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STRECHING THE DISPUTE SETTLEMENT UNDERSTANDING: *U.S.—COTTON’S* RELAXED INTERPRETATION OF CROSS-RETALIATION IN THE WORLD TRADE ORGANIZATION

*David J. Townsend**

I. INTRODUCTION

In August 2009, the World Trade Organization (“WTO”) authorized Brazil to impose sanctions against the United States for its continued subsidization of cotton producers¹ in violation of the WTO Agreement on Subsidies and Countervailing Measures (“SCM Agree-

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¹ Decision by the Arbitrator, *United States — Subsidies on Upland Cotton — Recourse to Arbitration by the United States Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS267/ARB/1 (Aug. 31, 2009) [hereinafter *U.S. — Cotton* or *U.S. — Cotton* (4.11)]; see also Decision by the Arbitrator, *United States — Recourse to Arbitration by the United States Under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement*, WT/DS267/ARB/2 (Aug. 31, 2009). These reports are collectively referred to as *U.S.—Cotton* in this paper. Section V of both reports, on cross-retaliation, are identical, including paragraph numbering. The reports differ in that WT/D267/ARB/1 concerns retaliation for U.S. export credit guarantees and Step-2 payments (prohibited subsidies under the SCM) and WT/D267/ARB/2 concerns retaliation for U.S. Marketing Loan (ML) and Countercyclical payments (CC) (actionable subsidies under the SCM). See *U.S. — Cotton*, *supra*, ¶¶ 1.27-31 (discussing why the WTO issued two separate reports). I refer in the main body and footnote text to the *U.S.—Cotton* case to denote the entire U.S. — Brazil dispute over cotton subsidies. In citations, any reference to *U.S.—Cotton* is limited to the arbitrator’s decision in August 2009, as cited in this footnote. Where cited as *U.S. — Cotton* (4.11), this refers only to the report on prohibited subsidies. The Arbitrator held in these cases that Brazil could only cross-retaliate under non-GATT agreements if Brazil’s damages exceed \$409.7 million on an annual basis, and also found that the annual damages accruing to Brazil in this case were only \$294.7 million, *U.S. — Cotton*, ¶¶ 5.183, 5.201, 6.1-6.5. Following the report, however, Brazil has sought to demonstrate its current damages exceed the arbitrator’s calculations and would therefore allow cross-retaliation, see Erik Wasson, *USTR Under Pressure to Bring Cotton Compliance Panel After Ruling*, 27 *INSIDE U.S. TRADE* No. 34, Sept. 4, 2009 (saying that Brazil and U.S. farm groups believe the current figure “will likely be much higher when newer data is used”).

ment”)² and the Agreement on Agriculture.³ The WTO approved Brazil’s use of sanctions outside the General Agreement on Tariffs and Trade (“GATT”),⁴ authorizing cross-retaliation against rights owed to the United States under the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS”).⁵ This is the third case of cross-retaliation authorized by a WTO arbitrator⁶ under the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).⁷

This paper considers when the WTO should permit cross-retaliation, which allows members to impose sanctions against the violating state outside of the WTO agreement where the violation took place.⁸ This paper provides evidence suggesting that the threat of cross-retaliation would not have changed Congress’ or the executive’s reaction to the *U.S.—Cotton* case and that the WTO’s emphasis on inducing compliance through cross-retaliation is misplaced. This paper argues that cross-retaliation under the DSU is most plausibly read to be limited to situations where only small amounts of goods, services, or intellectual property are exported from the violating state. The *U.S. — Cotton* de-

² Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments — Results of the Uruguay Round, 1867 U.N.T.S. 14 (1994) [hereinafter SCM Agreement], available at http://www.wto.org/english/docs_e/legal_e/24-scm.pdf.

³ Agreement on Agriculture, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments — Results of the Uruguay Round, 1867 U.N.T.S. 410 (1994), available at http://www.wto.org/english/docs_e/legal_e/14-ag.pdf.

⁴ General Agreement on Tariffs and Trade, Oct. 30, 1847, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT]; see *U.S. — Cotton*, *supra* note 1.

⁵ Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments — Results of the Uruguay Round, 33 I.L.M. 1197 (1994) [hereinafter TRIPS]; see *U.S. — Cotton*, *supra* note 1.

⁶ The other two cases are: Decision by the Arbitrator, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services — Recourse to Arbitration by the United States under Article 22.6 of the DSU*, WT/DS285/ARB (Dec. 21, 2007) [hereinafter *U.S. — Gambling*]; and Decision by the Arbitrators, *European Communities — Regime for the Importation, Sale and Distribution of Bananas — Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU*, WT/DS27/ARB/ECU (Mar. 24, 2000) [hereinafter *E.C. — Bananas*].

⁷ Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments — Results of the Uruguay Round, 33 I.L.M. 1226 (1994) [hereinafter DSU].

⁸ *Id.* art. 22.3.

cision allowing cross-retaliation where Brazil imports significant amounts of American goods therefore stretches the DSU to a legally distorted position. In short, this paper argues that: (1) legally, the DSU is better understood to preclude cross-retaliation on the facts of the *U.S. — Cotton* case; and (2) politically, cross-retaliation is unlikely to induce greater compliance with WTO obligations in many cases. Overall, this paper advocates a greater reliance on the level of trade between the countries in determining whether cross-retaliation is appropriate.

This paper proceeds as follows: Part II provides an overview of the DSU and the legal standard for cross-retaliation established under DSU Article 22.3. Part III examines the most recent ruling concerning cross-retaliation under DSU Article 22.3 and demonstrates that the *U.S. — Cotton* case relaxes the cross-retaliation legal standard. It argues that WTO arbitrators should focus more on the level of trade between the members in the dispute. Part IV examines the American response to the *U.S. — Cotton* case and shows that the threat of cross-retaliation was unlikely to induce the United States to change certain farm programs in order to comply with WTO rulings. Part V concludes with cautionary remarks concerning the use of retaliation under the WTO more broadly.

II. CROSS-RETALIATION UNDER DSU ARTICLE 22.3

A. *DSU Article 22.3 in its Context and in Light of the DSU's Object and Purpose*

The DSU both constrains and enables states to retaliate under the WTO. The DSU authorizes cross-retaliation aimed at inducing compliance from the violating state. At the same time, the DSU constrains retaliatory actions by limiting the size of retaliation and establishing procedures that must be followed before cross-retaliation is permissible. This section argues that retaliation under the DSU article should be read as having broader goals than simply inducing compliance.

When a WTO member violates trade obligations and fails to comply with rulings that find its domestic measures to be illegal under the WTO, DSU Articles 22 and 3 require victim states to pursue a hierarchy of remedies against a violating state before retaliating.⁹ The hierarchy starts with requiring an effort by members to reach a “mutually acceptable” solution, which is “clearly . . . preferred.”¹⁰ Next in the hierarchy is for the violating state to compensate the victim

⁹ *Id.* arts. 3, 22.

¹⁰ *Id.* art. 3.7. DSU Article 22.2 requires members to first enter into negotiations to find a mutually acceptable solution until a reasonable period of time has ex-

state.¹¹ Compensation must be accorded on a most-favored-nation basis and thus is rarely used.¹² As a “last resort,” Article 3 allows states to “suspend [] . . . concessions”¹³ (the WTO’s term of art for retaliation)¹⁴ that would otherwise be owed to the violating state under WTO agreements.

Retaliation under the WTO requires following the procedures established in DSU Article 22.3.¹⁵ A state must suspend concessions within the same sector or agreement,¹⁶ unless doing so “is not *practicable or effective*.”¹⁷ If not practicable or effective, and the victim state considers “circumstances are serious enough,” it may cross-retaliate by seeking to suspend trade concessions in other WTO agreements.¹⁸ DSU Article 22.3(d) provides factors to consider in suspending concessions across agreements; including trade under the agreement, the importance of that trade to the complaining party, and “the broader economic elements related to the nullification or impairment and the

pired, plus 20 days, for the violating state to bring its law into compliance with WTO obligations, *see id.* art. 22.2.

¹¹ *See id.* arts. 3.7, 22.2.

¹² KEVIN KENNEDY, INTERNATIONAL TRADE REGULATION: READINGS, CASES, NOTES AND PROBLEMS 43 (2009) (arguing that the MFN requirement for compensation has “effectively gutted compensation as a remedy”). A recent example of such compensation is new concessions given to the EU following the *U.S. — Gambling* decision, *see Public Citizen Warns of Error in U.S.-EU Gambling Compensation Deal*, 27 INSIDE U.S. TRADE, No. 26 (July 3, 2009) (discussing legal problems with the compensation and its relation to the *U.S. — Gambling* case).

¹³ DSU, *supra* note 7, art. 3.7.

¹⁴ World Trade Organization, Hong Kong WTO Ministerial 2005: Briefing Notes, http://www.wto.org/english/thewto_e/minist_e/min05_e/brief_e/brief10_e.htm (stating that to “suspend concessions” under the DSU is also known as “to retaliate”); *see* Steve Charnovitz, *Rethinking WTO Trade Sanctions*, 95 AM. J. INT’L L. 792, 805–08 (2001) (discussing how the term “sanctions” came to be used in WTO commentary instead of “suspension of concessions”).

¹⁵ *See* DSU, *supra* note 7, art. 1 (explaining the scope of the DSU).

¹⁶ DSU Article 22.3(a)-(b) requires retaliation within the same “*sector(s)*” or the “*same agreement*” unless it is impracticable or ineffective, DSU, *supra* note 7, art. 22.3(a)-(b). Sector is defined under DSU Article 22.3(f). For goods, sector means *all goods*, *id.* art. 22.3(f)(i). For the cases considered here, the distinction between sector and agreement is irrelevant. I refer in this paper to cross-retaliation under the same “agreement,” but it is important to note that in some circumstances, states must first show ineffectiveness and impracticability within the same sector before considering whether they can retaliate more broadly within the same agreement.

¹⁷ *Id.* art. 22.3(b)-(c) (emphasis added).

¹⁸ *Id.* art. 22.3(c). WTO arbitrators have deferred to the complaining state’s assessment that the circumstances were serious enough to cross-retaliate. *See U.S. — Cotton*, *supra* note 1, ¶ 5.217; *U.S. — Gambling*, *supra* note 6, ¶ 4.113; *E.C. — Bananas*, *supra* note 6, ¶¶ 126–27.

broader economic consequences of the suspension of concessions or other obligations.”¹⁹ Compliance with these procedures is subject to review by WTO arbitrators.²⁰ The text of DSU Article 22.3 therefore establishes the practicable and effective standard and the context of DSU Article 22.3 establishes the hierarchy of remedies. WTO arbitrators have looked to the broader purpose of retaliation under the DSU to give the practicable and effective standard greater clarity.²¹

WTO agreements are interpreted according to customary international law,²² including analyzing treaty text in its context and in light of the treaty’s object and purpose.²³ Much of the DSU supports the proposition that its purpose is to induce violating states to remove offending measures.²⁴ The DSU provides that the “first objective” when a member is in violation of obligations is “to secure the withdrawal of the measures concerned.”²⁵ The DSU also provides that sanctions are “temporary measures,”²⁶ used as a “last resort”²⁷ when a member obstinately refuses to comply with its WTO obligations. The overarching purpose of the DSU is ensuring predictable results within

¹⁹ DSU, *supra* note 7, art. 22.3(d)(i)-(ii).

²⁰ *Id.* art. 22.3; see *U.S. — Cotton*, *supra* note 1, ¶¶ 5.50–51; *U.S. — Gambling*, *supra* note 6, ¶ 2.16; *E.C. — Bananas*, *supra* note 6, ¶¶ 50, 51. The DSU might be read to preclude a probing analysis by WTO arbitrators of a complaining member’s choice of retaliation in light of its references to, for example, whether a party “considers that it is not practicable or effective” to impose sanctions within the same sector or agreement, DSU, *supra* note 7, art. 22.3(a)-(b) (emphasis added). Additionally, the arbitrators review “shall not examine the nature of the concessions or other obligations to be suspended but shall determine whether the level of such suspension is equivalent to the level of nullification or impairment,” DSU *supra* note 7, art. 22.7 (emphasis added). This suggests that these terms may have been intended to be self-defining by the complaining member. WTO arbitrators have found authority to review adherence to the DSU procedures in Article 22.3 by citing their obligation under DSU Articles 22.6 and 22.7 to evaluate compliance with the DSU procedures, *U.S. — Cotton*, *supra* note 1, ¶¶ 5.50–51; *U.S. — Gambling*, *supra* note 6, ¶ 2.16.; *E.C. — Bananas*, *supra* note 6, ¶¶ 50–51.

²¹ See *U.S. — Cotton*, *supra* note 1, ¶¶ 5.81; *U.S. — Gambling*, *supra* note 6, ¶ 4.29; *E.C. — Bananas*, *supra* note 6, ¶¶ 72, 76.

²² See DSU, *supra* note 7, art. 3.2 (specifying that a purpose of the DSU is to “preserve the rights and obligations of Members. . . in accordance with customary rules of interpretation of public international law.”).

²³ Vienna Convention on the Law of Treaties, art. 31, *opened for signature* May 23, 1969, 1155 U.N.T.S. 331 [hereinafter Vienna Convention].

²⁴ See DSU, *supra* note 7, art. 3.7.

²⁵ *Id.*

²⁶ *Id.* art. 22.1.

²⁷ *Id.* art. 3.7.

the multilateral trading system and to “preserve the rights and obligations of Members.”²⁸

WTO arbitrators considering the question have concluded that the object and purpose of the cross-retaliation is indeed to induce compliance from the violating member.²⁹ In the WTO arbitrators’ views, inducing compliance imbues the meaning of DSU Article 22.3 procedures, including what it means to be practicable or effective to suspend obligations within the affected agreement rather than employing cross-retaliation.³⁰ This view is supported by experts in WTO law.³¹

Given the textual support of such a reading, it seems clear that the DSU aims to induce the violating state to remove the offending measure. It is, however, not the *exclusive* purpose of the DSU. The DSU also constrains state responses toward the violating state, principally by limiting the level of retaliation “equivalent to the level of the nullification.”³² If inducing compliance from the violating state were the only goal, the DSU would approve retaliating as much as necessary to achieve this outcome.³³ Therefore, an equally plausible read-

²⁸ *Id.* art. 3.2.

²⁹ *U.S. — Cotton*, *supra* note 1, ¶ 5.81; *U.S. — Gambling*, *supra* note 6, ¶ 2.7 (noting that while retaliation aims at inducing compliance, it is limited by level of retaliation); *see E.C. — Bananas*, *supra* note 6, ¶¶ 72, 76.

³⁰ *See E.C. — Bananas*, *supra* note 6, ¶¶ 70–79; *U.S. — Gambling*, *supra* note 6, ¶¶ 4.29–31.

³¹ *See* John H. Jackson & Carlos M. Vázquez, *Some Reflections on Compliance with WTO Dispute Settlement Decisions*, 33 *LAW & POL’Y INT’L BUS.* 555, 562–66 (2002) (discussing various purposes of the DSU, including inducing compliance with underlying trade obligations); *see also* Charnovitz, *supra* note 14, at 804 (“[t]he tenor of these provision [the DSU] is that a suspension operates to drive compliance”). *But see* Warren F. Schwartz & Alan O. Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31 *J. LEGAL STUD.* §179, 189 (2002) (arguing that the WTO members are not obliged to comply with rulings, but may compensate the victim under the DSU if the violating state is “willing to pay that price”).

³² DSU, *supra* note 7, art. 22.4. The size of retaliation against subsidies is defined slightly differently. Under the SCM, members may impose “appropriate countermeasures” in response to prohibited subsidies. SCM Agreement, *supra* note 2, art. 4.10. In response to actionable subsidies, Members may impose retaliation “commensurate with the degree and nature of the adverse effects determined to exist.” SCM Agreement, *supra* note 2, art. 7.9. The Arbitrator in *US—Cotton* emphasized that SCM Article 4.10 gives greater “flexibility” in determining the size of countermeasures, although all three take into consideration the trade effects from the illegal measure. *See U.S.—Cotton* (4.11), *supra* note 1, ¶¶ 4.95–107.

³³ Thomas Sebastian, *World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness*, 48 *HARV. INT’L L.J.* 337, 365–66 (2007) (inducing compliance as the purpose of the DSU “is difficult to reconcile with the limitations on the intensity and form of retaliation set out in Article 22”).

ing of DSU Article 22.3 is that it seeks to limit and define the scope and substance of retaliation.

The DSU performs a “non-escalation” function, preventing rapidly escalating trade wars.³⁴ It does so by precluding retaliation by non-parties to a case.³⁵ Such retaliation undermines the compliance objective because the injury for violating WTO obligations runs to many WTO members.³⁶

The DSU also strives to provide “security and predictability” to disputes and to “clarify the existing” obligations of members under the WTO.³⁷ This suggests that the DSU clarifies the precise contours of legal obligations³⁸ and could be undermined by liberal use of retaliation against members for breaches of WTO obligations.

