the other factors, largely or entirely. In *Dominican Republic – Cigarettes*, the Appellate Body in essence held that the market share was a *closer* cause for the disparate impact on imports. Though there is no denying that the measure at issue was also a causal factor for the disparate impact, its link to the detrimental impact on trade was arguably not sufficient or as strong as the market share factor.

Furthermore, as the Appellate Body stated in *Korea – Various Measures on Beef*, a formally identical measure could lead to disparate impact in the market place. Precisely because imported cigarettes have a smaller market share, the uniform 5M bond requirement had a detrimental impact on imported cigarettes on a per unit basis in *Dominican Republic – Cigarettes*. This heavier burden would likely make it more difficult for imported cigarettes to increase its market share. To ensure the equality of competitive conditions, it is reasonable not to levy the bond in a uniform amount of 5 million. Rather, the amount should vary in light of the smaller market shares held by imported cigarettes. Therefore, the denial of the causal relationship between the disputed measure and the detrimental impact by the Appellate Body in *Dominican Republic – Cigarette* is not entirely convincing.

A more appropriate interpretation of the Appellate Body's report on *Dominican Republic – Cigarettes* is that the Appellate Body recognized that to ensure absolute equality of treatment in all circumstances is too costly and that it will make the design and implementation of a *bona fide* regulation unnecessarily complicated. The uniform bond requirement in the case had only incidental and unintended disparate impact on imported cigarettes. Another causal

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<sup>90</sup> Howse, above n 7.

factor having little or nothing to do with the governmental measure, different market shares, better explains the disparate impact identified by the complaining party. Related, the calculation carried out by the Panel showed that the bond requirement represented a very small cost for the importer—equivalent to 0.2 per cent of the value of cigarette imports made by the importer in the year 2003.<sup>91</sup> Such a small cost had not affected the exportation of cigarettes from Honduras to the Dominican Republic. Indeed, the exports from Honduras had increased significantly over the years since the measure was introduced.<sup>92</sup> The Appellate Body thus concluded:

[a]s long as the difference in costs does not alter the conditions of competition in the relevant market to the detriment of imported products, that fact in itself should not be enough to conclude that the expense creates a less favourable treatment for imported products.<sup>93</sup>

This analysis shows that the genuine relationship requirement offers some room for a clearly non-protectionist measure with only incidental and negligible trade impact on imports to pass muster the ‘treatment no less favorable’ test. In future trade disputes, whether there is a genuine relationship between the measure at issue and its adverse impact on competitive opportunities for imported products vis-à-vis like domestic products will be a main battlefield for the defending party.

### ***3.2 The Role of ‘Design, Structure and Expected Operations of the Measure’***

The second issue is the role of ‘the design, structure and expected operations of the measure’ in the NT analysis. In *EC – Seal Products*, the Appellate Body explicitly denied the relevance of Article III:1 in interpreting ‘treatment no less favorable’. Even so, there is lingering doubt on whether the Appellate Body has *implicitly* considered the regulatory purpose of the

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<sup>91</sup> Appellate Body Report, *Dominican Republic – Cigarettes*, above n 4, para 97.

<sup>92</sup> *Ibid.*, para 71.

<sup>93</sup> *Ibid.*

contested measure. This point could be observed from the Appellate Body's emphasis on examining 'the design, structure and expected operations of the measure' when assessing 'treatment no less favourable' in *Thailand – Cigarettes*.<sup>94</sup> This is precisely the same approach that the Appellate Body has taken when assessing whether the dissimilar taxation of imported and domestic like DCS products is applied 'so as to afford protection' in the second sentence of Article III:2.<sup>95</sup>

The second sentence of Article III:2 specifies a NT obligation for internal taxation on DCS products . It specifically refers to Article III:1. Article III:2 reads:

The [imported] products ... shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products *in a manner contrary to the principles set forth in paragraph 1*.

Article III:2, second sentence, has an Interpretative Note that reads:

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between... the taxed product and... a *directly competitive or substitutable product* which was not similarly taxed.

In the Appellate Body's view, Article III:1 is relevant for the whole of Article III:2. However, it informs the two sentences of Article III:2 in different ways. The first sentence of Article III:2 does not refer specifically to Article III:1. The Appellate Body interpreted the omission as meaning that the presence of 'so as to afford protection' in Article III:1 need not be established separately.<sup>96</sup> Unlike the first sentence of Article III:2, the language of the

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<sup>94</sup> Appellate Body Report, *Thailand – Cigarettes*, above n 4, para 130 and 134.

