

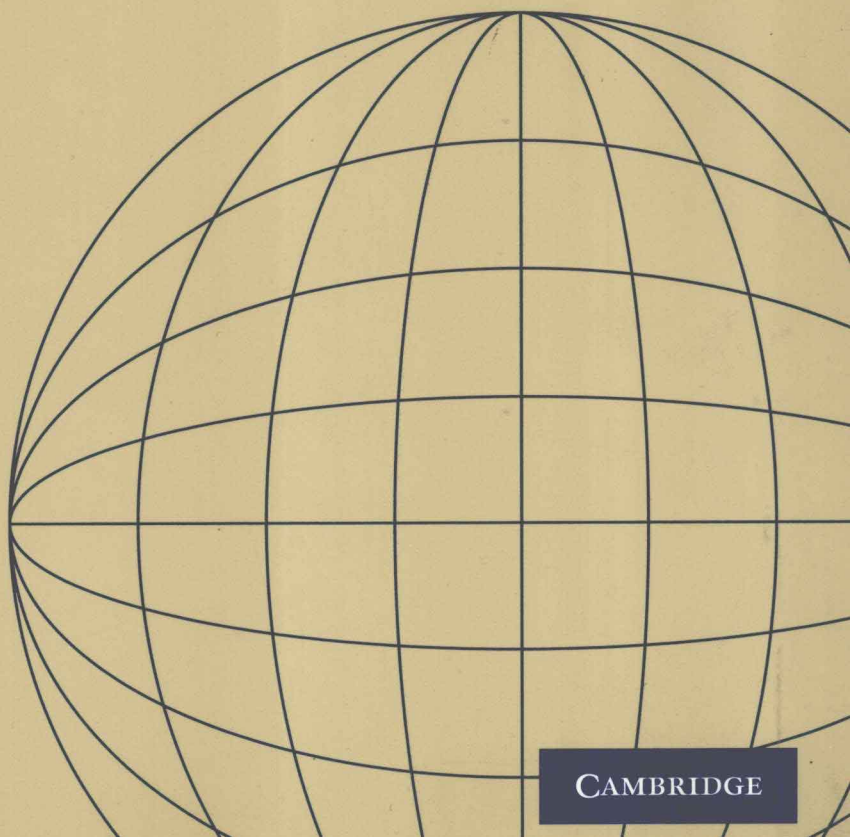


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The WTO CASE LAW of 2004–2005

LEGAL AND ECONOMIC ANALYSIS

Edited by
Henrik Horn and Petros C. Mavroidis



CAMBRIDGE

THE AMERICAN LAW INSTITUTE

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CAMBRIDGE
UNIVERSITY PRESS

CAMBRIDGE UNIVERSITY PRESS
Cambridge, New York, Melbourne, Madrid, Cape Town, Singapore, São Paulo

Cambridge University Press
The Edinburgh Building, Cambridge CB2 8RU, UK

Published in the United Kingdom by Cambridge University Press

www.cambridge.org
Information on this title: www.cambridge.org/9780521730761

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Printed in the United Kingdom at the University Press, Cambridge

A catalogue record for this publication is available from the British Library

ISBN 978-0-521-73076-1 paperback

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Foreword

This volume, containing analyses of decisions rendered by the adjudicating bodies of the World Trade Organization in 2004 and 2005, is The American Law Institute's most recent contribution in its continuing examination of the developing law of world trade. As with our previously published volumes analyzing decisions rendered from 2001 through 2003, each study is the joint work of a lawyer and an economist, and each study has been subjected to additional review and analysis by the other contributors and by an international group of experts at an invitational conference in Geneva in March 2007. The studies are the work of the individual authors and not of The American Law Institute.

With five years of WTO case law studies now to our credit, we have begun the second phase of our world trade work, seeking to draft general principles of world trade law based on that developing body of case law. The Chief Reporters for this phase are Henrik Horn of Stockholm University and Petros Mavroidis of the University of Neuchâtel and of Columbia University School of Law. We also hope to continue our reporting and analysis of individual WTO decisions.