Finally, the DSU procedures might also be read as a political “safety valve,”³⁹ allowing breach of obligations under the WTO with certainty as to the cost of such breaches.⁴⁰ The United States argued in the *U.S. — Cotton* case that the DSU’s purpose was rebalancing the bargain under the WTO agreements by compensating victim states at a level equal to the injury caused by the violating state.⁴¹ This concept

³⁴ *Id.* at 378–80; see also Jackson & Vázquez, *supra* note 31, at 562 (arguing that parts of the DSU suggest “that its purpose may be simply to afford a peaceful mechanism for settling individual disputes.”).

³⁵ See DSU, *supra* note 7, art. 23.1 (“[w]hen Members seek the redress of a violation of obligations. . . they shall have recourse to, and abide by, the rules and procedures of this Understanding.”).

³⁶ See *id.* (“[w]hen Members seek the redress of a violation of obligations. . . they shall have recourse to, and abide by, the rules and procedures of this Understanding.”) (emphasis added); *id.* art. 22.3 (making the DSU the exclusive way to seek retaliation under the WTO).

³⁷ *Id.* art. 3.2.

³⁸ See Jackson & Vázquez, *supra* note 31, at 563.

³⁹ Charnovitz, *supra* note 14, at 818.

⁴⁰ See *id.* at 820 (seeing the DSU as a political safeguard puts it in “a more charitable light” than reading it as a sanction aimed at inducing compliance).

⁴¹ See Written Submission of the United States, *United States — Subsidies on Upland Cotton: Arbitration Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, United States — Subsidies on Upland Cotton: Arbitration Under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement*, WT/DS267, at ¶¶ 339–41 (Dec. 9, 2008) [hereinafter U.S. Submission to the Arbitrator], available at http://www.ustr.gov/webfm_send/572 (“[t]ailoring countermeasures to what is most likely to promote compliance invites Members to act *disproportionately*”); see also Schwartz & Sykes, *supra* note 31, at §181 (arguing the DSU deters “inefficient breach” of WTO obligations by limiting retaliation).

is controversial and has been rejected by commentators⁴² and, implicitly, by WTO arbitrators' reliance on inducing compliance.⁴³

Retaliation under the DSU is most plausibly read as enabling state retaliation, but also as constraining such a response. This dual-purpose understanding of the DSU is supported by the historical and legal context within which the DSU was adopted.

B. Placing the DSU Within Historical and International Legal Perspective

It is useful to contextualize the DSU remedies by looking at traditional remedies under international law and the pre-WTO GATT, as well as by examining the negotiating history of the DSU.⁴⁴ The DSU lies between the baseline of international legal remedies, which allow significantly greater compensation for breach of treaties, and GATT remedies, which were effectively non-existent because violating states could prevent their approval. When considered in light of its negotiating history and the international law of remedies, the DSU should be understood equally as constraining state retaliation as enabling it. By institutionalizing retaliation, treaty-makers allowed retaliation, but only in limited circumstances.

Post-World War II treaty makers created the GATT and its later-aborted institutional companion, the International Trade Organization ("ITO"), as a means to avoid the beggar-thy-neighbor policies that plagued the interwar years of the 1930s.⁴⁵ In crafting a trade regime premised on reciprocity and non-discrimination, post-war plan-

⁴² See Jackson & Vázquez, *supra* note 31, at 563–65 (arguing that rebalancing function undermines predictability and “conflates the primary obligations imposed on the members by the covered agreements and the secondary obligations provided for in the DSU” by effectively redefining the primary obligations); Sebastian, *supra* note 33, at 371 (asserting that this reading of the WTO asks DSU arbitrators to “rewrite the WTO agreements between the two WTO Member states”); See *supra* text accompanying notes 29–31.

⁴³ See *supra* note 29.

⁴⁴ The materials considered in this section are an appropriate way to confirm the meaning of DSU Article 22.3. The Vienna Convention allows considering “preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when interpretation according to article 31: (a) leaves the meaning ambiguous or obscure. . . .” Vienna Convention, *supra* note 23, art. 32.

⁴⁵ See ROBERT E. HUDEC, *THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY*, 6 (2d ed. 1990) (in describing the historical lesson of the interwar years, “[g]overnments in their desperation had experimented with many new and generally worse forms of trade restrictions.”); cf. Meredith A. Crowley, *An Introduction to the WTO and GATT*, 17 J. ECON. PERSPECTIVES 42, at 44–47 (2003) (describing how the WTO helps states avoid a prisoners dilemma where, although individually

ners sought a legal mechanism to avoid disproportionate and unconstrained responses to a member's protectionist policies.⁴⁶ The pre-GATT legal regime was characterized by states having, and often exercising, unbridled discretion to raise barriers against one another.

The GATT, by contrast, effectively precluded trade retaliation as a multilateral remedy. Authorized retaliation under the GATT was almost non-existent because the violating state could veto any ruling adverse to it.⁴⁷ This resulted in only one case of actual retaliation under GATT.⁴⁸ The WTO's DSU eliminates these problems by automatically establishing panels.⁴⁹ The DSU allows appellate review of alleged violations and the adoption of rulings unless the Dispute Settlement Body ("DSB") unanimously rejects a panel or appellate report.⁵⁰ Similarly, arbitrator reports are "final" and adopted by the DSB unless unanimously rejected.⁵¹

The negotiating context of DSU also suggests states were equally concerned with both enabling and limiting the scope and kind of retaliation possible under the DSU. The United States sought to preclude WTO panels from authorizing compensation for *past* injury—a practice that GATT panels allowed in retaliation for GATT-inconsistent U.S. antidumping duties.⁵² Developing countries were concerned about the numerous new trade obligations contained in the WTO, including under GATS and TRIPS.⁵³ Countries were also concerned about the increasing use of unilateral sanctions, particularly U.S. sanctions under Section 301 of the Trade Act of 1974.⁵⁴ To address

rational to impose tariffs, it is collectively more efficient to coordinate open trade policies).

⁴⁶ See HUDEC, *supra* note 45, at 7 (stating that to avoid repeats of the interwar period, obligations were required "in binding form" that would "be looked after by a more permanent institution."). JOHN H. JACKSON, *THE WORLD TRADING SYSTEM*, at 31 (1997) (MIT Press 1989) (describing the post-war consensus concerning the "importance of establishing postwar economic institutions that would prevent these mistakes from happening again.").

⁴⁷ Sebastian, *supra* note 33, at 345.

⁴⁸ See *Netherlands Measure of Suspension of Obligations to the United States* (Nov. 8, 1952), GATT B.I.S.D. (1st Supp.) at 32 (1953) (authorizing retaliations against U.S. wheat for GATT obligations breached by section 104 of the Defense Production Act).

⁴⁹ DSU, *supra* note 7, art. 6.

⁵⁰ *Id.* arts. 16–17.

⁵¹ *Id.* art. 22.7.

⁵² Petros C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place*, 11 EUR. J. INT'L L. 763, 789–90 (2000).

⁵³ See Sebastian, *supra* note 33, at 347–49.

⁵⁴ See Schwartz & Sykes, *supra* note 31, at §198–200, 201–02.

these concerns, the DSU limited retaliation to a level equivalent of the obligation suspended and barred compensation for past harm.⁵⁵

The context of the WTO negotiations suggests that DSU Article 22.3 itself was a compromise both to enable and inhibit cross-retaliation. The proponents of TRIPS in Uruguay Round negotiations introduced the concept of the right to cross-retaliate and argued it was necessary to ensure a remedy under the DSU where the violating country exported no intellectual property to the developed countries, and thus there was nothing to retaliate against.⁵⁶ Negotiators agreed to permit cross-retaliation but limited it through the DSU's procedures in Article 22.3.⁵⁷ Thus, while states may impose sanctions against a

⁵⁵ Compare DSU, *supra* note 7, art. 22.4 (providing for suspension "equivalent to the level of nullification or impairment"), with GATT, *supra* note 4, art. XXIII(2) (allowing for retaliation "appropriate in the circumstances"); see also Schwartz & Sykes, *supra* note 31, at § 204 (concluding the DSU resulted from "the danger of excessive unilateral sanctions that exists in the absence of centralized oversight regarding the magnitude of sanctions."); Sebastian, *supra* note 33, at 347–48. The United States argued in *U.S. — Cotton* that the DSU should not be interpreted as focused on compliance, see U.S. Submission to the Arbitrator, *supra* note 41, ¶ 341 (arguing that inducing compliance is beyond the legal mandate of DSU arbitrators). Compensation for past injury was rejected in *U.S. — Cotton*, *U.S. — Cotton*, *supra* note 1, ¶ 3.62 (holding that Brazil may not seek countermeasures in retaliation for laws found to violate WTO obligations but subsequently removed). Peter Mavroidis argues that this is not the correct conclusion concerning the scope of remedies under the DSU, Mavroidis, *supra* note 52, at 790.

⁵⁶ See JOHN CROOME, *RESHAPING THE WORLD TRADING SYSTEM: A HISTORY OF THE URUGUAY ROUND* 244, 112–14, 279–83 (2d ed. 1999) (summarizing cross-retaliation in the DSU negotiations as "implied" by the TRIPS agreement and agreed to by those who did not support it because it was an important "bargaining chip" in DSU negotiations); see also Andrew L. Stoler, *The WTO Dispute Settlement Process: Did the Negotiators Get What They Wanted?*, 3 *WORLD TRADE REV.* 99, 103–04 (2004) (noting that cross-retaliation was a "specific objective" of the United States). *But see* Sebastian, *supra* note 33, at 348 (saying that developing countries viewed cross-retaliation as a way to "limit the enforceability" of the new WTO obligations). The broader negotiating history of the DSU suggests other countries strongly objected to unilateral imposition of U.S. sanctions and that the right to cross-retaliate, presumably under TRIPS, would hurt developing countries because revoking rights in other agreements would most likely be under TRIPS, see generally CROOME, *supra*, at 112–14, 126–29. This suggests cross-retaliation was contemplated only in rare circumstances: where retaliation within the same agreement was impossible because the violating state exported nothing under the agreement, the victim state could cross-retaliate to ensure it had a remedy under the DSU.

⁵⁷ Stoler, *supra* note 56, at 105 (distinguishing between affirming cross-retaliation permitted under the DSU, which was a goal for developed countries, and the limits of cross-retaliation in DSU Article 22.3, which were a "victory" for developing countries); see CROOME, *supra* note 56, at 279–83.

violating state, the DSU carefully limits the size and scope of permissible sanctions.

The DSU also stands in contrast to traditional compensation for wrongs against states under the international law of state responsibility. Under international law, a state is under an obligation to cease the violating actions.⁵⁸ This is consistent with the DSU which aims “to secure the withdrawal of the measures concerned if these are found to be inconsistent”⁵⁹ with WTO obligations. Unlike the WTO, however, the international law of state responsibility calls for compensation for *past* damages caused by the violating state.⁶⁰ The U.N. International Law Commission points to the Permanent Court for International Justice’s decision in *Factory at Chorzow* as establishing the right to compensation for past wrongs in international law: “[t]he essential principle . . . is that reparation must, so far as possible, *wipe out all the consequences of the illegal act and* reestablish the situation which would, in all probability, have existed if the act had not been committed.”⁶¹ Unlike the international law requirement to compen-

⁵⁸ *Report of the International Law Commission to the General Assembly, Draft Articles on Responsibility of States for Internationally Wrongful Acts, With Commentaries*, 56 U.N. GAOR Supp. (No. 10) at 26, U.N. Doc A/56/10, reprinted in [2001] 2 Y.B. Int’l L. Comm’n 241, U.N. Doc. A/CN.4/SER.A/2001, art. 30, [hereinafter *ILC Draft Articles*], available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (“[t]he State responsible for the internationally wrongful act is under an obligation: (a) to cease that act, if it is continuing . . .”).

⁵⁹ DSU, *supra* note 7, art. 3.7.

⁶⁰ *ILC Draft Articles*, *supra* note 58, art. 31. Article 31, entitled “[r]eparation” says that states are responsible “to make full reparation for the injury caused by the internationally wrongful act,” *id.*; see RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 901 (1987) (“[u]nder international law, a state that has violated a legal obligation to another state is required to terminate the violation and, ordinarily, to make reparation, including in appropriate circumstances restitution or compensation for loss or injury.”). Comment *e* of the Restatement provides that interest on compensation “is generally payable from the date of the injury to the date of the payment,” RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 901 cmt. e (1987). Article 35 of the International Law Commission’s Draft Articles similarly states that when one state breaches its international obligations, the violating state’s duty to provide reparations includes an obligation to “re-establish the situation which existed before the wrongful act was committed,” *ILC Draft Articles*, *supra* note 58, art. 35.

⁶¹ *Factory at Chorzow*, The Merits, (F.R.G v. Pol.) 1928 P.C.I.J. (ser. A) No. 17, at 47 (Sept. 13) (emphasis added); see *ILC Draft Articles*, *supra* note 58, art. 31 cmt. 2 (citing *Factory at Chorzow*, The Merits, (F.R.G v. Pol.) 1928 P.C.I.J. (ser. A) No. 13, at 47 (Sept. 13)). The Arbitrator cited the ILC’s Draft Articles in *U.S. — Cotton* for the proposition that the sole purpose of countermeasures is to induce compliance. See *U.S. — Cotton* (4.11), *supra* note 1, ¶ 4.113. The Draft Articles approve of countermeasures designed to address continued violations (permissible

sate for the loss of a state's expectation interest, under the WTO, once the offending measure is removed, the matter is considered resolved and becomes non-actionable under the DSU.⁶²

WTO negotiators thus opted out of customary international legal remedies and changed the status quo from the limited remedies available under GATT. The DSU is best viewed in this context as a carefully balanced agreement to limit protectionist impulses in trade law, while allowing effective WTO remedies.

III. THE EVOLVING STANDARD FOR CROSS-RETALIATION UNDER WTO ARBITRATION

WTO arbitrators have now authorized cross-retaliation in three cases.⁶³ The arbitrators have developed a shared vocabulary concerning DSU Article 22.3 and it thus appears they agree on the legal standard for when states may cross-retaliate. This section argues, however, that when the facts of these cases are examined, the most recent interpretation of DSU Article 22.3 in *U.S. — Cotton* represents a significant relaxation of cross-retaliation, one that is too liberal in light of the size and diversity of Brazil's trade with the United States. A greater emphasis on the level of trade between the victim and violating state is consistent with the DSU text and broader purpose of the DSU to both enable and constrain retaliation under the WTO.

The DSU constrains retaliation in two broad ways: first by limiting compensation to the "equivalent" of the ongoing harm and second by restraining the use of cross-retaliation according to the procedures in DSU Article 22.3.⁶⁴ This section only discusses the latter.

When states seek cross-retaliation, the WTO arbitrator looks to "whether the complaining party in question has considered the necessary facts objectively" and also "whether, on the basis of these facts, it

under DSU Article 22.3) and the right to seek remedies for past harm (impermissible under DSU Article 22.8). Compare *ILC Draft Article*, *supra* 58, art. 31, with *id.*, art. 49.

⁶² DSU, *supra* note 7, art 22.8 ("[t]he suspension of concessions or other obligations. . . shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed . . ."); *U.S. — Cotton*, *supra* note 1, ¶ 3.62 (holding that Brazil may not retaliate for U.S. laws found to violate WTO obligations but subsequently removed, even where Brazil alleged similar measures were subsequently re-enacted).

⁶³ See generally *U.S. — Cotton*, *supra* note 1; *U.S. — Gambling*, *supra* note 6; *E.C. — Bananas*, *supra* note 6.

⁶⁴ See Sebastian, *supra* note 33, at 348–49 (describing the DSU limits on retaliation as primarily those precluding collective retaliation and limiting cross-retaliation). The cross-retaliation analysis is analyzed separately from determining the level of damages, see *U.S. — Cotton*, *supra* note 1, ¶¶ 5.24–26.

could plausibly arrive at the conclusion that it was not practicable or effective” to retaliate within the same agreement.⁶⁵ If retaliation within the same agreement is *either* ineffective or impractical, the WTO authorizes cross-retaliation.⁶⁶ This has led to a consensus in defining “practicable” as “feasible” with reference to the harm such measures may impose on the retaliating country⁶⁷ and “effective” as able to increase “the likelihood of compliance” after the retaliation is imposed.⁶⁸

DSU Article 22.3(d) clarifies the “practicability” and “effectiveness” analysis by requiring consideration of general economic factors.⁶⁹ Whether cross-retaliation is permissible under WTO decisions depends on (i) the size and diversity of trade with the violating state⁷⁰ and (ii) the size of the complaining state’s economy and disparity in economic power between it and the violating state.⁷¹ This paper argues arbitrators should place greater emphasis on these textual commands rather than the broader purpose of inducing compliance.