<sup>95</sup> Appellate Body Report, *Japan – Alcoholic Beverages II*, above n 66, at 28-29; Appellate Body Report, *Philippines – Distilled Spirits*, above n 10, para 190.

<sup>96</sup> *Ibid*, 18-9; Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather*, WT/DS155/R, adopted 16 February 2001, paras 11.132-138. Henrik Horn and Petros C Mavroidis, 'Still Hazy after All These Years: The Interpretation of National Treatment in the GATT/WTO Case- Law on Tax Discrimination' (2001) 15 *European Journal of International Law* 39, at 48.

second sentence of Article III:2 specifically invokes Article III:1. The Appellate Body reasoned that:

The significance of this distinction... is that it acts explicitly as an entirely separate issue that must be addressed along with two other issues that are raised in applying the second sentence. As a result, a separate finding that the [so as to afford protection] requirement has been violated is necessary in the case of [DCS products].<sup>97</sup>

On how to establish this element, the Appellate Body made it clear that this is not an issue of intent behind a measure, but is an issue of how the measure in question is *applied*. In practice, it is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent. It is irrelevant that protectionism was not an intended objective.<sup>98</sup> The Appellate Body further held that it is possible to examine objectively the underlying criteria used in a particular tax measure. The Appellate Body noted:

We believe [it] requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products. ...Although it is true that the aim of a measure may not be easier ascertained, nevertheless its protective application can most often be ascertained *from the design, the architecture, and the revealing structure of a measure*.<sup>99</sup>

In *Chile – Alcoholic Beverages*, the Appellate Body found that the structure of the Chilean tax did not relate to the purposes stated by Chile, and concluded that this lack of correlation confirmed its finding that the Chilean measure was applied ‘so as to afford protection’.<sup>100</sup> Moreover, in the course of agreeing with Chile that its measures need not be shown to be necessary to Chile’s asserted purposes, the Appellate Body stated:

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<sup>97</sup> Appellate Body Report, *Japan – Alcoholic Beverages II*, above n 66, at 24.

<sup>98</sup> *Ibid*, at 27-28.

<sup>99</sup> *Ibid*, at 29.

<sup>100</sup> Appellate Body Report, *Chile – Alcoholic Beverages*, above n 67, para 71.

[I]t appears to us that the panel did no more than try to relate to the observable structural features of the measure with its declared purposes, a task that is *unavoidable* in appraising the application of the measure as protective or not of domestic production.<sup>101</sup>

Here the Appellate Body seems to say that the inquiry was undertaken precisely to identify the measure's objective or purpose.<sup>102</sup> Revealingly, in *Thailand – Cigarettes*, the Appellate Body similarly mandated the Panel to examine the 'design, structure and expected operations of the measure' when assessing whether the regulation at issue has modified the conditions of competition between imported and domestic like products.<sup>103</sup> By examining the same elements, the Appellate Body will be able to ascertain, even if implicitly, whether the measure in dispute is applied 'so as to afford protection' for domestic production. The Appellate Body's blunt rejection of the need to consider the possible policy rationale in *EC – Seal Products* raises the question of the purpose of examining 'the design, structure and expected operations' of the disputed measure under Article III:4 in future disputes. One plausible interpretation may be that in Article III:4, the purpose of examining the 'design, structure and expected operations' of the measure is to ascertain the disparate impact on imported products, whilst in the second sentence of Article III:2, the purpose is to ascertain the protectionism intent. But this is clearly an artificial distinction. In practice, a panel member will instinctively want to know if the measure has a *bona fide* regulatory purpose and to what extent its market effects are protective when they are called to decide whether the measure in question is in violation of Article III.<sup>104</sup> Rather than being a separate step in Article III:2 analysis, it may be argued that the consideration of Article III:1 is *subsumed* within the 'treatment no less favourable' analysis. As a matter of fact, many leading WTO experts hope that the Appellate Body might step back from its drastic decision to ignore all possible policy

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<sup>101</sup> *Ibid*, para 72.

<sup>102</sup> Donald Regan, 'Further Thoughts on the Role of Regulatory Purpose under Article III of the GATT', 37 (4) *Journal of world trade* 737 (2003), at 740.

<sup>103</sup> Appellate Body Report, *Thailand – Cigarettes*, above n 4, para 130 and 134.