We are grateful to the economists and lawyers who contributed the studies in this volume and to those who reviewed and constructively criticized their earlier drafts. We also express our appreciation to the Jan Wallander and Tom Hedelius Foundation and the Milton and Miriam Handler Foundation for their continued and generous financial support of this endeavor.

LANCE LIEBMAN
Director
The American Law Institute

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Introduction

HENRIK HORN AND PETROS C. MAVROIDIS

This is the fourth round of Reporters' Studies undertaken in the context of the American Law Institute project 'Principles of World Trade Law: The World Trade Organization'. The aim of the project is to provide systematic analysis of WTO law based in both economics and law. This year's focus has been on disputes that came to an administrative end during the years 2004 and 2005, either because they were not appealed or because the appeal process had come to an end. Each dispute has been evaluated jointly by an economist and a lawyer. Their general task has been to evaluate whether the ruling 'makes sense' from an economic as well as a legal point of view, and, if not, whether the problem lies in the legal text or in the interpretation thereof. The teams of lawyers and economists do not always cover all issues discussed in a case, but they seek to discuss both the procedural and the substantive issues that form the 'core' of the dispute as they see it.

Earlier versions of the Reporters' Studies were presented at a meeting at the WTO in Geneva in February 2007. The comments provided by discussants and other participants have been very helpful in the preparation of the final version of the papers in the volume, and we want to thank discussants and other participants for their efforts. We would also like to thank the WTO for providing a venue for the February meeting.

This project would not have existed had it not been for the efforts and commitment of Professor Lance Liebman, Director of the ALI. We have also benefited greatly from the support of ALI President Michael Traynor, ALI Deputy Director Elena Cappella, and former ALI Deputy Director Michael Greenwald. We would also like to thank Judy Cole, Sandrine Forgeron, and Marianne Walker of the ALI's staff for very efficient administrative and editorial help. Finally, we are extremely grateful for financial support from Jan Wallander's and Tom Hedelius' Research Foundation, the Milton and Miriam Handler Foundation, and Svenska Handelsbanken of Stockholm.

The Reporters' Studies on the WTO Case Law of 2004–2005

In this edition, we discuss Appellate Body (AB) reports only.

Horn and Howse discuss the *EC-Chicken Cuts* customs classification dispute. Superficially, the dispute thus only concerned the meaning of 'salted', and, in particular, whether it subsumed a long-term preservation condition. The parties, the Panel, and the AB all dealt with this issue as a question of treaty interpretation,

the central task being to decide the meaning of ‘salted’ in accordance with the canons of treaty interpretation to be found in Articles 31 and 32 of the Vienna Convention on the Law of Treaties. Horn and Howse disagree with the determination by the Panel and the AB on several core issues. First, the courts bias the outcome against the importing country due to the interpretation of the burden of proof in cases where two customs classification headings can be argued with equal force as the appropriate classifications. Second, in their view the case is about customs classification (despite the arguments by the parties and the courts to the contrary). For this determination, the Panel should have asked for expert opinion by the WCO. Third, they argue against the conclusion that the result of an EC violation of Art. II of the GATT could be justified on the basis of the evidence presented in this dispute. But Horn and Howse still believe that the actual outcome of the case might be justified on other grounds.

The comment by Meagher addresses several of the points made in Howse and Horn’s paper. In tariff-classification cases, it is important to strike a balance between ensuring that exporting Members may benefit from the tariff concession in question and still permitting importing Members to protect their tariffs. In the WTO context, this case raised not just issues of customs classification, but also the interpretation of treaty provisions in the form of the EC’s tariff schedules. As such, the WTO panel was compelled to accept jurisdiction and resolve the issue. The comment also disagrees with the authors’ suggestion that the issue should properly have been addressed under GATT Article X:3.