The three cross-retaliation cases represent a spectrum of instances relaxing the DSU Article 22.3 legal standard. The least controversial authorization of cross-retaliation is in *U.S. — Gambling*

⁶⁵ *U.S. — Cotton*, *supra* note 1, ¶ 5.51 (quoting *E.C. — Bananas*, *supra* note 6, ¶ 52).

⁶⁶ *U.S. — Cotton*, *supra* note 1, ¶ 5.70; *U.S. — Gambling*, *supra* note 6, ¶ 4.29–30; *E.C. — Bananas*, *supra* note 6, ¶ 74.

⁶⁷ *U.S. — Cotton*, *supra* note 1, ¶ 5.73; *U.S. — Gambling*, *supra* note 6, ¶ 4.29; *E.C. — Bananas*, *supra* note 6, ¶ 74.

⁶⁸ *U.S. — Cotton*, *supra* note 1, ¶ 5.81; *see U.S. — Gambling*, *supra* note 6, ¶¶ 4.29–30; *E.C. — Bananas*, *supra* note 6, ¶ 72.

⁶⁹ DSU, *supra* note 7, art. 22.3(d)(ii).

⁷⁰ This analysis is dictated by DSU Article 22.3(d)(i) and arbitrators have universally considered it, DSU, *supra* note 7, art. 22.3(d)(1); *see U.S. — Cotton*, *supra* note 1, ¶¶ 5.111–41 (detailing the size and diversity of the Brazilian economy and trade between Brazil and the United States); *U.S. — Gambling*, *supra* note 6, ¶¶ 4.93–100 (discussing size and nature of service trade between Antigua and the United States); *E.C. — Bananas*, *supra* note 6, ¶¶ 87–120 (discussing size and nature of trade in goods and services).

⁷¹ This analysis is mandated by the terms of DSU Article 22.3(d)(ii) which requires consideration of “the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations,” DSU, *supra* note 7, art. 22.3(d)(ii); *see U.S. — Cotton*, *supra* note 1, ¶ 5.139 (expressly holding that size disparity between the countries alone does not make suspension within the agreement ineffective or impracticable); *U.S. — Gambling*, *supra* note 6, ¶¶ 4.89–92 (recognizing this as a valid consideration, but noting it must be tied to practicability and effectiveness); *E.C. — Bananas*, *supra* note 6, ¶ 73 (stating that where a “great imbalance” exists, the arbitrator should primarily consider only practicability, or “least harmful” retaliations, in deciding whether cross-retaliation is permissible).

where the arbitrator authorized Antigua to cross-retaliate against the United States for obligations breached under GATS.⁷² The total trade in services between Antigua and the United States was \$102 million.⁷³ The arbitrator concluded that it would not be practicable or effective for Antigua to retaliate within GATS because Antigua's trade under GATS with the United States was confined to transportation, insurance and tourism—sectors where retaliation would “entail a negative impact for the Antiguan local economy.”⁷⁴ Antigua had few retaliatory options and the arbitrator accordingly authorized cross-retaliation.⁷⁵

Next, along the spectrum is *E.C. — Bananas*' less-relaxed reading of DSU Article 22.3. In *E.C. — Bananas*, Ecuador imported somewhere between \$60.8 and \$194 million in consumer goods and \$198 million in services from the E.C.⁷⁶ *E.C. — Bananas* held that it was practicable and effective for Ecuador to retaliate against at least some of the consumer goods under the GATT but was not practicable or effective to do so against services under the GATS,⁷⁷ and thus permitted cross-retaliation.⁷⁸ Under the GATT, the arbitrator emphasized that while the retaliation on consumer goods may impose costs, Ecuador failed to show there were no alternatives available to importing E.C. goods and, therefore, could retaliate against at least some of those goods.⁷⁹ Under the GATS, retaliation against non-wholesale services imported would undermine foreign investment and cross border ser-

⁷² *U.S. — Gambling*, *supra* note 6, ¶¶ 4.117–19. The arbitrator first held that there could be no retaliation within the same sector because Antigua had almost no trade with the U.S. within the service sector in question, *see id.* ¶¶ 4.55–60. The arbitrator then considered retaliation within all GATS sectors and held any GATS retaliation would be impracticable and ineffective as well, *id.* ¶ 4.99.

⁷³ *Id.* ¶ 4.82.

⁷⁴ *Id.* ¶ 4.98.

⁷⁵ *Id.*

⁷⁶ *E.C. — Bananas*, *supra* note 6, ¶¶ 97–98, 119.

⁷⁷ Ecuador sought to retaliate against E.C. “wholesale trade services” under GATS. *Id.* at ¶ 61. Because this service trade is in the same sector as the obligations violated by the E.C., the arbitrator did not make any findings about whether retaliation against such services were effective or practicable, but simply authorized such retaliation under DSU Article 22.3(a). *See id.* at 62–64.

⁷⁸ *Id.* ¶¶ 101, 120. The arbitrator held that “Ecuador’s nullification and impairment” was \$201.6 million per year, *id.* ¶ 170. The arbitrator did not say how much of the consumer goods Ecuador must retaliate against before resorting to cross retaliation, but because the damages exceeded the total number of goods, it had to decide the cross-retaliation issue under GATS to afford Ecuador a remedy equal to its damages, *id.* ¶ 173(d).

⁷⁹ *Id.* ¶ 100. The *U.S. — Cotton* arbitrator explicitly rejected *E.C. — Bananas* in this interpretation and rejected requiring the victim state to show alternative supplies were available to demonstrate it was the “least harmful” mode of retaliation, *U.S. — Cotton*, *supra* note 1, ¶ 5.78.

vices, hurting the fragile Ecuadorian economy.⁸⁰ The United States later pointed to *E.C. — Bananas* case as establishing “bookends” on the DSU Article 22.3 practicable and effective standard.⁸¹ Under this reading, the *E.C. — Bananas* and *U.S. — Gambling* cases stand for the proposition that cross-retaliation is rarely necessary; only where the retaliating country has very small amounts of trade under the agreement is it impracticable and ineffective to retaliate within the same agreement. *E.C. — Bananas* and *U.S. — Gambling* are consistent with one another in that they allowed cross-retaliation, but only where there was a very limited number of cross-border transactions within the agreement where the breach occurred.

U.S. — Cotton rejected this understanding and provided the most relaxed interpretation of DSU Article 22.3 of the three cases. The arbitrator found that Brazil imported at least \$1.27 billion in consumer goods from the United States.⁸² The arbitrator then held that of those consumer goods, only food, arms, medical products and “other” goods are practicable and effective to retaliate against under DSU Article 22.3.⁸³ The arbitrator in *U.S. — Cotton* held that twenty percent of those consumer goods were practicable and effective to retaliate against, totaling \$409.7 million of goods Brazil must retaliate against before cross-retaliating in other agreements.⁸⁴

The *U.S. — Cotton* case departs from the previous readings of DSU Article 22.3 in two ways: (1) the arbitrator in *U.S.—Cotton* calculated a precise level of goods that were practicable and effective for Brazil to retaliate against; and (2) the arbitrator in *U.S. — Cotton* found that it was impracticable or ineffective for Brazil, a large and diverse economy relative to Ecuador and Antigua, to retaliate solely within the GATT.⁸⁵ Concerning the first difference, this significantly limits Brazil’s ability to cross-retaliate because the damages must, at

⁸⁰ *E.C. — Bananas*, *supra* note 6, ¶¶ 108–20.

⁸¹ U.S. Submission to the Arbitrator, *supra* note 41, ¶ 333.

⁸² *U.S. — Cotton*, *supra* note 1, ¶ 5.144 (assuming this figure, Brazil’s estimate, is correct). Both the *U.S. — Cotton* and *E.C. — Bananas* cases eliminated trade in capital or industrial goods from those where it could be practicable and effective to retaliate against, *id.* ¶ 5.149; *E.C. — Bananas*, *supra* note 6, ¶ 91.

⁸³ *U.S. — Cotton*, *supra* note 1, ¶¶ 5.166–78.

⁸⁴ *Id.* ¶¶ 5.181–83, tbl. 4. This figure also rejects as practicable or effective retaliation against food, pharmaceuticals and arms where U.S. market share exceeded twenty percent of Brazil’s imports, *id.* ¶ 5.182.

⁸⁵ The arbitrator in *E.C. — Bananas* did not calculate how much of the trade under GATT was practicable and effective for the E.C. to retaliate against, *see E.C. — Bananas*, *supra* note 6, ¶ 173 (stating that the E.C. may retaliate under TRIPS if an undefined level of goods where it was both practicable and effective to retaliate was less than its level of damages, set at \$201.6 million).

some future date, exceed \$409.7 million.⁸⁶ The *E.C. — Bananas* arbitrator, in contrast, required some retaliation against consumer goods before resorting to cross-retaliation, although it was unclear how much relation was necessary.⁸⁷ Nonetheless, the second finding significantly relaxed DSU Article 22.3 relative to previous decisions because cross-retaliation had not been approved where large volumes of commerce occurred from the violating state under the agreement breached.⁸⁸

A comparison⁸⁹ between the cases is straightforward because the violating members in all three cases are the United States and the E.C., which are among the largest trade economies in the world.⁹⁰ However, the economic factors relevant to the DSU Article 22.3 analysis show that the victim states differed in important ways. For example: Brazil's economy is almost thirty-two times larger than Ecuador's economy.⁹¹ Brazil's imports of American consumer goods were be-

⁸⁶ *U.S. — Cotton*, *supra* note 1, ¶ 5.183.

⁸⁷ *Compare id.* (holding Brazil was required to retaliate against \$409.7 million of consumer goods under GATT prior to cross-retaliating) *with E.C. — Bananas*, *supra* note 6, ¶¶ 97–101, 173(d) (holding Ecuador could cross-retaliate “[t]o the extent. . . [retaliation under GATT] is insufficient” but never specifying the precise level of consumer goods that Ecuador must retaliate against before cross-retaliating).

⁸⁸ *Compare U.S. — Cotton*, *supra* note 1, at ¶ 5.144 (noting \$1.27 billion in U.S. exports of consumer goods to Brazil) *with E.C. — Bananas*, *supra* note 6, at ¶¶ 97–99 (noting somewhere between \$60.8 and 194 million in E.C. exports of consumer goods to Ecuador); *U.S. — Gambling*, *supra* note 6 at ¶ 4.82 (noting \$101.8 million in U.S. exports of services to Antigua). By volume of trade, the *U.S. — Cotton* decision seems to be a significant relaxation of the DSU Article 22.3 standard. The arbitrators' view that only *consumer goods* should be practicable and effective to retaliate against has been criticized as “mercantilist.” *See* Mavroidis, *supra* note 52, at 806.

⁸⁹ It is worth noting the SCM Agreement provides for “appropriate countermeasures,” for prohibited subsidies, *see* SCM Agreement, *supra* note 2, art. 4.10, and retaliation “commensurate with the degree and nature of the adverse effects” of actionable subsidies, *see* SCM Agreement, *supra* note 2, art. 7.9, while the DSU provides for only retaliation that is “equivalent to the level of the nullification or impairment,” DSU, *supra* note 7, art. 22.4. The arbitrator in *U.S. — Cotton* held that the two standards provide for different *levels* of countermeasures, while the cross-retaliation procedures in 22.3 remained applicable under the SCM Agreement, *U.S. — Cotton*, *supra* note 1, ¶¶ 5.24–27.

⁹⁰ *See* WORLD TRADE ORGANIZATION, INTERNATIONAL TRADE STATISTICS 2009, at 13 (2009), available at http://www.wto.org/english/res_e/statis_e/its2009_e/its2009_e.pdf (listing the United States as the largest importer and third largest exporter and the European Union as the largest exporter and second largest importer).

⁹¹ U.N. Conference on Trade and Development, *Developing Countries in International Trade 2007: Trade and Development Index*, at 76, 94, UNCTAD/DITC/TAB/2007/2 (Nov. 6, 2007), available at http://www.unctad.org/en/docs/ditctab20072_

tween six and twenty-one times larger than Ecuador's from the E.U.⁹² Brazil's share of global export in goods and services is 1.66% while Ecuador's is only .13%.⁹³ Further, the diversity of Brazil's trade compared to that of Ecuador reveals that Ecuador's economy is significantly less diverse and more vulnerable to trade shocks than Brazil's economy.⁹⁴ These basic economic figures show a relaxation of the DSU Article 22.3 standard.

U.S. — *Cotton* misreads DSU Article 22.3 by focusing on inducing compliance to the detriment of economic factors listed in the treaty text. In assessing whether cross-retaliation is practicable or effective, the DSU lists weighing the "broader economic consequences" to the victim state of requiring retaliation in lieu of cross-retaliation.⁹⁵ The treaty text also focuses on the "trade. . . and the importance of such trade" to the victim state as well as "the broader economic elements" implicated by the violation.⁹⁶ Brazil had sufficient retaliatory options given its \$18.7 billion in imports of U.S. goods, including \$1.27 billion in consumer goods imports,⁹⁷ that the arbitrator should have confined retaliation to GATT instead of allowing cross-retaliation. Brazil's economic diversity and trade with the United States are simply too great to allow retaliation outside of GATT.⁹⁸

Interpreting DSU 22.3 as creating what might be termed a level of trade standard⁹⁹ gives fuller meaning to the treaty text¹⁰⁰

en.pdf [hereinafter U.N. TDI]. See generally *id.* (listing GDPs in individual country profiles).

⁹² See *U.S.* — *Cotton*, *supra* note 1, ¶ 5.144; *E.C.* — *Banana*, *supra* note 6, ¶¶ 97–99.

⁹³ U.N. TDI, *supra* note 91, at 76, 94 (listing individual country profiles).

⁹⁴ *Id.* For example, Brazil's trade performance index, which takes into consideration the country's share of trade in merchandise and services, the market concentration of its merchandise exports and the ration of exports to its GDP, *id.* at 9, scores considerably higher (102) than Ecuador (66), *id.* at 76, 94. Also, one study's attempt to create a composite index to assess vulnerability of developing countries for purposes of special treatment under trade law concludes that Brazil, because of its economic size and diverse basket of goods and services traded, would not merit special consideration while both Ecuador and Antigua would, see generally Fen-May Liou & Cherng G. Ding, *Positioning the Non-Least-Developed Developing Countries Based on Vulnerability-Related Indicators*, 16 J. INT'L. DEV. 751, 751–67. The vulnerability assessment seems particularly relevant under DSU Article 22.3 because it should be strongly suggestive of the amount of goods where it is practicable to retaliate against.

⁹⁵ *Id.* art. 22.3(d)(ii).

⁹⁶ DSU, *supra* note 7, art. 22.3(d)(i)–(ii).

⁹⁷ *U.S.* — *Cotton*, *supra* note 1, ¶ 5.144.

⁹⁸ See *supra*, notes 91–94 and accompanying text.

⁹⁹ WTO arbitrators have weighed level of trade in these cases, see e.g. *E.C.* — *Bananas*, ¶ 125–26, although the disparity in the level of trade between the victim

while remaining true to the object and purpose of the DSU to *both* enable and constrain retaliation under the WTO.¹⁰¹ Economic data suggests that the *E.C. — Bananas* and *U.S. — Gambling* decisions were appropriate under such a standard, while *U.S. — Cotton* departs from this principle.¹⁰² At some point, the DSU Article 22.3 limit on cross-retaliation must take priority over the goal of inducing compliance in order to give the legal standard a meaningful effect and the *U.S. — Cotton* case should have represented this point.

The DSU text and its context, as well as the DSU's object and purpose and the historical setting against which the text of DSU Article 22.3 was created suggest that the *U.S. — Cotton* interpretation of cross-retaliation distorts the legal standard. The next section addresses whether cross-retaliation would have been likely to change the U.S. reaction to the case.

IV. THE LIMITED UTILITY OF CROSS-RETALIATION

This Part explores the U.S. response to the *U.S. — Cotton* case. As discussed below, the *U.S. — Cotton* case is particularly insightful because the domestic laws held illegal by the WTO, four different farm programs, varied in the amount of political pain required to comply with the rulings.¹⁰³ The United States ignored some parts of the ruling¹⁰⁴ while making substantive legal changes to conform to other parts of the ruling.¹⁰⁵ The U.S. response demonstrates a desire to comply with its WTO obligations, but only where it could do so without changing fundamental policy choices.¹⁰⁶ The U.S. response suggests that the prime considerations of policy makers had little to do with the threat of retaliation under the WTO.¹⁰⁷ In short, this section argues that the prospect of cross-retaliation likely would not have changed Congress' or the executive's reaction to the *U.S. — Cotton* case. Finally, this Part argues there are strong theoretical reasons to believe that retaliation, more generally, will often fail to induce compliance.¹⁰⁸

states in *U.S. — Cotton* and both *E.C. — Bananas* and *U.S. — Gambling* shows the *U.S. — Cotton* Arbitrator significantly moved away from looking at the level of trade. *See supra*, notes 87–92 and accompanying text.