<sup>104</sup> Robert E. Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test', 32 *International Lawyer* 619 (1998), at 634-635.

justifications under Article III:4 itself in future decisions.<sup>105</sup>

### ***3.3 Consumer Preferences and ‘Like Products’ Determination***

The third issue is how flexible the Appellate Body will use the different criteria for the determination of ‘like products’. The case law emphasized the importance of a competitive market relationship between products, *from a consumer perspective*, as a way to determine their likeness.<sup>106</sup> A Panel is mandated to examine each of the criteria, and then, weigh all of that evidence, along with any other relevant evidence, in making an overall determination on ‘like products’. In this weighing and balancing exercise, some evidence may reflect a competitive relationship between products, while other evidence may point to a different conclusion. The Appellate Body made it clear that not all products which are in *some* competitive relationship are ‘like products’ under Article III:4.<sup>107</sup> What is at stake is a contextual and qualitative judgment about competitive relationships, not merely the economic analysis of cross-elasticity of demand between two groups of products. Such an assessment must be made on a case-by-case basis, informed by the general principle of anti-protectionism which informs all of Article III.<sup>108</sup>

In particular, it has been frequently suggested that some criterion such as consumer tastes and habits may be used to distinguish between products that would otherwise be seen as like, for example, sustainable versus unsustainable, or carbon-intensive versus low-carbon goods.<sup>109</sup> In *EC – Asbestos*, the Appellate Body remedied the narrow scope given to the concept of likeness in prior case law by allowing non-economic interests and values, such as health, to be

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<sup>105</sup> Howse, Langille and Sykes, above n 83.

<sup>106</sup> Erich Vranes, *Trade and The Environment: Fundamental Issues in International Law, WTO Law and Legal Theory* (Oxford: Oxford University Press 2009), 200-215.

<sup>107</sup> Appellate Body Report, *EC – Asbestos*, above n 8, para 99.

<sup>108</sup> Robert Howse and Elisabeth Turk, ‘The WTO Impact on Internal Regulations: A Case Study of the *Canada-EC Asbestos* Dispute’ in George A. Bermann and Petros C. Mavroidis (eds), *Trade and Human Health and Safety* (Cambridge: Cambridge University Press, 2006), at 89.

<sup>109</sup> Erich Vranes, ‘Climate Labelling and the WTO: The 2010 EU Eco-labelling Program as a Test Case under WTO Law’, [http://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=1444518](http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1444518) (9 March 2010), at 14.

considered in the determination of ‘like products’.<sup>110</sup> In *US – Clove Cigarettes*, the Appellate Body confirmed that the regulatory concerns may play a role in determining ‘like products’.<sup>111</sup> A more flexible and imaginative use of ‘like products’ analysis is surely a promising path to open up more regulatory space for a regulating WTO Member.

However, there are some stumbling blocks on this path. In *US – Clove Cigarettes*, the Appellate Body emphasized that the regulatory concerns are relevant to ‘like products’ determination only to the extent that they are *reflected* in the competitive relationship between and among the products concerned.<sup>112</sup> In other words, it is one thing to argue that an increasing number of consumers is interested in, and sensitive to, the labor, environmental and other social concerns embodied in a product, it is quite another to *demonstrate* that such regulatory concerns indeed shape consumer preferences and guide consumer choices in the market place. If there is evidence showing that a significant segment of consumers perceive two groups of products differently, then a strong argument could be made that two products at issue are not ‘like products’. However, in reality, more often consumers are primarily guided by the price and quality of the products in their choice between products.<sup>113</sup> If so, it is unlikely to overturn the ‘like products’ determination between two otherwise identical products with only divergent environmental impact. Looking at the issue from this perspective, *EC – Asbestos* is a unique case because what is at stake is human health, the importance of which is undisputable.<sup>114</sup> International standards also support the classification of asbestos as a carcinogen, whose use should be eliminated. This made the interpretation of

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<sup>110</sup> Appellate Body Report, *EC – Asbestos*, above n 8, paras 114 and 122.

<sup>111</sup> Appellate Body Report, *US – Clove Cigarettes*, above n 6, para 120.

<sup>112</sup> *Ibid.*

<sup>113</sup> Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization* (3<sup>rd</sup> Edition, Cambridge University Press 2013), at 393.

<sup>114</sup> Ming Du, ‘Autonomy in Setting Appropriate Level of Protection under the WTO Law: Rhetoric or Reality?’, 13 (4) *Journal of International Economic Law* 1077 (2010), at 1100-1101.

consumer tastes and habits in *EC – Asbestos* fairly unambiguous even if there was not sufficient evidence supporting the claim.<sup>115</sup>

In *US – Tuna II*, the preference by American consumers for dolphin-friendly tuna was so intense that all major American retailers no longer sell tuna caught by setting on dolphins.<sup>116</sup> The finding of the Panel that American tuna and Mexican tuna are ‘like products’ was not appealed by the parties. However, it could have been argued that in view of the intense consumer preferences, dolphin-friendly tuna and dolphin-unfriendly tuna were not ‘like products’, so that a different regulatory regime for dolphin-unfriendly tuna would have been deemed legitimate.<sup>117</sup> In any case, the US never raised a ‘like products’ argument and both parties agreed that the products at issue were simply tuna.<sup>118</sup>