Hoekman and Trachtman discuss the *Canada–Wheat Exports and Grain Imports report*. Statutory marketing boards that have exclusive authority to purchase domestic production, sell for export, and set purchase and sales prices of commodities, are a type of state trading enterprise that is subject to GATT disciplines. The United States submitted its dispute with Canada to the WTO, alleging that WTO rules require state trading enterprises to operate solely in accordance with commercial considerations, and that the Canadian government did not require the Canadian Wheat Board to do so. The panel and the AB found that the primary discipline of the WTO regarding state trading enterprises was nondiscrimination, and that operating on the basis of commercial considerations was not an independent obligation. Instead, WTO disciplines regarding the pricing behavior of state trading enterprises use a commercial-considerations test as a possible indicator of discrimination. Although a significant degree of price discrimination is observed in the case of Canadian wheat exports, there are economic arguments why this might also be pursued by a private, profit-maximizing firm.

Commenting on the Hoekman and Trachtman paper, Roessler argues that the fundamental question that has been left open by the AB is what the principles of nondiscriminatory treatment covered by Art. XVII:1(a) GATT are. Roessler’s answer is that it is neither necessary nor appropriate to apply this article to the denial of National Treatment through state trading operations, but that the

standards set out in Articles III:2 and III:4 can and should be applied to prevent this.

The controversial *US–Gambling* report by the AB is discussed by **Irwin and Weiler**. The authors note that this report is significant mainly because of the examination of the nature of market access under Article XVI GATS, the relationship of that Article to Articles XIV and XVII GATS, and the parallels with Articles III, XI and XX GATT. Notably, the AB took the position that what on its face appeared as an internal regulatory measure, which, nonetheless, had equivalent effect to a zero quota, was captured by Article XVI GATS. A similar measure in the area of goods would have been examined under Article III GATT and would require a showing of discrimination. The facts of the case would have allowed the decision to be based on Article XVII GATS. The lion's share of the paper deals with this issue. The authors agree with this interpretation of Article XVI GATS by the AB, but are critical of its hermeneutics, suffering in their eyes from a textual fetish and a policy phobia. Some other elements in the decision are also examined critically.

Ortino, in his comment, principally criticizes the AB's decision in *US–Gambling* insofar as (i) it potentially expands the scope of the *per se* prohibition in Article XVI GATS to cover measures having an effect equivalent to an express quantitative restriction, and (ii) it reiterates the apparent confusion, created since *Korea–Beef*, on the nature of the 'balancing' exercise carried out under Article XIV GATS. Furthermore, he briefly highlights two interesting developments in *US–Gambling* on the 'burden of proof' and 'availability of alternative measures' under the least-trade-restrictive test of Article XIV GATS.

In the remaining part of the volume we discuss seven reports dealing with contingent protection instruments, the first four from the field of subsidies, and the remaining three from the field of antidumping. **Bown and Sykes** address issues that came before the AB in the *US–Softwood Lumber V* dispute, concerning an affirmative antidumping determination by the US Department of Commerce. The paper discusses both the original AB opinion in the dispute, and the later opinion reviewing the compliance panel findings. The authors focus primarily on the 'zeroing' issue in 'transaction-to-transaction' calculations of dumping. In general, they are ambivalent about the AB's approach to the zeroing issue. On the one hand, zeroing inflates dumping margins without any sound economic rationale for doing so. On the other hand, zeroing has been a standard administrative practice for many years and the Anti dumping Agreement (ADA) does not clearly prohibit it. The AB's legal analysis of the matter in T-T cases, in particular, rests on shaky premises. Bown and Sykes also consider the wisdom of addressing the zeroing issue in piecemeal fashion through what has proven to be a lengthy sequence of narrow decisions.

In her comment, **Crowley** concurs with the analysis of Bown and Sykes and offers two additional points. First, allowing zeroing in the calculation of dumping margins penalizes foreign exporting firms subject to volatile costs. Second, cost

allocation within a multi-product firm should attempt to equate the real economic returns across products.