¹⁰⁰ *Cf.* DSU, *supra* note 7, art 22.3 (a)–(d).

¹⁰¹ *See supra* Part II.

¹⁰² *See supra*, notes 87–92 and accompanying text discussing economic data from the cases.

¹⁰³ *See infra*, Part IV.A.

¹⁰⁴ *See infra*, notes 116–17 and accompanying text.

¹⁰⁵ *See infra*, notes 104–15 and accompanying text.

¹⁰⁶ *See infra*, Part IV.A.1 & 2.

¹⁰⁷ *See infra*, Part IV.A & B.

¹⁰⁸ *See infra*, Part IV.B.

A. *The American Response to the WTO Cotton Case*

The programs at issue in *U.S. — Cotton* ranged from those that could be changed by executive fiat (export credit guarantees), those requiring Congressional approval but only affecting cotton producers (step-2 payments) and two generally applicable programs whose change would require far-reaching effects on American farm policy (countercyclical (“CC”) and marketing loans (“ML”) payments). Unsurprisingly, the U.S. response varied accordingly.

The WTO’s ruling that various subsidies to U.S. cotton producers violated the SCM Agreement produced three distinct responses in the American polity. First, the Bush Administration changed export credit guarantees to make them more subject to market conditions.¹⁰⁹ By making the fees subject to market conditions, the Bush Administration believed the United States no longer conferred a benefit on U.S. producers and would therefore no longer constitute a “subsidy”¹¹⁰ within meaning of the SCM Agreement. The U.S. Trade Representative (“USTR”) later argued that the United States effectively withdrew the illegal subsidies because they are market-based and operated at no-net cost to the government.¹¹¹ While these changes were later approved by Congress¹¹² with slightly more extensive statutory changes to the export credit guarantees,¹¹³ the programs were initially changed through legal discretion already available to the Department

¹⁰⁹ See Press Release, U.S. Dep’t of Agric., USDA Announces Changes to Export Credit Guarantee Programs to Comply with WTO Findings (June 30, 2005); U.S. Submission to the Arbitrator, *supra* note 41, ¶ 31, n.30 (summarizing changes to the export credit guarantee programs). The U.S. Department of Agriculture announced they would no longer accept applications for long-term export subsidies (GSM-103) and the Supplier Credit Guarantee Program (SCGP), that they had changed the fee structure of shorter-term export credit guarantees (GSM-102) and would change eligibility requirements for the loans based on the financial risk posed by guarantees to various countries, USDA Press Release, *supra*.

¹¹⁰ See SCM Agreement, *supra* note 2, art. 1 (defining subsidy); *id.* at annex I(j) (providing an “illustrative list of export subsidies.” which includes export credits “at premium rates which are inadequate to cover the long-term operating costs and losses of the programs.”).

¹¹¹ See Written Submission of the United States, *United States — Subsidies on Upland Cotton: Recourse to Article 21.5 of the DSU by Brazil*, ¶¶ 75–128, WT/DS267/AB-2008-2 (Feb. 19, 2008), available at http://www.ustr.gov/webfm_send/594.

¹¹² Food, Conservation, and Energy Act of 2008, § 3101, Pub. L. No. 110–246, 122 Stat. 1651 [hereinafter 2008 Farm Bill] (describing codification of executive changes and also lifting caps on fees for the program).

¹¹³ See H.R. REP. NO. 110–256, at 222 (2007); see also 2008 Farm Bill, §3101 (requiring a risk-based assessment of export credit guarantees).

of Agriculture (“USDA”).¹¹⁴ The Bush Administration changed the export credit guarantees prior to the deadline set by the WTO for compliance.¹¹⁵

Second, Congress eliminated the Step-2 program.¹¹⁶ The Step-2 program provided payments to purchasers of cotton to make-up the difference between more-expensive U.S. cotton and the international price of cotton, thereby encouraging its use by domestic mills and international buyers.¹¹⁷ Congress eliminated Step-2 in the context of a series of budget cuts trimming spending on other programs, but Step-2 was the only USDA program eliminated in those cuts.¹¹⁸ The Agriculture Committees in Congress eliminated Step-2 as part of broader cuts to agriculture programs mandated by the less farm-friendly Budget Committees under Congressional budget rules.¹¹⁹ In this context, Step-2 was eliminated because it allowed the Bush Administration and Congress to assert their intent to comply with WTO rulings,¹²⁰ while helping the Agriculture Committees meet their targets for spending cuts.

¹¹⁴ See 7 USC § 5622(a)–(c) (2005) (amended 2008) (providing USDA discretion in structuring the export credit guarantees with certain limitations). The older version of 7 USC § 5622 (b) & (c) have been replaced by the farm bill provisions enacted in 2008. See H.R. REP. NO. 110–627, at 757–59 (2008) (Conf. Rep.) (discussing changes to the program).

¹¹⁵ See Sophie Walker & Charles Abbott, *U.S. Tweaks Credits for WTO, Key Cotton Aid Untouched*, REUTERS, July 1, 2005 (noting the changes were “announced less than two hours before the deadline to act”).

¹¹⁶ Deficit Reduction Act of 2005 § 1103, 7 U.S.C. § 7937 [hereinafter 2005 Budget Reconciliation]; see also *Congress Approves Legislation Repealing Cotton Subsidy Program*, FARM FUTURES, Feb. 2, 2006, <http://farmfutures.com/story.aspx?s=27649&c=17>.

¹¹⁷ RANDY SCHNEPF, CONGRESSIONAL RESEARCH SERVICES, BRAZIL’S WTO CASE AGAINST THE U.S. COTTON PROGRAM, at 8 (Mar. 17, 2009), available at <http://www.nationalaglawcenter.org/assets/crs/RL32571.pdf>.

¹¹⁸ See H.R. REP. NO. 109–362, at 187–94 (2005) (Conf. Rep.) (describing the cuts to USDA programs). See generally 2005 Budget Reconciliation, *supra* note 116.

¹¹⁹ See H.R. REP. NO. 109–362. This process is called budget reconciliation and allows budget committees to “instruct” authorizing committees to make changes to mandatory spending programs, see ROBERT KEITH, CONGRESSIONAL RESEARCH SERVICE, BUDGET RECONCILIATION LEGISLATION IN 2005, at 1–5, (Nov. 1, 2005), available at <http://fpc.state.gov/documents/organization/57222.pdf> (providing an overview of budget reconciliation and recent Congressional use of budget reconciliation).

¹²⁰ See H.R. REP. NO. 109–276, at 7 (2005) (citing the *U.S. — Cotton* case as the impetus for eliminating Step-2); S. REP. NO. 110–220, at 30 (2007) (“[a]spects of U.S. export credit programs were successfully challenged in the 2005 WTO Brazil cotton case, and thus must be modified to bring the United States into compliance with the panel’s rulings in this case”).

Third, Congress did nothing concerning the CC and ML payments found to cause “serious prejudice” to Brazil in violation of the SCM and Agriculture Agreements.¹²¹ Those programs were extended through the 2008 Farm Bill and the arbitrator in *U.S. — Cotton* noted that when viewed side-by-side, both the ML and CC programs were identical and contained only minor changes not relevant to their legality under the WTO.¹²² The 2008 Farm Bill actually expands CC payments by giving farmers a new contract option in addition to those found illegal under the SCM.¹²³

What explains these different outcomes in response to the WTO ruling?

1. Changes in Programs Were Driven by a Desire to Comply With the WTO Rulings

The changes to export credit guarantees and elimination of Step-2 are best seen as reflecting a desire by the United States to comply with its WTO obligations. One explanation is that the United States never sought to comply with the rulings but wanted give the appearance of compliance while avoiding substantive changes.¹²⁴ Some evidence suggests that U.S. policy makers had no intent to comply with the rulings. First, the export credit guarantees, as found later by the WTO, were *not* in fact substantively changed but continued to

¹²¹ SCHNEPF *supra* note 117, at 23–24. Congress reauthorized CC and ML payments as part of the 2008 Farm Bill, with minor changes, *see* 2008 Farm Bill, *supra* note 112, title I. It also authorized a new form of CC payments, *see* H.R. REP. NO. 110–627, at 676–77 (2008) (Conf. Rep.) (describing a new CC contract option for commodity producers).

¹²² *See U.S. — Cotton*, *supra* note 1, ¶¶ 3.21–29. The United States asserted, and the arbitrator rejected, the seemingly frivolous argument that because the 2002 farm bill had legally “expired” and been replaced by the 2008 farm bill, the measures no longer existed, U.S. Submission to the Arbitrator, *supra* note 41, at 77–79. Neither Congress nor USTR assert that changes to the ML and CC payments bring the United States into compliance with the ruling, *see* U.S. Submission to the Arbitrator, *supra* note 41, at 77–79 (explaining that the USTR defense was based on calculation of damages rather than program changes). *See also* Press Release, Senator Chambliss Statement on WTO Decision Against U.S. Cotton (Aug. 31, 2009) (defending the ML and CC payments as lawful because of declining global market share of U.S. cotton exports); *cf.* S. REP. NO. 110–220, at 90–91 (making a passing reference to Congressional changes to ML and CC payments in asserting U.S. compliance with the WTO rulings).

¹²³ *See* 2008 Farm Bill, *supra* note 112, § 1105; *see also*, DAN MORGAN, THE FARM BILL AND BEYOND 53 (German Marshall Fund of the United States, Jan. 2010) (quoting a source as saying the new program is a “time bomb” under WTO rules for the United States).

¹²⁴ *See* Mavroidis, *supra* note 52, at 794 (describing how the WTO DSU procedures allow for states to behave in bad faith following DSU rulings against them).

function as export subsidies.¹²⁵ Also, given the wide variety of domestic payment support for cotton producers, including ML and CC payments, elimination of the Step-2 program may seem insignificant.¹²⁶ Additionally, the United States enacted measures in the 2008 Farm Bill that appear similar to the WTO-illegal Step-2 program and give a four cent per pound subsidy to users of cotton.¹²⁷ Finally, key policy makers asserted that the United States would continue prohibited cotton subsidies regardless of WTO obligations to the contrary.¹²⁸

Asserting that the United States had no intent to comply, however, ignores that there has been *some* substantive change to U.S. farm policy that would not have taken place absent the WTO rulings. Congress' elimination of the Step-2 program removed an expected \$282 million in payments to purchasers of American cotton.¹²⁹ The changes to the export credit guarantees removed access to long-term guarantees on export financing and changed the users fees associated with those programs.¹³⁰ Both the Bush Administration and Congress were eager to demonstrate their commitment to making changes in light of the ruling. Bush Administrations officials consistently stated their intent to comply¹³¹ and, while Congress gave mixed signals, key Congressional committees have asserted U.S. compliance with the rulings based on these changes.¹³² Further, the timing and selection of

¹²⁵ See Appellate Body Report, *United States — Subsidies on Upland Cotton Recourse to Article 21.5 of the DSU by Brazil*, WT/DS267/AB/RW (June 2, 2008).

¹²⁶ See Michael J. Shumaker, Comment, *Tearing the Fabric of the World Trade Organization: United States - Subsidies on Upland Cotton*, 32 N.C. J. INT'L L. & COM. REG. 547, 552–60 (2007) (summarizing USDA's cotton subsidies).

¹²⁷ See 2008 Farm Bill, *supra* note 112, § 1207(c) (establishing a new subsidy for users of cotton without regard to whether the cotton is domestic or foreign sourced); see also SCHNEPF *supra* note 117, at 24 (noting that the “United States imports very little cotton,” likely creating a de facto subsidy for U.S. cotton growers). Interestingly, the arbitrator in *U.S. — Cotton* refused to consider these measures as actionable, *U.S. — Cotton*, *supra* note 1, ¶ 3.62. This suggests the possibility for repeated violations of the WTO, where measures are revoked prior to punishment, and then re-enacted, making them immune from WTO sanctions.

¹²⁸ See Charles Abbott, *Keep U.S. Cotton Subsidy as Long as Possible - Senator*, REUTERS, Sept. 8, 2005.

¹²⁹ H.R. REP. NO. 109–276, at 7 (2005).

¹³⁰ See Press Release, U.S. Dep't of Agric., *USDA Announces Changes to Export Credit Guarantee Programs to Comply with WTO Findings* (June 30, 2005).

¹³¹ See Walker & Abbott, *supra* note 115 (quoting Secretary of Agriculture Mike Johanns who stated that “[w]e're going to comply with the WTO ruling”); see also Charles Abbott & Sophie Walker, *U.S. Plans End of Cotton Subsidy Outlawed by WTO*, REUTERS, July 1, 2005 (quoting USDA Undersecretary J.B. Penn who stated “[w]e think this package. . . will bring us into compliance”).

¹³² See S. REP. NO. 110–220, at 90–91 (2007) (asserting that elimination of Step-2, the changes to the export credit guarantees and that the minor changes in the ML

the programs for changes or elimination strongly suggests the United States sought to comply with portions of the WTO rulings.¹³³

The changes are also attributable to the different *legal* status of the payments under WTO law. The SCM Agreement distinguishes between “prohibited” export and domestic content subsidies,¹³⁴ and “actionable subsidies” that are only illegal if they are shown to have “adverse effects” on other members.¹³⁵ The Step-2 and export credit guarantee payments were deemed by the WTO to be prohibited export subsidies¹³⁶ while the ML and CC payments were found to be illegal actionable subsidies because they depressed global markets.¹³⁷ The U.S. inaction on ML and CC payments may be a product of the legal ambiguity concerning actionable subsidies, compared to the straightforward prohibition against export subsidies, thus prompting changes to the latter. Additionally, the SCM Agreement imposes shorter timelines for removing prohibited subsidies.¹³⁸

In short, the best explanation for the changes to export credit guarantees and elimination of Step-2 is a desire to comply with the WTO rulings and prevent continued violations of U.S. trade commitments. While this helps explain the elimination of Step-2 and changes to the export credit guarantees, it fails to explain why the WTO rulings failed to induce compliance with the ruling that the CC and ML payments were also illegal under the WTO.

and CC payments “as a whole constitute sufficient and adequate compliance by the United States in the [U.S. — *Cotton*] dispute. It is the view of the Committee that no other changes should be necessary to satisfy a compliance panel in the WTO”); see also H.R. REP. NO. 110-627, at 758 (2008) (Conf. Rep.) (“the [m]anagers believe that the changes in this section satisfy U.S. commitments to comply with the Brazil cotton case with regard to the export credit guarantees.”).¹³³ That Step-2 was the only program eliminated in Budget Reconciliation suggests the timing and choice was driven by WTO concerns, see H.R. REP. NO. 109-362, at 187-94 (2005) (Conf. Rep.) (describing the cuts to USDA programs).

¹³⁴ See SCM Agreement, *supra* note 2, art. 3.

¹³⁵ See *id.* art. 5.

¹³⁶ See *U.S. — Cotton*, *supra* note 1, ¶ 1.2 (discussing the previous Appellate Body holding that Step-2 and export guarantees were prohibited subsidies within meaning of SCM Article 3); see also SCM Agreement, *supra* note 2, art. 3.

¹³⁷ See *U.S. — Cotton*, *supra* note 1, ¶ 1.2 (discussing the previous Appellate Body holding that ML and CC payments were actionable subsidies creating significant price suppression within meaning of SCM Article 6.3(c)); see also SCM Agreement, *supra* note 2, art. 6.3(c).

¹³⁸ Compare *id.* art. 4.7 (removal “without delay” upon finding of prohibited subsidy), with *id.* art. 4.12 (requiring compliance in half the time as specified under the DSU for other violations of the SCM Agreement); see also SCHNEPF, *supra* note 117, at 14-17 (summarizing these timelines in the *U.S. — Cotton* case and how changes are mandated to be quicker under the SCM Agreement for prohibited subsidies).

2. *The U.S. Congress Failed to Change Programs Despite the WTO Findings Where Doing so Would Require Fundamental Changes to U.S. Farm Policy*

Unlike Step-2, which was cotton-specific, and the export credit guarantees, which could be changed administratively, ML payments and CC payments are pillars of U.S. farm policy. The ML payments regulate sales of commodities, helping stabilize the price farmers receive for cotton and discouraging slumps in market prices immediately following harvest.¹³⁹ The CC payments compensate farmers if market prices fall below a specified trigger.¹⁴⁰ Both programs encourage overproduction of cotton, and because of limited domestic use of cotton, the exports help cause serious prejudice to Brazil.¹⁴¹ Unlike export credit guarantees, modifying ML and CC payments could not be done in a WTO-compliant way without undermining the very purpose they are designed to serve.