Another stumbling block is the relationship between the government regulation and consumer preferences. In *Japan – Alcoholic Beverages I*, the panel warned that while the subjective factor of consumer taste should not be left out of account, a tax should not be allowed to ‘crystallize’ consumer preferences for traditional domestic products.<sup>119</sup> This position was later repeated in other panels’ reports.<sup>120</sup> The underlying assumption, that government regulation should not influence consumer preferences, is not surprising, given the free market basis of the WTO.<sup>121</sup> However, when applying this logic to a public policy context, it has radical implications. Governments routinely make normative regulations such as sustainability criteria to affect consumer preference and influence consumers to adapt to

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<sup>115</sup> Lydgate, above n 11, at 178.

<sup>116</sup> Panel Report, *US- Tuna II*, WT/DS381/R, adopted 13 June 2012, as modified by Appellate Body Report WT/DS/381/R, para. 7.352.

<sup>117</sup> Partiti, above n 64, at 81.

<sup>118</sup> Panel Report, *US – Tuna II*, above n 117, paras. 7.249- 7.250.

<sup>119</sup> GATT Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, adopted on 10 November 1987, L/6216 – 34S/83, para. 5.7.

<sup>120</sup> Panel Report, *Japan – Alcoholic Beverages II*, WT/DS/8/R, adopted 1 November 1996, as modified by Appellate Body Report WT/DS8/AB/R, para. 6.28; Panel Report, *Canada – Periodicals*, WT/DS/31/R, adopted 30 July 1997, as modified by Appellate Body Report WT/DS31/AB/R, para. 5.22.

<sup>121</sup> Lydgate, above n 11, at 185.

shifting or emerging norms. These regulatory preferences likely reflect their national values and priorities. It is important that the WTO system not act as a braking mechanism for more progressive regulations that support emerging norms such as regulations that support environmental sustainability, or climate change mitigation.<sup>122</sup>

#### **4. Conclusion**

With respect to domestic instruments, Article III of the GATT 1994 is an incomplete contract in that it provides neither an exhaustive nor even an indicative list of the measures covered.<sup>123</sup>

WTO Members are allowed to unilaterally choose their domestic policies but all policies must be applied in an even-handed manner to domestic and imported goods alike, no matter what their final choice is. Increasingly, the Appellate Body's interpretation of 'treatment no less favorable' has attracted the most attention in the NT obligation. As the case law has shown, the 'treatment no less favorable' standard prohibits WTO Members from modifying the conditions of competition in the market place to the detriment of imported products vis-à-vis like domestic products. There has been a long-standing debate on whether the regulatory purpose should be considered in the interpretation of 'treatment no less favorable'. The Appellate Body finally made it clear in *EC – Seal Products* that 'treatment no less favorable' only refers to a detrimental impact on competitive opportunities for imported products. There is no need to consider the regulatory purpose of the measure in Article III:1 separately.

The Appellate Body's equation of a detrimental impact on imported products with less favorable treatment is potentially problematic. It seems questionable, given that the purpose of GATT Article III:1 is anti-protectionism, to characterize the enactment of a normal government regulation with some incidental negative effects on the competitive opportunities

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<sup>122</sup> Ibid, at 186.

<sup>123</sup> Petros C. Mavroidis, *Trade in Goods* (2<sup>nd</sup> Edition, Oxford University Press, 2012), at 233.

of foreigners as a presumptively internationally wrongful act requiring strict justification. On the other hand, the Appellate Body's approach has the benefits of a clear division of labour between Article III:4 and Article XX; acute awareness of the textural differences between Article III of the GATT 1994 and Article 2.1 of the TBT Agreement, and the avoidance of depriving Article XX of *effect utile*. Going forward, the scope of national regulatory autonomy under Article III:4 will be determined, to a large extent, by the Appellate Body's further elaboration on three key concepts. First, the 'genuine relationship' requirement between the measure at issue and its adverse impact on competitive opportunities for imported products vis-à-vis like domestic products. Second, the place of 'the design, structure and expected operations' of the measure in the 'treatment no less favorable' analysis. Third, the role of consumer preferences in the 'like products' analysis. It remains to be seen how flexible Article III:4 will be interpreted in future cases to allow an origin-neutral measure with only incidental negative trade impact to be consistent with the NT obligation.