Hoekman and Howse discuss the *EC–Export Subsidies on Sugar* litigation, which implicated a large number of developing countries with divergent interests. Brazil, Thailand, and Australia alleged that the EU exports had substantially exceeded permitted levels as established by European Union commitments in the WTO. This case had major implications for both European Union sugar producers and developing countries that benefited from preferential access to the European Union market. It was also noteworthy in the use of economic arguments by the WTO dispute-settlement panel, which held that the excess sugar exports were in part a reflection of illegal *de facto* cross-subsidization rents from production that benefited from high support prices being used to cover losses associated with exports of sugar to the world market. Although in principle the economic arguments of the panel could apply to many other policy areas, in practice WTO provisions greatly limit the scope to bring similar arguments for trade in products that are not subject to explicit export subsidy reduction commitments of the type that were made for sugar and other agricultural commodities.

Conconi, in her comment, notes that the most controversial issue regarding the dispute involves the EC exports of so-called C sugar. The WTO Panel and AB found that below-cost exports of an agricultural product might represent proof of export subsidization, even in the absence of direct export subsidies, if there is close linkage between these exports and domestic support programs. In her discussion of the economic analysis of the case, she reviews the possible reasons for the production of C sugar to evaluate the validity of the cross-subsidization argument.

Sapir and Trachtman deal with the *US–Upland Cotton* litigation, which, in their view, illustrates the challenges that panels face when they are required to evaluate complex economic matters. The serious-prejudice provisions of the SCM Agreement call for an initial determination by the panel, rather than the review of national agency determinations that is called for in the countervailing-duty provisions. In the countervailing-duty context, as in the safeguards and dumping contexts, the AB, the authors note, has seemed satisfied to have panels engage in procedural review of national agency determinations, rather than substantive review. Although this position is subject to question, given the substantive requirements of WTO law, it is patently untenable in the serious-prejudice context, where there is no initial national agency determination. In these cases, requirements to determine issues such as ‘causation’, ‘price suppression’, and ‘significant’ must, in the authors’ view, be understood as requirements that panels use the best analytical tools reasonably available to make such determinations.

Commenting upon the analysis by Sapir and Trachtman, **Vandenbussche** discusses the validity of the argument advanced by the complainants to the effect that the United States, through its subsidies, was indeed depressing world prices for cotton. In her view, the authors argue that the decision in favor of Brazil insufficiently demonstrated a causal link between price depression and US

subsidies to upland cotton. The Panel and the AB, she argues, made no effort to disentangle the effects of a US subsidy from other potential causes of price depression. In line with the arguments advanced by Sapir and Trachtman in favor of the application of rigorous economic methods in the determination of *causality*, she tries to shed, by means of a graphical exposition, some additional light on how economic analysis can be used for the causation analysis.

Francois and Palmeter discuss *US–Countervailing Duty Investigation on DRAMS*. In modifying and largely reversing the Panel’s decision that the US improperly levied countervailing duties on DRAMS from Korea, the AB dealt for the first time with the ‘entrusts or directs’ language of subparagraph (iv) of Article 1.1(a) of the *SCM Agreement* and set forth the proper methodology for deciding issues on the basis of circumstantial evidence. The AB essentially held that a finding that subsidy exists can be lawfully based on circumstantial evidence. The authors take the view that it is unavoidable that the WTO adjudicating bodies will have to rely on circumstantial evidence in similar cases, and welcome the AB’s openness to such a test in this respect. Additionally, they find no serious fault with the standard of review employed in this case.

In his comment, **Prusa** notes that the analysis of the two authors focuses on the question of whether creditors were ‘entrusted or directed’ to make financial contributions to Hynix, the Korean company at stake in this dispute. In Prusa’s account, the view of the authors is that a series of events taken together can be construed to satisfy the ‘entrusted or directed’ standard even though any single incident is not definitive; the old adage ‘the sum of the parts is greater than the whole’ could be used to summarize their argument. He does not necessarily disagree with this view, but adds that a related question is whether the intervention of the government of Korea changed the market outcome. While not addressed in the analysis of the authors, this issue is also crucial to understanding the economic impact of the alleged subsidization.