The *U.S. — Cotton* case threatens numerous farm programs outside of those supporting cotton. When the WTO's initial decision was made, it came as a shock to many in the agriculture community.¹⁴² The long-term implications remain undefined, but many view *U.S. — Cotton* as opening the door to attack numerous U.S. farm programs under the WTO.¹⁴³ American reactions to the most recent *U.S. — Cotton* decision reaffirm that Congress intends to ignore the WTO's

¹³⁹ See Shumaker, *supra* note 126, at 555 (describing ML payments); USDA Economic Research Service, *Farm and Commodity Policy: Program Provisions: Marketing Assistance Loans and Loan Deficiency Payments*, available at <http://www.ers.usda.gov/briefing/farmpolicy/malp.htm>.

¹⁴⁰ See Shumaker, *supra* note 126, at 555–56 (describing CC payments); USDA Economic Research Service, *Farm and Commodity Policy: Program Provisions: Counter-Cyclical Payments*, available at <http://www.ers.usda.gov/Briefing/FarmPolicy/countercyclicalpay.htm>.

¹⁴¹ The United States is presently the largest global exporter of cotton. For a summary of the U.S. role in global cotton trade, see SCHNEPF *supra* note 117, at 1–2.

¹⁴² See Stephanie Mercier, *The WTO and US Agricultural Policy: Intersections and Consequences*, CHOICES, 4th Quarter 2004, at 26 (stating that while the ruling was limited to cotton “it potentially has much broader implications for U.S. agricultural policy”); see also Darren Hudson, et al, *The WTO Cotton Case and US Domestic Policy*, CHOICES, 2d Quarter 2005, at 143 (asserting that the *U.S. — Cotton* case may be “an event. . . that portends to reshape agricultural policy”).

¹⁴³ E.g. Stephen J. Powell and Andrew Schmitz, *The Cotton and Sugar Subsidies Decisions: WTO's Dispute Settlement System Rebalances the Agreement on Agriculture*, 10 DRAKE J. AGRIC. L. 287, 312–15, 330 (identifying, corn, dairy, rice, soybeans, and wheat subsidies as “hardly any different” from cotton subsidies and concluding that *U.S. — Cotton* has “far reaching” consequences that “pose serious threats to United States farm policy.”). RANDY SCHNEPF, CONGRESSIONAL RESEARCH SERVICE, BRAZIL AND CANADA'S WTO CASES AGAINST U.S. AGRICULTURAL SUPPORT (Feb. 1, 2008), available at <http://www.ncseonline.org/NLE/CRSreports/>

finding that ML and CC payments are illegal under the SCM Agreement and instead Congressional leaders continue emphasizing the changes made to Step-2 and export credit guarantees while avoiding any acknowledgement that CC and ML payments require changes under the WTO.¹⁴⁴ It is far from clear that the calculations of key legislators from Arkansas, Georgia, Montana or Minnesota would have been different if a credible threat of cross-retaliation to non-agriculture interests was imminent.¹⁴⁵ Acknowledging the illegality of ML and CC payments under the WTO would call into question much of the U.S. farm support system extended under the 2008 Farm Bill.¹⁴⁶ Members of Congress would be loathe to acknowledge such inconsistency between WTO law and current U.S. farm policy.

That Congress has asserted U.S. compliance with the *U.S. — Cotton* case while failing entirely to address actionable subsidies¹⁴⁷ is tantamount to a statement that it will go no further in the dispute, regardless of the consequences under the WTO. The U.S. response to the WTO rulings on cotton programs illustrates, in summary, a desire to comply, but only where it would not produce significant pain. Some legal changes by the United States demonstrate a resolve to comply with U.S. legal obligations under the WTO, but the U.S. ignored parts of the WTO rulings calling into question fundamental farm policy choices. Given the far-reaching consequences of changing ML and CC payments, it is doubtful that cross-retaliation would have induced compliance.

B. Retaliation and Issue Linkage in Resolving Disputes in International Relations Theory and State Practice

Supporters of retaliation surmise that for developed countries whose comparative advantage is in services and intellectual property,

08Mar/RL34351.pdf (summarizing cases against U.S. farm programs brought by Brazil and Canada following the *U.S. — Cotton* case).

¹⁴⁴ See Press Release, Harkin Comments on WTO Decision on Brazil Cotton Case, (Aug. 31, 2009), available at http://216.40.253.202/~usscanf/index.php?option=com_content&task=view&id=1943&Itemid=2 (noting other changes in response to the *U.S. — Cotton* rule but not addressing ML and CC payments); Press Release, Senator Chambliss Statement on WTO Decision Against U.S. Cotton (Aug. 31, 2009) (failing to mention ML and CC payments in a summary of U.S. actions to comply).

¹⁴⁵ Cf. DAN MORGAN, *supra* note 123, at 52–53 (discussing Congressional reaction to *U.S. — Cotton* and concluding that lengthy delays for penalties under the DSB mean lawmakers “can ignore the WTO without serious consequences”).

¹⁴⁶ See generally Powell and Schmitz, *supra* note 143; 2008 Farm Bill, *supra* note 112.

¹⁴⁷ See S. REP. NO. 110–220, at 90–91 (2007) (asserting compliance with the rulings, despite failing to substantively change ML and CC payments).

linking rights under TRIPS and GATS with obligations under GATT will significantly increase compliance with the latter.¹⁴⁸ This proposition is questionable as a matter of international relations theory as well as state practice. Retaliation changes the calculus of states, but only to a limited degree. Instead, compliance is most often driven by the traditional institutional role in monitoring and clarifying when a WTO member is in breach, similar to the function of pre-WTO GATT panels.

Mainstream international relations theory assumes states are rational actors, but diverges into two broad camps that explain compliance with international obligations as a product of either underlying power disparities between states (realism)¹⁴⁹ or international regimes that coordinate cooperation between states (institutionalism), usually in an efficient manner.¹⁵⁰ Realists explain patterns of cooperation, whether or not in an institutional setting, as reflecting underlying international power structures.¹⁵¹ Institutionalists emphasize that in-

¹⁴⁸ See Andrew S. Bishop, *The Second Legal Revolution in International Trade Law: Ecuador Goes Ape in Banana Trade War with European Union*, 12 INT'L LEGAL PERSP. 1, 3, 126 (2002) (arguing that the *E.C. — Bananas* case “effectively levels the playing field between the weaker developing WTO members and the stronger industrial WTO members . . . [and] will most likely set a precedent inducing compliance”); Gabriel L. Slater, *The Suspension of Intellectual Property Obligations Under TRIPS: A Proposal for Retaliating Against Technology-Exporting Countries in the World Trade Organization*, 97 GEO. L.J. 1365, 1370 (2009) (“suspending U.S. and European IP rights offers a powerful stick in their trade with developed countries.”); see also Georgia Hamann, Note, *Replacing Slingshots With Swords: Implications of the Antigua-Gambling 22.6 Panel Report for Developing Countries and the World Trading System*, 42 VAND. J. TRANSNAT'L L. 993, 998 (2009) (stating that TRIPS retaliation “constitutes a grave threat to developed economies [by] . . . effectively exerting pressure on developed economies to either honor obligations or pay fair settlement prices”). Note here that my analysis in this section applies equally to regular retaliation and cross-retaliation although I use the term retaliation here.

¹⁴⁹ A variant of realism is the theory of hegemonic stability, which posits that the creation of international regimes, and sometimes institutions, result from the leading economic power's ability and willingness to bear the costs of them. For the original exposition of this theory in explaining the Great Depression and lack of international cooperation in monetary affairs, see CHARLES P. KINDLEBERGER, *THE WORLD IN DEPRESSION 1929–39*, 1–13 (rev. and enlarged ed. 1986). This is relevant because it predicts that when major players view the WTO legal regime as unnecessarily binding them, the multilateral trading system will be undermined.

¹⁵⁰ See JOSÉ E. ALVAREZ, *INTERNATIONAL ORGANIZATIONS AS LAW-MAKERS* 17–31 (2005) (describing institutionalists as “functionalists” and comparing institutionalist theory with realism).

¹⁵¹ See John J. Mearsheimer, *The False Promise of International Institutions*, INT'L SECURITY, Winter 1994–95, at 7.

ternational organizations facilitate information sharing, transparency and monitoring of compliance with obligations, and reducing but not eliminating obstacles to cooperation posed by power disparities.¹⁵²

Explicit in both iterations of mainstream international relations theory is that states are rational actors with pre-determined preference schedules.¹⁵³ The analogy that states act like billiard balls in international relations suggests that states' preferences are hard to alter outside of traditional power politics.¹⁵⁴ In the context of the WTO, the victim state's ability to alter trade preferences necessarily confronts disparities in international power¹⁵⁵ and the limited legal capacity conferred on the DSU to change these preferences.¹⁵⁶

The DSU's limitation that retaliation only may be employed by countries bringing complaints¹⁵⁷ also runs contrary to international relations scholarship examining when sanctions succeed in inducing compliance. One of the assumptions of this scholarship is that sanctions are often ineffective and less effective when done without multilateral support.¹⁵⁸ This scholarship examines when sanctions succeed

¹⁵² See ROBERT O. KEOHANE, *AFTER HEGEMONY COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* 85–109 (1984). See generally Robert O. Keohane & Lisa L. Martin, *The Promise of Institutional Theory*, 20 INT'L SECURITY 1, 39–51 (1995).

¹⁵³ See generally KEOHANE, *supra* note 152, chs. 1, 5–6 (demonstrating how states as rational actors create institutions to coordinate behavior).

¹⁵⁴ See ARNOLD WOLFERS, *DISCORD AND COLLABORATION* 19–24 (1962) (using the billiard ball analogy to and noting deviations from that model in international relations before asserting that explaining state behavior requires “primary attention” to the nation-state and multistate systems).

¹⁵⁵ Mavroidis believes that while the WTO does not have a mandate to address inequalities under all circumstances, they may in the context of the dispute settlement to ensure “inequalities will not adversely affect the rights of states concerned,” Mavroidis, *supra* note 52, at 808, n.134. This is true to the extent permitted under the terms of the DSU, which restricts the size of permissible retaliations permitted, see DSU, *supra* note 7, art. 22.4, and the kind of retaliations under the “practicable” and “effective” procedures, see DSU, *supra* note 7, art. 22.3.

¹⁵⁶ See DSU, *supra* note 7, art. 22.4 (limiting the size of retaliation to that “equivalent” to the level impairment due to the violating measure); *id.* art. 22.3 (limiting the manner of retaliation and when states may resort to cross-retaliation); see generally *supra* Part II.

¹⁵⁷ See DSU, *supra* note 7, art. 23.1 (“[w]hen Members seek redress of a violation of obligations. . . they shall have recourse to, and abide by, the rules and procedures of this Understanding”).

¹⁵⁸ See Daniel W. Drezner, *Bargaining, Enforcement, and Multilateral Sanctions: When is Cooperation Counterproductive*, 54 INT'L ORG. 1, 73–102 (2000) (providing an explanation for why there has been a lack of empirical support for the assumption that sanctions are only effective when implemented multilaterally); *cf.* GARY

in changing political or security goals of states, a considerably tougher task than changing trade preferences. Linking compliance with WTO obligations to the threat of sanctions requires, at the least, that the suspension carries sufficient market power¹⁵⁹ so that it will inflict real pain on the non-compliant state.¹⁶⁰ The DSU limits the amount of pain that the victim state may apply, and arbitrators have acknowledged that economic disparities between the violating state and the victim state necessarily limit the ability of retaliations to induce compliance.¹⁶¹ The WTO's ability to induce compliance strictly through retaliation is therefore sharply limited.¹⁶²

CLYDE HUFBAUER, ET AL, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS, ECONOMIC SANCTIONS RECONSIDERED 158–75 (2007) (finding that sanctions by states since 1914 were “at least partially successful” 34% of the time, that stronger diplomatic ties between the sanctioning state and sanctioned state improve success, but also that broader multilateral support does not necessarily change this success rate); James Mayall, *The Sanctions Problem in International Economic Relations: Reflections in the Light of Recent Experience*, 60 INT'L AFF. 4, 631–42 (taking a dim view of sanctions in practice during the Cold War, particularly where diplomacy cannot ensure multilateral participation in them).

¹⁵⁹ If states are rational actors, by analogy, the antitrust concept of “tying” between two products is instructive of how difficult it will be to induce compliance through sanctions. Tying one product to another will not “force” a consumer to buy the tied product unless the seller has sufficient market power in the tying product, see *Jefferson Parish Hosp. Dist. v. Hyde*, 466 U.S. 2, 12 (1984) (holding that tying of products is not per se illegal unless there is market power in the tying product sufficient to force consumers to purchase the tied product). Here, Brazil cannot force compliance from the United States (the tied product) unless it has sufficient market power in some other sector to retaliate (the tying product). The United States thus will not change its farm policies unless Brazil can impose large and painful sanctions. The analogy is misleading because, unlike consumers in the market, states have institutionalized an entire spectrum of interactions under the WTO and are not in fact unitary actors. This analogy suggests however the rare instance when retaliation itself will bear sufficient economic power to force compliance from a state determined to resist.

¹⁶⁰ Robert E. Hudec, *Broadening the Scope of Remedies in the WTO Dispute Settlement*, in *IMPROVING WTO DISPUTE SETTLEMENT PROCEDURES ISSUES AND LESSONS FROM THE PRACTICE OF OTHER INTERNATIONAL COURTS AND TRIBUNALS* 369, 388 (Friedl Weiss ed. 2000) (“[h]opefully the economic pain caused by the retaliation will enlist the support of affected economic interests”).

¹⁶¹ See *U.S. — Gambling*, *supra* note 6, ¶¶ 4.109–16 (discussing the vulnerability of Antigua’s economic situation and its relevance in considering the practicability and effectiveness of suspending obligations within the same sector or agreement).

¹⁶² Cf. *U.S. Submission to the Arbitrator*, *supra* note 41, ¶ 341 (“[t]he DSU regime establishes remedies that could potentially be *insufficient to lead the government to comply with the DSB ruling*, but this outcome was knowingly considered and selected by Members when negotiating the DSU”) (emphasis added).

As an empirical matter, it is impossible to know when a state's compliance with a WTO panel is driven by a desire to avoid potentially painful sanctions or whether it complies because of other factors.¹⁶³ One study of compliance with GATT panels finds that, unsurprisingly, the larger economies tended to succeed more and comply less than weaker states.¹⁶⁴ In *U.S. — Cotton*, it cannot be definitively determined whether U.S. policy makers were driven to make the changes to farm programs because of the threat of sanctions or the desire to maintain international credibility and improve diplomatic relations, or a combination of these factors. There is good reason to think states often will comply with legal obligations regardless of potential sanctions.

Legal analysts generally agree that WTO panels, appellate body and arbitrator reports, like the text of the WTO agreements themselves, create a legal obligation on states not in compliance to remedy the continuing violation.¹⁶⁵ Compliance with international WTO rulings is, to a large extent, self-enforcing because of the negative long-term consequences of breach and associated reputation losses.¹⁶⁶ Robert Hudec argues that on the whole, the GATT panels were quite successful in inducing compliance, despite the absence of effective economic sanctions.¹⁶⁷ This suggests that the WTO's most effective tools are traditional institutional functions such as monitor-

¹⁶³ Cf. ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 359 (1990) (“one can never really *prove* that an international legal institution has made a difference”).

¹⁶⁴ See *id.* at 355.

¹⁶⁵ Mavroidis, *supra* note 52, at 782; see also; John Jackson, *The WTO Dispute Settlement Understanding—Misunderstandings on the Nature of Legal Obligation*, in DISPUTE RESOLUTION IN THE WORLD TRADE ORGANIZATION 69 (James Cameron & Karen Campbell eds., 1998); but see Schwartz & Sykes, *supra* note 31, at §189 (arguing that the WTO members are not obliged to comply with rulings).

¹⁶⁶ HUDEC, *supra* note 163, at 361 (discussing compliance with GATT panels where no effective sanctions were employed, concluding that “[t]he main impact [of GATT rulings] comes from a series of events that, on the one hand, communicate the international community’s condemnation with increasing clarity and authority, and, on the other hand, create repeated occasions upon which the government’s policy must be reviewed and may be changed”).