Grossman and Wauters review the WTO AB report on *US–OCTG Sunset Reviews*. This dispute is one of several that deal with sunset reviews of anti-dumping duty orders. In its ruling, the AB reasserts a rigid distinction between mandatory and discretionary law and sets a very high standard for Member challenges to laws or practices that allow for violations of WTO obligations but do not mandate such behavior. The authors argue that this ruling is unfortunate, because it diminishes scope of and incentives for ‘as-such’ challenges to laws and practices, which have a potentially useful role to play in the world trading system. The AB ruling also overlooks the purpose and objectives of sunset reviews – to ensure that duty orders are not extended when their removal would generate no harm to an import competing industry – by failing to impose sufficient discipline on their conduct. The authors further argue that a sunset review requires an evaluation of competitive conditions in the industry and of the reasons and incentives for dumping, in order that the investigating authority can judge whether the removal of a duty order would lead to a continuation or recurrence of dumping

and injury. The AB's rulings in this and other similar cases have the effect of relieving the investigating authority of this responsibility and thereby render the sunset review process virtually meaningless.

In his comment, **Vermulst**, argues that the reason the United States is the main target of WTO challenges to its antidumping law and practice is not because it is more protectionist than other AD users, but because its system is the most transparent. Article 3 of the ADA, which regulates the requirements that a lawful demonstration of injury must contain, ought to apply equally in sunset and interim reviews. In his view, the conditions in Article 3(3)(a) ADA do not necessarily need to be applied in sunset/interim reviews. Proposals to change the underpinnings of sunset reviews in isolation of the general underpinnings of the ADA are, in his view, unlikely to succeed.

Bown and Wauters discuss *US-AD Measures on OCTG*. This paper reviews the WTO AB report on *United States-Anti-Dumping Measures on Oil Country Tubular Goods (OCTG) from Mexico* (WT/DS282/AB/R 2 November 2005). This dispute concerns the disciplines imposed by the ADA on WTO Members seeking to extend their antidumping measures beyond the original five-year period through a sunset review. Their analysis focuses on the AB's finding in this case that no causation analysis is required in sunset reviews, and addresses the AB's approach towards the legal instrument that provides for the US policy in terms of sunset reviews, the Sunset Policy Bulletin. They conclude that the ADA, as interpreted by the AB in this and other similar cases, imposes only minimal disciplines of a general nature on Members wishing to extend the antidumping measure beyond its original five-year period. They argue that the 'textual' argument relied on to support this deferential approach is weak and has resulted in undermining the practical effect of, what was considered to be, one of the major achievements of the Uruguay Round ADA: limiting the life span of an antidumping measure to five years. From an economic perspective, panels and the AB are simply debating the wrong type of questions. The prospective nature required by a sunset review analysis raises questions such as why exporters engaged in dumping in the first place, and what the conditions of the industry were so that the dumped imports caused injury. At the moment, sunset reviews seem adrift as panels and the AB fail to give guidance to Members on how to do a more economically sound and informed review.

Davey, in his comment, notes that the greater use of econometric models in the determination of whether dumping and injury are likely to recur would introduce more, desirable rigor into the sunset review process, but the inherently speculative nature of the review process ultimately precludes ever establishing an analytically satisfactory way of assessing the likelihood of recurring dumping and injury. Accordingly, in his view the rule should be that antidumping duties terminate after five years, with no possibility of extension, but with the possibility of initiation a new proceeding and reestablishing the required elements for imposing such duties.

Mavroidis and Sapir discuss *Mexico–Antidumping Measures on Rice*, which concerns the manner in which dumping margins should be calculated for exporters who have not been individually examined during the investigation process. The AB, in the authors' view, took a cautious approach seeking to limit the risk of abusing the investigation process by outlawing recourse to certain facts. It could not, however, undo the intrinsic inadequacies of the Anti-dumping Agreement, which go much deeper than the lack of clarity with respect to the treatment of unidentified exporters. It relates to whether it is countries or firms that are responsible for dumping and that should pay AD duties if they engage in injurious dumping. The authors argue that a fundamental incoherence must be removed from the AD Agreement, whereby it considers dumping a private practice on the one hand and presumes that dumping is a countrywide practice on the other. If this incoherence remains, we risk seeing many other dumping cases being brought before the WTO adjudicating bodies.

Dordi, in his comment, covers two issues: (i) the AB interpretation of the term 'known' exporters contained in article 6.10 of ADA cannot be considered either 'restrictive' or 'completely textual'; indeed, 'known' is a qualified term that has a common meaning in the procedural law of most of the countries of the international community; and (ii) companies that are located in countries where the competition is not particularly protected from abuses and where there are high import barriers potentially have more opportunity to dump products in other markets than do companies in countries where the competition is strictly regulated and where there are lower import barriers.

European Communities – Customs Classification of Frozen Boneless Chicken Cuts

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1. Background

The EC is bound in its tariff schedule not to apply a duty rate in excess of 15.4 % to ‘Meat and edible meat offal, salted, in brine, dried, or smoked’ (Tariff item 02.10). The complainants, Brazil and Thailand, had been exporting frozen chicken cuts treated with salt to the EC, since, respectively, 1996 and 1998. Between 1996 and 2002, EC customs points generally, although not always and everywhere, applied the bound rate in tariff item 02.10 to these imports; beginning in 2002, however, the Commission issued regulations requiring that customs authorities classify imports of meat under 02.10 only where salt has been added to the meat for the purpose of long-term preservation. The result of this regulatory action was that the exports of the claimants were reclassified as falling under tariff item 02.07, which applies to ‘fresh, chilled or frozen’ poultry; the bound rate under 02.07 is higher than under 02.10 (102.4 Euros per 100 kgs, an effective ad valorem rate of between 40 and 60 %). As well, products under 02.07 may face special safeguard action pursuant to the WTO Agreement on Agriculture. Because the exports of the complainants were not salted for purposes of long-term preservation, European customs authorities were thus required to apply the higher tariff rate under 02.07 to these products. The complainants argued that through its binding under 02.10, the EC was obligated to apply a duty that did not exceed 15.4 % ad valorem to their exports, *regardless of whether the salt was applied for purposes of long-term preservation*. By applying a higher rate of duty since 2002, the EC and its member-state customs authorities were, according to the complainants, in violation of Art. II:1(a) and II:1(b) GATT, which prohibit WTO Members from applying duties and charges higher than the bound rates in their schedules for the product in question.

We are grateful for very helpful discussions with Petros C. Mavroidis, Chad Bown, Tom Prusa, and Don Regan.

The disputing parties agreed that: (1) the exports in question were *not* salted for long-term preservation; (2) as explained above, the tariff rate applied to the products in question was, during the period of time that was the subject of the complaint, always higher than the bound rate under 02.10; (3) *if* the products in question did *not* fall within 02.10, the EC would not be in violation of Article II in applying the higher rate prescribed by 02.07; (4) in determining whether the products in question fell under 02.10, the EC could specify a minimum quantitative threshold in ascertaining whether the products were ‘salted’ (historically, in EC Regulations, the minimum threshold had been 1.2%).

Thus, the *only* issue in this dispute, as framed by the parties, was whether or not the term ‘salted’ in 02.10 means, exclusively, ‘salted for purposes of long-term preservation’.