¹⁶⁷ *Id.* at 353 (finding “the overall success rate of 88 percent” for GATT panels); see Hudec, *supra* note 160, at 400 (closing a discussion of remedies by saying that “[t]he ultimate ‘remedy’ which made the GATT dispute settlement procedure as successful as it was the force of community pressure . . . that can be generated without an elaborate structure of remedial procedures”). Compliance with WTO reports similarly has been strong, see generally Bruce Wilson, *Note, Comment and Development, Compliance by WTO Members With Adverse WTO Dispute Settlement Rulings: The Record to Date*, 10 J. INT’L ECON. L. 397 (2007).

ing state behavior, clarifying legal obligations, and legitimizing retaliatory actions in the face of a trade partner's continued breach.¹⁶⁸

The question is how significantly increased retaliation, including cross-retaliation, adds to the likelihood of compliance with WTO rulings.¹⁶⁹ It cannot be denied that an institutionalized regime of sanctions may increase compliance over the medium-to-long term, and possibly induce liberal trade policies in situations where it otherwise would not occur.¹⁷⁰ The improved compliance will likely be marginal, however,¹⁷¹ and must be considered in light of the associated drawbacks of increased sanctions. Countervailing considerations include distracting from multilateral economic liberalization,¹⁷² unleashing domestic protectionist lobbying in the victim state,¹⁷³ and enhancing larger states economic power in the DSU.¹⁷⁴ Limiting cross-retaliation to situations where the victim state has little trade with the violating state will usually prevent DSU Article 22.3 from becoming a tool of the powerful against the weak because, on the whole, weak states

¹⁶⁸ See Kenneth W. Abbott & Duncal Snidal, *Why States Act Through Formal International Organizations*, 42 J. CONFLICT RES. 1, 16–23 (1998) (identifying independence as a key reason why states act through formal international organizations rather than ad hoc legal regimes without such organizations); Judith Goldstein & Lisa L. Martin, *Legalization, Trade Liberalization, and Domestic Politics: A Cautionary Note*, 52 INT'L ORG. 3, 603, 608–09 (2000) (noting that “precision” concerning legal requirements is a key function of trade liberalization). See generally HUDEC, *supra* note 163, at 357–72 (assessing why states complied with GATT panels).

¹⁶⁹ Compare HUDEC, *supra* note 163, at 353 (noting a study finding a compliance rate of 88 percent under GATT dispute panels), with Judith L. Goldstein & Richard H. Steinberg, *Negotiate or Litigate? Effects of WTO Judicial Delegation on U.S. Trade Politics*, 71 LAW & CONTEMP. PROBS. 257, 275 (noting a study finding a 95 percent compliance rate with WTO rulings as of 2007).

¹⁷⁰ See generally Goldstein & Steinberg, *supra* note 169 (arguing that WTO decisions affect domestic interest in ways that may encourage liberalization not possible through traditional negotiations).

¹⁷¹ HUDEC, *supra* note 163, at 363 (assessing increased retaliation “higher costs of resistance” as unlikely “to have much political impact”).

¹⁷² Charnovitz, *supra* note 14, at 832 (arguing that sanctions may be “distracting attention from the task of economic liberalization”); Shumaker, *supra* note 126, at 602 (asserting that the long-term consequences of Brazil's victory in the WTO is likely to undermine efforts to reduce barriers to trade).

¹⁷³ See Charnovitz, *supra* note 14, at 814–18 (discussing the painful effects on the imposing state, and noting domestic industry lobbying efforts to have protection afforded to them through sanctions).

¹⁷⁴ HUDEC, *supra* note 163, at 363 (“higher costs of resistance will be most effective as a deterrent against non-compliance by those relatively smaller countries”).

have less trade than larger developed countries.¹⁷⁵ Under the standard proposed here, the opportunity to cross-retaliate usually will remain open to small states against larger ones.

The increased limits of the proposed standard often would benefit developing countries while sacrificing only marginal gains in increased compliance with WTO rulings. The compliance-inducing benefits of the WTO are unlikely to be significantly enhanced through more cross-retaliation, although the drawbacks may be substantial.

V. CONCLUSION

While inducing compliance with WTO obligations is a central tenant of the DSU, it is not the exclusive purpose. This paper suggests inducing compliance through retaliation will often be difficult and also argues that the *U.S. — Cotton* decision stretches the standard under the DSU to a legally distorted position. The *U.S. — Cotton* case also shows that a sense of legal obligation spurs change, but only to a point. When there is significant trade between countries under the agreement breached, there is good reason to think that the compliance inducing effects of the WTO will succeed or fail regardless of the victim state's ability to retaliate. Instead of focusing solely on inducing compliance, WTO arbitrators should look at the level of trade between the victim and violating state. This is consistent with the overall purpose of the DSU to both enable and constrain state retaliation and remains true to the legal standard established by treaty makers in creating DSU Article 22.3.

¹⁷⁵ Of course, under the proposed standard it could still be used by powerful IP exporting countries against weak states where the weak state exports no goods or services protected under TRIPS. This was the situation envisioned when DSU Article 22.3 was originally proposed, see CROOME, *supra* note 56, at 112–14, 244, 279–83.

ENHANCING THE WTO TOOL KIT: THE CASE FOR FINANCIAL COMPENSATION

Rebecca Ullman

INTRODUCTION

World Trade Organization Dispute Settlement Understanding 160 represents an intersection of domestic law and international law. The subject of Dispute Settlement Understanding 160 (“DSU 160”) is the Fairness in Music Licensing Act, an American legislative act that extended copyright protection terms and carved out significant exemptions for commercial establishments.¹ The exemptions set forth in the Fairness in Music Licensing Act (“FMLA”) conflict with U.S. international intellectual property obligations such that one must question whether there should be new and different remedies available to assist parties in meeting their international obligations.

The objective of this paper is to provide background information on DSU 160 and an update as to its recent progress, or lack thereof, and to argue that the case, as it stands now, is convincing evidence that financial compensation should be a remedy available to World Trade Organization (“WTO”) members. Section I provides a context of the FMLA within the history of public performance rights in American copyright law, detailing the provisions of the legislation in question. Section II discusses the FMLA in the context of international copyright obligations and the development of DSU 160. Section III describes the currently available WTO remedies and introduces the concept of financial compensation as a remedy. Finally, Section IV presents a hypothetical situation in which financial compensation is used as a remedy in DSU 160, and argues that such a situation presents strong evidence in favor of adopting financial compensation as a WTO remedy.

I. HISTORY OF COPYRIGHT PROTECTION

From its inception, the United States recognized the value and importance of copyright protection. The U.S. Constitution contains a clause authorizing Congress to enact legislation granting authors the right to benefit from their literary production.² Many attribute the cultural and economic power of the United States to its early embrace

¹ Fairness in Music Licensing Act of 1998, Pub. L. No. 105-298, 112 Stat. 2830 (codified as amended at 17 U.S.C. §§ 101, 110, 504 & 512) [hereinafter FMLA].

² U.S. Const. art. 1, § 8 cl. 8.

of copyright protection and the reward and incentive it offered authors in the form of a limited monopoly.³

Congress granted copyright owners the right to control public performances of dramatic compositions in 1856,⁴ and the public performance right was extended to musical works in 1897.⁵ The 1909 Copyright Act provided some protection against unauthorized public performance of a non-dramatic musical work.⁶ Owners of non-dramatic musical works had only the right to prevent unauthorized *for profit* performance, whereas non-profit, non-dramatic musical performances were exempt. Owners of dramatic works had the exclusive right to control public performance regardless of whether it was for profit.⁷

After the passage of the 1909 Act, the term “for profit” was the focus of much disagreement. Clearly, a concert at which the audience paid to hear a singer or listen to a recording was considered for profit. But what about music played in restaurants, retail stores, or hotels? In these situations, the music is not the focus of the economic transaction, but played because it adds to the atmosphere and contributes to the profit earned by the establishment. The U.S. Supreme Court first interpreted the term “for profit” in *Herbert v. Shanley Co.* where it found that to establish that music was played for profit, a plaintiff only had to show that the music contributed to the profitability of the establishment.⁸ In the opinion, Justice Holmes stated:

It is true that the music is not the sole object, but neither is the food, which could be cheaper elsewhere. The object is a repast in surroundings that to people having limited powers of conversation, or disliking the rival noise, give a luxurious pleasure not to be had from eating a silent meal.⁹

In *Buck v. Jewell-La Salle Realty*, a hotel broadcasted radio programming over loudspeakers into the guest rooms.¹⁰ The Supreme Court held that the broadcast constituted a public performance under

³ See generally Todd Hagins, *Robbing Peter Gabriel to Pay Paul's Diner: Plunder, the Free Market, and the Fairness in Music Licensing Act*, 7 TEX. REV. L. & POL. 385, 389 nn.12–13 (2003) (citing articles discussing the Americanization of European television and the important role of intellectual property in the global marketplace and the value of companies trademarks).

⁴ Act of Aug. 18, 1856, ch. 169, 11 Stat. 138–39 (1856).

⁵ Act of Jan. 6, 1897, ch. 4, 29 Stat. 481 (1897).

⁶ Copyright Act of 1909, 17 U.S.C. §1 (1976) (repealed 1976).

⁷ *Id.* at §1(d).

⁸ *Herbert v. Shanley*, 242 U.S. 591, 595 (1917).

⁹ *Id.*

¹⁰ *Buck v. Jewell-La Salle Realty*, 283 U.S. 191 (1931).

the 1909 Copyright Act, and in doing so, established the doctrine of “multiple performances.”¹¹ Under this doctrine, the first performance is the original broadcast by the radio station (which must be licensed), and the second is the commercial establishment’s broadcast of radio programming over speakers (which had to be licensed in for-profit situations under the 1909 Copyright Act). The Court emphasized the hotel’s control over the music and compared it to hiring an orchestra to play live music: “[i]n each the music is produced by the instrumentalities under its control.”¹²

After the *Buck* decision, copyright owners sought enforcement of their newly elaborated right to receive compensation for re-broadcasts of radio programming.¹³ If a commercial establishment wanted to play the radio, and therefore create a multiple performance, they were required to obtain a license. Performing rights organizations, such as the American Society of Composers, Artists, and Publishers (“ASCAP”), soon began including, and charging for, specific provisions for multiple performances in their standard licenses.¹⁴ The right to collect for re-broadcasts was also extended to cable television.¹⁵ Those who did not purchase a license risked liability.

The Supreme Court returned to the issue of re-broadcasts in 1975 in *Twentieth Century Music Corp v. Aiken*, where copyright owners sued for infringement a small fast food restaurant that played the radio via a receiver and four speakers of the type typically found in private homes.¹⁶ The copyright owners claimed the broadcast constituted a performance for which they were not compensated.¹⁷ The Court held that playing the radio in such a manner did not constitute a performance because of the small size of the establishment and the limited broadcasting equipment.¹⁸ The Court also used a floodgates argument, stating that thousands of small businesses would be subject to liability should the Court find it was a performance.¹⁹

The *Aiken* decision became the basis for statutory exemptions in the 1976 Copyright Act. The House Conference Report stated:

¹¹ *Id.*; David E. Shipley, *Copyright Law and Your Neighborhood Bar and Grill: Recent Developments in Performance Rights and the Section 110(5) Exemption*, 29 ARIZ. L. REV. 475, 480 (1987).

¹² *Buck*, 283 U.S. at 201.

¹³ Shipley, *supra* note 11 at 480–81.

¹⁴ *Id.* at 481.

¹⁵ *Id.* at 481–82.

¹⁶ *Twentieth Century Music v. Aiken*, 422 U.S. 151, 152–53 (1975).

¹⁷ *Id.* at 153.

¹⁸ *Id.* at 162

¹⁹ *See id.*

It is the intent of the conferees that a small commercial establishment of the type involved in *Twentieth Century Music Corp v. Aiken* . . . which merely augmented the home-type receiver and which was not of sufficient size to justify, as a practical matter, a subscription to a commercial background music service, would be exempt. However, where the public communication was by means of something other than a home-type receiving apparatus, or where the establishment actually makes a further transmission to the public, the exemption would not apply.²⁰

The final version of the 1976 Copyright Act gave the owner of a copyright in a musical composition the exclusive right to “perform the copyrighted work publicly.”²¹ The Act defines perform as “[to] recite, render, play, dance, or act it, either directly or by means of any device or process or, in the case of a motion picture or other audiovisual work, to show its images in any sequence or to make the sounds accompanying it audible.”²² The Act defined public as a performance that was either in a space open to the public or a place where a “substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered.”²³ A transmission is considered to be a public performance if it is transmitted to the public, “whether the membership of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times.”²⁴ Section 110(5)(A), entitled the “Homestyle Exemption,” carved out a public performance exemption for:

Communication of a transmission embodying a performance or display of a work by the public reception of the transmission on a single receiving apparatus of a kind commonly used in private homes, unless —

- (A) a direct charge is made to see or hear the transmission; or
- (B) the transmission thus received is further transmitted to the public.²⁵

Although the 1976 Copyright Act sought to clarify the rules regarding radio play in small commercial establishments, it left many of the statutory terms undefined, and thus open to judicial interpreta-

²⁰ H.R. REP. NO. 94-1733, at 75 (1976) (Conf. Rep.).

²¹ Copyright Act of 1976, Pub. L. No. 94-553, § 106(4) 90 Stat. 2541.

²² *Id.* at § 101.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.* at § 110(5)(A).

tion.²⁶ Courts had differing opinions on what constituted homestyle equipment, whether it was acceptable to hide the speakers from view, and whether “small commercial establishment” referred to the physical size of the premises in question only or the size of the parent company.²⁷ Courts agreed that modifying homestyle equipment to increase its impact disqualifies the user from the Homestyle Exemption; that, in general, the greater number of speakers, the less the chance of exemption; and that the use of homestyle equipment does not give the user permission to further transmit the broadcast.²⁸

The public performance exemption was further explicated in the FMLA of 1998.²⁹ The main purpose of the FMLA was to extend the term of copyright protection, but it also included modifications to the Homestyle Exemption in Section 110(5) of the 1976 Copyright Act.³⁰ The original Homestyle Exemption moved to subsection (A) and a second exemption, called the Business Exemption, was added in subsection (B) to cover the performance of non-dramatic musical works in commercial establishments.³¹ The Business Exemption is divided into two sections, one covering restaurants and the other general commercial enterprises. If a general commercial enterprise is less than 2,000 gross square feet, then it does not need to obtain a license to play music via a radio or television.³² If it is more than 2,000 gross square feet, it is subject to restrictions regarding the equipment through which it re-broadcasts.³³ Thus, to be exempt, audio equipment may have no more than six loudspeakers in total and no more than four per room.³⁴ With audiovisual equipment, there may be no more than four televisions per room, no more than six televisions total, and no television with a screen greater than fifty-five inches.³⁵ Restaurants smaller than 3,750 gross square feet are exempt from re-broadcast licenses, and those larger than 3,750 gross square feet must follow the same restrictions as general commercial establishments larger than 2,000 gross square feet.³⁶

²⁶ See Copyright Act of 1976, *supra* note 21 at § 101.

²⁷ Laura A. McCluggage, *Section 110(5) and the Fairness in Music Licensing Act: Will the WTO Decide the United States Must Pay to Play?*, 40 IDEA 1, 12–15 (2000).

²⁸ *Id.*

²⁹ FMLA, *supra* note 1.

³⁰ Copyright Act of 1976, *supra* note 21 at § 1105(5).

³¹ *Id.*

³² *Id.* at § 110(5)(B).

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

The FMLA, in general, was a product of concerted lobbying efforts.³⁷ Lobbies for copyright owners, including the Disney Corporation and famous singers like Don Henley from the musical group The Eagles, testified before Congress, urging it to extend the term of protection.³⁸ The exemptions in Section 110(5)(B) were the result of lobbying efforts by the restaurant and bar associations.³⁹ The exemptions were hotly contested by U.S. performing rights organizations.⁴⁰ In testimony before the Subcommittee on Courts and Intellectual Property, Wayland Holyfield, a singer, songwriter, and representative of ASCAP, said:

We're individual American songwriters who have made American music the most popular in the world. Our efforts should be the pride of all Americans. Instead, here we are defending ourselves against legislation which would take our property and give it for free to people who would profit from it. And that's the whole deal about why we're here.⁴¹

Conversely, Peter Madland, a restaurant owner and representative of Wisconsin taverns, said:

The issue is a very, very complicated one, but let's keep in mind we do have 134 cosponsors to this bill. There was a national survey that said 72 percent of the people agreed that restaurants and bars should not have to pay for use of radio and television. These are your constituents that say this. I don't know what they do for contributions, but they're your constituents, and I think you, as Congress people, should listen to them.⁴²

³⁷ Hagins, *supra* note 3 at 402.

³⁸ Christina N. Gifford, *The Sonny Bono Copyright Term Extension Act*, 30 U. MEM. L. REV. 363, 388 (2000).

³⁹ See generally *Music Licensing in Restaurants and Retail and Other Establishments: Hearing on H.R. 789 Before the Subcomm. on Courts and Intell. Prop.*, 106th Cong. 74 (1997).

⁴⁰ See e.g., *Music Licensing in Restaurants and Retail and Other Establishments: Hearings on H.R. 789 Before the Subcomm. on Courts and Intellectual Property*, 106th Cong. 4 (1997) (statement of Howard Coble, Chairman Subcomm. on Courts and Intellectual Property).

⁴¹ *Music Licensing in Restaurants and Retail and Other Establishments: Hearing on H.R. 789 Before the Subcomm. On Courts and Intellectual Property*, 106th Cong. 73, 74 (1997) (statement of Wayne Holyfield, songwriter).

⁴² *Music Licensing in Restaurants and Retail and Other Establishments: Hearing on H.R. 789 Before the Subcomm. on Courts and Intellectual Property*, 106th Cong. 216 and 219 (1997) (statement of Peter Madland, tavern owner).

Restaurant and store owners were victorious and saw the Business Exemption enacted, but the controversy soon moved to the international stage.

II. INTERNATIONAL COPYRIGHT LEGISLATION AND DSU 160

A. *International Copyright Legislation*

The FMLA took what was essentially a *de minimis* exemption in Section 110(5) of the 1976 Copyright Act and broadened it considerably.⁴³ Even before the FMLA was enacted, various experts expressed concern that the newly broadened exemptions would conflict with international obligations, specifically the Berne Convention for the Protection of Literary and Artistic Works (“Berne Convention”) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS”).⁴⁴

The United States acceded to the Berne Convention in 1988.⁴⁵ It requires parties to the treaty to treat the copyrighted work of other members as they would the works of their own nationals.⁴⁶ Article 11 of the Berne Convention gives authors of dramatic, dramatic-musical, and musical works the exclusive right to authorize the public performance of their works.⁴⁷ Article 11^{bis}(1) specifies that authors have the exclusive right to authorize the broadcasting, rebroadcasting, and public communication by loudspeaker or analogous instrument of their works to the public.⁴⁸ Article 11^{bis}(2) permits countries to determine the conditions under which Art 11^{bis}(1) may be enforced, as long as the enforcement regime does not prevent authors from obtaining equitable remuneration.⁴⁹ Article 11^{bis}(2) is interpreted to mean that countries may implement compulsory licensing regimes as long as they provide copyright owners with compensation.⁵⁰

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, 828 U.N.T.S. 221 (last revised at Paris on July 24, 1971) [hereinafter Berne Convention]. Dawn M. Larsen, *Note: The Effect of the Berne Implementation Act of 1988 on Copyright Protection for Architectural Structures*, 1990 U. ILL. L. REV. 151, 152 (1990).

⁴⁶ Berne Convention, *supra* note 45, at 233.

⁴⁷ *Id.* at 241.

⁴⁸ *Id.* at 241, 243.

⁴⁹ *Id.* at 243.

⁵⁰ World Intellectual Property Organization [WIPO], *Guide to the Copyright and Related Rights Treaties Administered by WIPO and Glossary of Copyright and Related Rights Terms*, at 79, BC-11bis. 22 (2003).

TRIPS is a WTO treaty, and as such all members of the WTO must accede to it.⁵¹ It requires member states to comply with the Berne Convention.⁵² Members are allowed to limit and provide exceptions to rights granted as long as these exceptions are limited in nature and do not “conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder.”⁵³ During the same hearings at which performing rights organizations and restaurant owners testified, the U.S. Copyright Office expressed concern that the proposed FMLA would violate U.S. international copyright commitments.⁵⁴ Marybeth Peters, Register of Copyrights, noted that an exemption as broad as the one proposed in Section 110(5)(B) appears to fall “outside the scope of the permissible ‘small exceptions’” permitted under both the Berne Convention and TRIPS.⁵⁵ Bruce A. Lehman, then Assistant Commissioner of Patents and Trademarks, testified that the United States joined the Berne Convention with the understanding that the Section 110(5) Homestyle Exemption was a *de minimis* exemption, and to subsequently enlarge the scope of the exemption would cause U.S. trading partners to claim a violation of international commitments.⁵⁶ Included in the Senate Congressional Record was a letter from Deputy U.S. Trade Representative Richard W. Fisher to Representative Mary Bono.⁵⁷ In it, he noted that the European Union had already expressed “significant concern about the pending legislation” and had threatened to bring dispute settlement proceedings in the WTO to challenge the existing Homestyle Exemption.⁵⁸ Adding the more expansive business exemption would only add fuel to the growing outrage over U.S. exemptions.⁵⁹

⁵¹ Marrakesh Agreement Establishing the World Trade Organization, Agreement on Trade-Related Aspects of Intellectual Property Rights, Annex 1C, Apr. 15, 1994 1869 U. N. T. S. 299, 301 [hereinafter TRIPS].

⁵² *Id.* at 301.

⁵³ *Id.* at 305.

⁵⁴ *Music Licensing in Restaurants and Retail and Other Establishments: Hearing on H.R. 789 Before the Subcomm. on Courts and Intellectual Property*, 106th Cong. 74 (1997) (statement of Marybeth Peters, Register of Copyrights, Copyright Office of the United States, Library of Congress), available at http://commdocs.house.gov/committees/judiciary/hju43667.000/hju43667_of.htm.

⁵⁵ *Id.* at 43.

⁵⁶ *Id.* (statement of Bruce Lehman, Assistant Comm’r of Commerce).

⁵⁷ *Music Licensing in Restaurants and Retail and Other Establishments: Hearing on H.R. 789 Before the Subcomm. On Courts and Intellectual Prop.*, 106th Cong. 74 (1997) (letter from Richard Fisher, Deputy Trade Representative).

⁵⁸ *Id.*

⁵⁹ *Id.*

B. World Trade Organization Dispute Settlement Understanding
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Despite admonishments from various experts, Congress passed the FMLA and thus enacted the Business Exemption in Section 110(5)(B) and the newly tailored Homestyle Exemption in Section 110(5)(A). In January of 1999, the European Communities (“EC”) requested consultations with the United States regarding Section 110(5) of the FMLA under Article 4 of the WTO Dispute Settlement Understanding and Article 64.1 of TRIPS.⁶⁰ Consultations were held in March of 1999, but the parties failed to reach a mutually acceptable agreement.⁶¹ The EC requested an examining panel under Dispute Settlement Understanding Article 6 and TRIPS Article 64.1.⁶² The EC alleged that the exemptions provided in Section 110(5)(A) and (B) violated U.S. obligations under TRIPS, and requested that the Panel: (1) find that the United States had violated Article 9.1 of TRIPS and Articles 11*bis*(1)(iii) and 11(1)(ii) of the Berne Convention, and (2) recommend that the United States bring its domestic legislation into conformity with its international obligations.⁶³ The United States countered that its legislation complied fully with both Article 13 of TRIPS and the substantive requirements of the Berne Convention.⁶⁴

The panel submitted its report in June of 2000. It found that the Section 110(5)(A) Homestyle Exemption satisfied Article 13 of TRIPS (minor exemptions) and was thus consistent with Berne Conventions obligations.⁶⁵ However, it found that the Section 110(5)(B) Business Exemption did *not* meet Article 13 requirements, and was, therefore, inconsistent with Berne Convention obligations.⁶⁶ The Panel’s decision focused on the TRIPS Article 13 test that requires that exemptions: (1) be confined to certain special cases, (2) do not conflict with the legitimate interests of the right holder, and (3) do not unreasonably prejudice the legitimate interests of the right holder.⁶⁷ The Panel found Section 110(5)(A) met the Article 13 requirements, because the exemptions were sufficiently limited⁶⁸ and dramatic musical right holders would not expect to license or receive compensation

⁶⁰ Panel Report, *United States-Section 110(5) of the US Copyright Act*, ¶ 1.1, WT/DS160 (June 15, 2000) [hereinafter Section 110(5) Case].

⁶¹ *Id.* ¶ 1.2.

⁶² *Id.*

⁶³ *Id.* ¶ 6.1.

⁶⁴ *Id.* ¶ 6.2.

⁶⁵ *Id.* ¶ 7.1.

⁶⁶ *Id.*

⁶⁷ TRIPS, *supra* note 51, at art. 13.

⁶⁸ Section 110(5) Case, *supra* note 60, ¶¶6.143, 7.1.

from the performances in question.⁶⁹ The Panel found Section 110(5)(B) did not meet the criteria because the number of businesses it included was too large,⁷⁰ right holders of musical works would be in a position to authorize secondary broadcasts and receive compensation,⁷¹ and the United States failed to prove that the exemption did not unreasonably prejudice the legitimate interests of the right holder.⁷²

In July of 2000, the WTO Dispute Settlement Body (“DSB”) adopted the Panel’s report, and in August, the United States informed the DSB that it would require a “reasonable period of time” to implement the recommendations and rulings, as permitted under Dispute Settlement Understanding Article 21.3.⁷³ After the parties failed to agree on the definition of a “reasonable period of time,” the EC requested binding arbitration to determine the implementation period.⁷⁴ The United States argued for an implementation between fifteen and seventeen months, ending on December 31, 2001,⁷⁵ while the EC maintained a reasonable period of time was ten months.⁷⁶ The arbiter found a reasonable time period was twelve months from the adoption of the Panel’s report (July 27, 2000),⁷⁷ making the deadline for implementation July 27, 2001.

With the implementation deadline quickly approaching and no sign of U.S. legislative compliance, the EC and the United States struck a deal giving the United States until December 31, 2001 to make the required changes in exchange for participation in a binding arbitration to determine the level of nullification and impairment of benefits to the EC as a result of Section 110(5)B.⁷⁸ Should the United States fail to make the required changes by the new, extended dead-

⁶⁹ *Id.* ¶¶ 6.218, 6.271.

⁷⁰ *Id.* ¶ 6.133.

⁷¹ *Id.* ¶ 6.210.

⁷² *Id.* ¶ 6.265.

⁷³ World Trade Organization, Dispute Settlement: DSU 160 United States - Section 110(5) of the Copyright Act, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds160_e.htm (last visited Feb. 9, 2010). *See generally* Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments-Results of the Uruguay Round art. 21.3, 33 I.L.M. 1125 (1994).

⁷⁴ World Trade Organization, Dispute Settlement: DS 160 United States - Section 110(5) of the Copyright Act, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds160_e.htm (last visited Feb. 9, 2010).

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Intellectual Property: EU Blasts WTO Arbitration Award in Music Licensing Dispute with U.S.*, Patent, Trademark & Copyright Law Daily (BNA), at D-2 (Nov. 26, 2001).

line, the EC was entitled to claim against the United States the amount of nullification and impairment determined by the arbitration panel.⁷⁹ The arbitration request was the first of its kind under Article 25.2 of the Dispute Settlement Understanding.⁸⁰

The financial compensation arbitration was important because there was a large discrepancy between the figures submitted by the United States and those submitted by the EC. The United States claimed annual losses from the legislation were approximately US\$446,000-\$733,000,⁸¹ while the EC claimed losses of approximately US\$25 million.⁸² The discrepancy was a result of different methods of calculation. The EC argued that the proper method of calculation was one that assumed all establishments using copyrighted works of EC right holders were licensed.⁸³ The United States argued for a *de facto* approach where damage was measured by determining the difference between the amount EC right holders were receiving before the amendment and the amount they received after the amendment.⁸⁴ The arbiters agreed with the United States that the level of compensation should equal the amount of licensing revenue that the EC could reasonably expect to receive.⁸⁵ The Panel determined that: (1) royalties should be calculated based on the amount paid by U.S. performing rights organizations to EC right holders as opposed to the amount collected by U.S. performing rights organizations,⁸⁶ (2) nullification and impairment should be assessed from the date the matter was referred to the Panel, in this case approximately June 30, 2001,⁸⁷ and (3) as a result of Section 110(5)(B) was US\$1.1 million per year.⁸⁸

January 2002 came and went without changes in U.S. legislation.⁸⁹ The EC proposed retaliation by levying a special fee on U.S. nationals in connection with border measures concerning copyrighted

⁷⁹ *Id.*

⁸⁰ *Trade: WTO Chief Moore Appoints Arbitrators in Music Licensing Decision Against U.S.*, Patent, Trademark & Copyright Law Daily (BNA), at D-5 (Aug. 13, 2001).

⁸¹ Award of the Arbitrators, *United States-Section 110(5) of the US Copyright Act* ¶ 4.3, WT/DS160/ARB25/1 (Nov. 9, 2001).

⁸² *Id.* at ¶ 4.2.

⁸³ *Id.* ¶ 3.4.

⁸⁴ *Id.* ¶ 3.5.

⁸⁵ *Id.* ¶ 3.33.

⁸⁶ *Id.* ¶ 3.58.

⁸⁷ *Id.* ¶ 4.24.

⁸⁸ *Id.* ¶ 4.73.

⁸⁹ *European Trade Commission, WTO Dispute Settlement, Cases Involving the EU, Recourse by the European Communities to Article 22.2 of the DSU*, Jan. 11, 2002, http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114288.pdf (last visited Feb. 20, 2010).

goods in the amount of US\$1.05 million per year.⁹⁰ The United States objected to this method of retaliation, claiming it did not conform to Dispute Settlement Understanding Articles 22.6 and 22.3, and called for arbitration.⁹¹ The EC agreed to give the United States more time to implement the required changes in exchange for a suspension of the arbitration proceeding.⁹²

In June 2003, the EC and United States reached an agreement where the United States paid US\$3.3 million into a fund for the promotion of authors' rights and assistance to EU performing rights organizations.⁹³ The payments were to be backdated to December 2001 to cover a three year period of U.S. legislative non-compliance.⁹⁴ The settlement was contingent upon the understanding that Section 110(5)(B) was to be amended by the end of 2004.⁹⁵

Dispute Settlement Understanding Article 21.6 requires adopted recommendations and rulings issued by WTO panels to be kept under surveillance until they are resolved.⁹⁶ Accordingly, the United States issues monthly updates communicating its progress toward implementation of the required legislative changes. Unfortunately, since the agreement in 2003, the updates have had little to

⁹⁰ *Id.* See *EU, Japan Agree to Give U.S. More Time to Comply with Copyright Ruling*, Patent, Trademark & Copyright Law Daily (BNA), at D-3 (Jan. 22, 2002).

⁹¹ *European Trade Commission, WTO Dispute Settlement, Cases Involving the EU, Request for Arbitration under Article 22.6 of the DSU*, Jan. 18, 2003, http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114298.pdf (last visited Feb. 20, 2010).

⁹² *EU, Japan Agree to Give U.S. More Time to Comply with Copyright Ruling*, Patent, Trademark & Copyright Law Daily (BNA), at D-3 (Jan. 22, 2002).

⁹³ *European Trade Commission, WTO Dispute Settlement, Cases Involving the EU, Notification of Mutually Satisfactory Temporary Agreement*, 26 June 2003, http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114303.pdf (last visited Feb. 20, 2010). See *U.S. to Pay \$3.3 Million to EU Music Groups in Temporary Settlement of Licensing Dispute*, Patent, Trademark & Copyright Law Daily (BNA), at D-8 (June 25, 2003).

⁹⁴ *European Trade Commission, WTO Dispute Settlement, Cases Involving the EU, Notification of Mutually Satisfactory Temporary Agreement*, 26 June 2003, http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114303.pdf (last visited Feb. 20, 2010).

⁹⁵ See *U.S. to Pay \$3.3 Million to EU Music Groups in Temporary Settlement of Licensing Dispute*, Patent, Trademark & Copyright Law Daily (BNA), at D-8 (June 25, 2003).

⁹⁶ Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments—Results of the Uruguay Round art. 21.6, 33 I.L.M. 1125 (1994) [hereinafter DSU].

offer in the way of substantive progress.⁹⁷ Each of the sixty updates state, “The U.S. Administration has been working closely with the U.S. Congress, and will continue to confer with the European Communities, in order to reach a mutually satisfactory resolution of this matter.”⁹⁸ Communication with the U.S. Trade Representative’s legal staff in charge of DSU 160 provided no further information than that provided in the official Art. 21.6 updates.⁹⁹ The most recent U.S. report to the DSB on December 21, 2009, provided no new updates.¹⁰⁰ The lack of progress toward amending Section 110(5)(B) cannot be attributed to U.S. congressional resistance to addressing copyright legislation because there have been many proposed amendments to U.S. copyright law, including one to Section 110(5)(C) in February of 2008,¹⁰¹ but none that would remedy the problems identified in DSU 160.

From the information above, one can draw several conclusions. First, the United States has not amended Section 110(5)(B) for undisclosed reasons and shows no sign of political progress toward a solution. In fact, when Representative Sensenbrenner, a sponsor of the FMLA, heard of the original panel’s decision, his spokesperson said the FMLA “is U.S. law, and allowing an international body to say, ‘You will change the law,’ is not a good precedent to set.”¹⁰² After nine years (2001–2010), presumably lack of time is no longer the issue. Second, the WTO Dispute Settlement Understanding provides for two remedies in the case of non-compliance—trade retaliation and trade concessions¹⁰³—neither of which have been used in the nine years of non-compliance. At one point, the EC threatened trade retaliation, but it quickly backed down. The United States has not offered, nor the EC demanded, trade concessions. This leads to the conclusion that the

⁹⁷ See, e.g., European Commission Trade, *WTO Dispute Settlement, Cases Involving the EU*, <http://trade.ec.europa.eu/wtodispute/show.cfm?id=155&code=1>; see, e.g. World Trade Organization, *Status Report Regarding Implementation of the DSB Recommendations and Rulings in the Dispute*, United States Section 110(5) of the US Copyright Act (WT/DS160).