The parties, the Panel, and the Appellate Body (AB) all dealt with this issue as a question of treaty interpretation: the central task was to decide the meaning of ‘salted’ in accordance with the canons of treaty interpretation to be found in Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT). Of course, the word ‘salted’ does not appear in any WTO treaty, and the document being interpreted here is a Harmonized System (HS) classification found in the defending member’s schedule. The obligation to follow the classification practice of the HS is an obligation of WTO Members in their capacity as members of the World Customs Organization (WCO), which develops the HS. Although the Panel solicited advice from the WCO on the interpretation of 02.07 and 02.10, neither the Panel nor the AB suggested that the WTO dispute settlement organs must, as a matter of law, defer to WCO interpretations or practice with respect to HS classifications. This is consistent with earlier AB jurisprudence that considers Members’ schedules as forming an integral part of the Single Undertaking: the terminology of schedules should be interpreted and applied as if one is interpreting and applying the GATT itself or any other treaty in the Single Undertaking (*EC – Lan Equipment*, Report of the AB, para. 84). The WCO Secretariat, however, took the view that it would be appropriate for the parties to resort to the WCO dispute settlement system and obtain a ruling on the meaning of ‘salted’ in 02.107 before having recourse to WTO procedures. The Panel concluded that there was no possibility of declining jurisdiction even temporarily under the DSU. The Panel therefore proceeded to determine whether, when read in accordance with VCLT Arts. 31 and 32, ‘salted’ in HS 02.10 means, exclusively, ‘salted for purposes of long-term preservation’.

The Panel interpreted the norms in Arts. 31 and 32 of the VCLT as intended to be applied sequentially: thus, it began with ‘ordinary meaning’ in Art. 31(1), and, having found that the ordinary meaning of ‘salted’ did not exclusively refer to salting for long-term preservation, then proceeded to examine whether, in light of the other interpretative considerations in Art. 31 VCLT (object, purpose, and context), this was the proper meaning to attribute to tariff item 02.10. While, as discussed below, it went on to correct some specific aspects of the Panel’s

interpretation and application to the VCLT, the AB upheld its general approach but also noted that it is appropriate to apply the VCLT in a holistic manner and that the factual considerations in question could be taken into account either in considering ‘ordinary meaning’ or in considering ‘context’ (para. 176): here the AB was responding to a claim that the Panel had violated its own sequential methodology in going beyond the dictionary and taking into account the factual context in its determination of ‘ordinary meaning’.

In what follows, we will discuss the adjudicating bodies’ treatment of the burden of proof (Section 2), ‘ordinary meaning of words’ (Section 3), ‘context’ (Section 4), the WCO General Rules (Section 5), ‘object and purpose’ (Section 6), ‘subsequent practice’ (Section 7), and ‘supplementary means’ of treaty interpretation (Section 8). We will also discuss the choice of forum for the resolution of this dispute (Section 9). We conclude by summarizing our views concerning the extent to which the outcome of the dispute was correct (Section 10).

2. The burden of proof

According to the complainants in *EC–Chicken Cuts*, the EC violated Art. II:1(a) and II:1(b) GATT by according a less favorable treatment than that provided for in the EC schedule. A threshold question is what the complainant is required to prove in order to establish a violation of Article II based on the scheduling practices of the defendant. The Panel interprets the appropriate burden of proof as follows:

7.78 ... In light of the rules governing the burden of proof, it is our view that the complainants bear the burden to prove that the products at issue are, in fact, covered by the concession contained in heading 02.10 of the EC Schedule.

In our view, there is a fundamental problem with this definition of the burden of proof, and this is a point we will return to repeatedly: we believe that this is a too-low standard for a finding of a *violation*, unless ‘covered by’ is read as ‘*only* covered by’. Due to the incomplete nature of the EC schedule (as of all such schedules), it may well be the case that several of its headings can cover the product at issue. In such a case, it would be inappropriate to require of the importing country to provide the most favorable treatment, without any rationale for why this should be the default case. On the contrary, we would argue that it should *not* be viewed as a violation of the agreement if the importing country applies a tariff heading that is shown to cover the product, even if there is another heading that would also fit the product.

In our view, in order for a classification under 02.07 to amount to a *violation* of the agreement, it would have to be incorrect to classify the product at issue under 02.07. The investigation by the adjudicating bodies does not address the appropriateness of classifying under this heading however; for instance, the VCLT canons of treaty interpretation are not employed to examine this heading. The focus in the reports is instead on heading 02.10, and the conclusion is only that this heading is not *exclusively* for chicken cuts preserved through salting. A leap is thus