⁹⁸ See e.g., European Commission Trade, *WTO Dispute Settlement, Cases Involving the EU, Status Report by the United States*, Dec. 7, 2004, http://trade.ec.europa.eu/doclib/docs/2004/december/tradoc_120595.pdf (last visited Feb. 20, 2010).

⁹⁹ E-mail from Probir Mehta, U.S. Trade Representative Attorney in charge of DSU 160, to author (Dec. 2, 2009) (on file with author).

¹⁰⁰ Statements by the U.S. at the Dec. 21, 2009 DSB Meeting, <http://geneva.usmission.gov/2009/12/21/1221dsb/>.

¹⁰¹ S. 2591, 110th Cong. §1 (2008).

¹⁰² Anne Hiaring, *Fish or Fowl? The Nature of WTO Dispute Resolution Under TRIPS*, 12 ANN. SURV. INT’L & COMP. L. 269, 282–83 (2006).

¹⁰³ DSU, *supra* note 96, at art. 22.1.

remedies are, in some way, ineffective or inappropriate for the current situation. Third, the parties agreed upon and exchanged financial compensation as temporary remedy to the dispute, which indicates they found it to be an effective temporary remedy. Finally, without progress toward a solution, DSU 160 is creating a precedent of non-compliance that threatens the integrity of the WTO system.

III. WTO TRADE REMEDIES AND THE FINANCIAL COMPENSATION MODEL

A. *Current Remedies Available Under the WTO System*

The WTO Dispute Settlement Body was established to settle disputes that arise when a country adopts a trade measure or takes some action that one or more fellow WTO members considers a violation of the WTO agreements, or when a member fails to live up to its international obligations.¹⁰⁴ If a member state fails to abide by the decision of the DSB, the winning party has two options to attempt to force compliance. The first option is trade retaliation where the winning country withdraws certain concessions in the amount equal to the damage caused by the original breach.¹⁰⁵ The second option is trade concessions; here, the losing country compensates the winning country with additional concessions equal to the original breach.¹⁰⁶

Financial compensation, such as that type paid by the United States to the EC in DSU 160, is not explicitly available as a remedy and DSU 160 was the first time financial compensation was used to temporarily resolve a dispute.¹⁰⁷ The financial compensation in DSU 160 was for only part of the period of non-compliance, differentiating it from the other trade remedies that last until there is compliance. Therefore, whether financial compensation has been successfully read into Article 22 is ambiguous and uncertain. The idea of financial compensation is not new and has been supported by developing countries since 1965, more recently by various countries calling for DSU reform.¹⁰⁸

¹⁰⁴ World Trade Organization, Understanding the WTO: Settling Disputes A Unique Contribution, http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm (last visited Feb. 9, 2010).

¹⁰⁵ DSU, *supra* note 96, at art. 22.

¹⁰⁶ *Id.*

¹⁰⁷ Pei-kan Yang, *Some Thought on a Feasible Operation of Monetary Compensation as an Alternative to Current Remedies in the WTO Dispute Settlement*, 3 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 423, 432-33 (2008); *see also* Joel P. Trachtman, *The WTO Cathedral*, 43 STAN. J. INT'L L. 127, 162 (2007) ("The Bananas case may have been settled informally between Ecuador and the European Communities through cash consideration.").

¹⁰⁸ Yang, *supra* note 107, at 447; Trachtman, *supra* note 107, at 145.

There are various models that propose financial compensation as a remedy. In their article *Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement*,¹⁰⁹ Marco Bronckers and Naboth van den Broek present a well-developed and comprehensive model that addresses the major benefits and difficulties associated with financial compensation. Using this model as a rubric, the following section will hypothesize that had financial compensation been available to the parties in DSU 160, it would have provided an expedient and satisfactory remedy for both parties and would have prevented the extended period of non-compliance that poses a threat to the integrity of the WTO system.

B. *Financial Compensation Model*

The Bronckers and van den Broek financial compensation model is based upon a proposed amendment to the WTO's Dispute Settlement Understanding, rather than a new interpretation of the current agreement.¹¹⁰ The proposed amendment would provide a member whose rights were infringed with a choice of remedies—trade concessions, trade retaliation, or financial compensation.¹¹¹ The amount of financial compensation would be assessed by a panel, and either backdated to the beginning of the infringement for clear or “bad faith” breaches, or, in more ambiguous cases, begin following the finding by a panel or the WTO Appellate Body.¹¹² Compensation would be restorative and not punitive in nature, though the model would allow for minor annual increases in the amount of damages due to reflect the increasing cost of non-compliance to those harmed by the measure, as well as to the WTO system itself.¹¹³ Finally, Bronckers and van den Broek suggest that individual WTO members must have sovereign discretion to distribute compensation payments to their domestic private parties that suffered from the breach.¹¹⁴

The model proposes a liquidated damages formula that would dictate pre-set standard sums for various types of violations.¹¹⁵ These pre-determined amounts could be linked to the size of the defending member's economy and assets so that effect of the compensation would

¹⁰⁹ Marco Bronckers & Naboth van den Broek, *Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement*, 8 J. INT'L ECON. L. 101 (2005).

¹¹⁰ *Id.* at 123–25.

¹¹¹ *Id.* at 107.

¹¹² *Id.* at 124–25.

¹¹³ *Id.* at 124.

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 125.

be proportional, regardless of the country's economic size.¹¹⁶ Establishing pre-set standard sums is a way to circumvent the problem of calculating damages, which can be done in many ways and thus could be a source of controversy.¹¹⁷ In DSU 160, the parties, with the help of an arbitration panel, were able to agree on the amount of financial compensation,¹¹⁸ though had pre-set sums been available they may have saved significant arbitration costs. The Bronckers and van den Broek model includes special allowances for developing countries, or those with smaller economies, that would allow them to claim financial compensation without having it claimed against them.¹¹⁹ It also suggests that larger or richer developing countries might be entitled to an "opt-out" clause that would exempt them from the system of financial compensation.¹²⁰

IV. DSU 160 – THE CASE FOR FINANCIAL COMPENSATION

A. *Embodying the Benefits*

The following section examines how DSU 160 embodies the benefits of financial compensation identified in the Bronckers and van den Broek model. A summary of each argument presented by Bronckers and van den Broek will be presented, followed by an application of the argument to DSU 160.

1. *Financial Compensation is not trade restrictive.*¹²¹

Currently, when a member does not comply with a Dispute Settlement Understanding, the member that suffered injury has two potential remedies—trade retaliation and trade concessions.¹²² Trade retaliation is restrictive because new restrictions on importation hurt domestic consumers and industries that rely on the now-limited imports.¹²³ Trade concessions do not restrict trade, *per se*, but can cause distortions to the negotiated trading system.¹²⁴ Retaliation and concessions can 'infect' innocent bystanders, who have their trading posi-

¹¹⁶ *Id.*

¹¹⁷ See Award of the Arbitrators, *United States-Section 110(5) of the US Copyright Act* ¶ 4.2, WT/DS160/ARB25/1 (Nov. 9, 2001), available at [www.worldtradelaw.net/reports/25awards/us-copyright\(25\).pdf](http://www.worldtradelaw.net/reports/25awards/us-copyright(25).pdf).

¹¹⁸ *Id.*

¹¹⁹ Bronckers & van den Broek, *supra* note 109, at 125.

¹²⁰ *Id.*

¹²¹ *Id.* at 110.

¹²² DSU, *supra* note 96, at art. 22.

¹²³ Arwel Davies, *Reviewing Dispute Settlement at the World Trade Organization: a time to Reconsider the Role/s of Compensation?*, 5 WORLD TRADE REV. 31, 34 (2006).

¹²⁴ *Id.* at 38.

tions altered by the remedy. With financial compensation, the breach is isolated to the parties involved and has few ramifications for the trading positions of other domestic parties or third parties. In a sense, the breach is quarantined and kept non-contagious until it is cured through compliance.

In DSU 160, the EC threatened to retaliate against U.S. non-compliance by implementing new measures on imported copyrighted goods.¹²⁵ The threat of retaliation was enough to spur a new agreement between the parties as to temporary compensation, demonstrating the extent to which the parties wanted to avoid retaliation in favor of a different remedy.¹²⁶

2. *Financial compensation helps redress injury.*¹²⁷

Financial compensation can provide at least partial reparation for damages caused by the WTO-illegal act.¹²⁸ In DSU 160, the arbitration panel identified the amount of income that European performing rights organizations did not receive as a result of the FMLA.¹²⁹ The amount paid by the United States to the EC could have gone to performing rights organizations to compensate the rights holders who were directly harmed by the U.S. breach, and thus redressed their injury. However, the EC chose to use the funds for different purposes.¹³⁰

3. *In most cases, financial compensation will work as well, and sometimes better, to induce compliance.*¹³¹

There are two aspects of compliance within the WTO system. The first aspect is compliance with the positive and negative aspects of the treaty obligations assumed by member states when they join the

¹²⁵ *European Trade Commission, WTO Dispute Settlement, Cases Involving the EU, Recourse by the European Communities to Article 22.2 of the DSU*, Jan. 11, 2002, http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114288.pdf (last visited Feb. 20, 2010).

¹²⁶ *See EU, Japan Agree to Give U.S. More Time to Comply with Copyright Ruling, Patent, Trademark & Copyright Law Daily (BNA)*, at D-3 (Jan. 22, 2002); *U.S. to Pay \$3.3 Million to EU Music Groups in Temporary Settlement of Licensing Dispute*, *Patent, Trademark & Copyright Law Daily (BNA)*, at D-8 (June 25, 2003).

¹²⁷ Bronckers & van den Broek, *supra* note 109, at 110.

¹²⁸ Davies, *supra* note 123, at 40.

¹²⁹ *U.S. to Pay \$3.3 Million to EU Music Groups in Temporary Settlement of Licensing Dispute*, *Patent, Trademark & Copyright Law Daily (BNA)*, at D-8 (June 15, 2003).

¹³⁰ *Id.*

¹³¹ Bronckers & van den Broek, *supra* note 109, at 110.

WTO.¹³² The United States was found to be non-compliant with its TRIPS obligations when it passed the FMLA and remains non-compliant today.¹³³ A secondary aspect is compliance within the remedy system. The language of the Dispute Settlement Understanding indicates that parties to a dispute should either be in the process of implementing the panel's recommendations,¹³⁴ or be pursuing trade retaliation or trade concessions.¹³⁵ If a country is neither actively pursuing compliance nor using one of the trade remedies, it is undermining the WTO trading system. Allowing a country to exist in a state of unsanctioned non-compliance sets a precedent that WTO obligations may be ignored. Therefore, it should be a goal of the WTO system to avoid such rogue situations.¹³⁶

In DSU 160, compliance with the DSU recommendations will be very difficult. Compliance would involve amending the FMLA, a difficult proposition considering the political bargaining that went into its passage.¹³⁷ Without amending the FMLA, there is no legislative

¹³² World Trade Organization, Principles of the trading system: Predictability through binding and transparency, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm (last visited Feb. 24 2010).

¹³³ Alben P. Petrova, *The U.S. – Section 110(5) of the Copyright Act Dispute Analysis and Forecasts for Compliance*, 15 CURRENTS: INT'L TRADE L.J. 43, 45–47 (2006).

¹³⁴ DSU, *supra* note 96, at art. 21.1 (“Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes.”).

¹³⁵ *Id.* at art. 22.2 (“If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation.”).

¹³⁶ International law must often address the argument that “real law” requires a sovereign to enforce it and therefore international law is not “real law.” MARK W. JANIS & RICHARD S. KAY, EUROPEAN HUMAN RIGHTS LAW, xl (Univ. of Connecticut Foundation Press) (1990). Janis and Kay, citing Max Weber, define “law” as an order system endowed with certain specific guarantees of the probability of its empirical validity. *Id.* Weber wrote of a “coercive apparatus, i.e., that there are one or more persons whose special task it is to hold themselves ready to apply specially provided means of coercion (legal coercion) for the purpose of norm enforcement.” *Id.* at xli. To be an effective and coherent legal system, the WTO must provide “certain specific guarantees of the probability of its empirical validity.” Instances in which members are neither in compliance with international obligations nor in compliance with trade remedies, undermine the specific guarantees of validity that make the WTO an efficacious legal system.

¹³⁷ See *supra* notes 39–42.

basis for the United States to collect royalties from commercial establishments. The more realistic option is to use a trade remedy to compensate the right holders who would otherwise receive royalties. As discussed above, the fact that trade retaliation or trade concessions have not been used indicates that the remedies are in some way ineffective or inappropriate for the situation. On the other hand, DSU 160 demonstrates that financial compensation can provide an alternative remedy and thus a way to remain a way for the breaching country to remain a compliant member of the WTO system.

4. *Financial compensation does not lead to disproportionate burden on innocent bystanders.*¹³⁸

As discussed above, trade retaliation and concessions impose costs upon private parties who were previously external to the dispute. Externalizing the costs of trade remedies is unfair in many respects and may cause domestic turmoil.¹³⁹ Financial compensation, on the other hand, would be an obligation that could be distributed over the offending country's budget, and thus not impose specific costs on specific, innocent bystanders.¹⁴⁰ In DSU 160, the financial compensation issued from the U.S. government's coffers and not from trade distortions applied to private parties.¹⁴¹

5. *Financial compensation can be a disincentive to foot-dragging.*¹⁴²

Allowing financial compensation as a remedy prevents countries from delaying the dispute settlement process, especially if damages are assessed retroactively.¹⁴³ If damages are assessed from the beginning of infringement, countries have an easily measurable incentive to come into compliance as soon as possible.¹⁴⁴ Financial compensation is an efficient remedy that imposes few procedural costs once it has been calculated, while traditional remedies involve additional calculations.¹⁴⁵ As trade volumes are not static, trade retaliation and

¹³⁸ Bronckers & van den Broek, *supra* note 109, at 110.

¹³⁹ Davies, *supra* note 123, at 44.

¹⁴⁰ *Id.*

¹⁴¹ Emergency Wartime Supplemental Appropriations Act, 2003, Pub. L. No. 108-11, 117 Stat. 559 (2003).

¹⁴² Bronckers & van den Broek, *supra* note 109, at 110.

¹⁴³ *Id.* at 110-11.

¹⁴⁴ Davies, *supra* note 123 at 40.

¹⁴⁵ See Robert Howse & Robert W. Staiger, *United States-Anti-Dumping Act of 1916 (Original Complaint by the European Communities)- Recourse to Arbitration by the United States Under 22.6 of the DSU*, WTREV 2005, 4(2), 295-316, 302. (Outlining the three-step analysis to be used to determine the level of nullification or impairment caused by the measure introduced by the defendant. In the case of financial compensation, the analysis would be complete after this step. With

trade concessions measures must be monitored and re-calculated to ensure that the remedy is proportional to the breach.¹⁴⁶ The third round of arbitration in DSU 160 began because the United States argued that retaliatory measures used by the EC were in excess of the determined harm, though the amount of nullification and impairment had already been determined through arbitration.¹⁴⁷ Financial compensation is much simpler and easy to execute than trade retaliation or trade concessions.

In DSU 160, the parties agreed to financial compensation in a relatively expedient manner, at least in comparison to the period of non-compliance. Were financial compensation an acceptable remedy, the parties could effectively exchange money and move on without costing each other, or the system, any more than was necessary.

6. *Financial compensation is in line with general public international law.*¹⁴⁸

The principles of public international law call for two reactions to breaches of treaty obligations: (1) compliance and (2) reparation for remedial purposes.¹⁴⁹ The traditional remedies address compliance but do not provide for reparations to private entities.¹⁵⁰ Financial compensation could act as a “stick” to induce compliance, and a “carrot” to make those hurt by the breach, whole.

Here, perhaps the parties agreed to financial compensation because compliance seemed unrealistic, but financial compensation offered the next best thing—reparations. In some ways, financial compensation can also achieve what WTO rule compliance seeks, making the parties whole again.

traditional remedies, a *second* three-step analysis would be needed to determine the trade impact of the complainant’s proposed retaliatory measure.) The figure determined by the second three-step analysis would need to be monitored and occasionally recalculated to ensure it remained proportional, per DSU article 22.4.

¹⁴⁶ DSU, *supra* note 96, at art. 22.4.

¹⁴⁷ *European Trade Commission, WTO Dispute Settlement, Cases Involving the EU, Request for Arbitration under Article 22.6 of the DSU*, Jan. 18, 2003, http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114298.pdf (last visited Feb. 20, 2010).

¹⁴⁸ Bronckers & van den Broek, *supra* note 109, at 111.

¹⁴⁹ *Id.* See Case Concerning the Factory at Chorzów (Ger. v. Pol.), 1928 P.C.I.J. (ser. A) No. 17 (Judgment of Sept. 13) (International Court of Justice case establishing reparations as a remedy in international law).

¹⁵⁰ Davies, *supra* note 123, at 48. “[N]ullification or impairment was equated with trade effects, which in turn refers to the total value of trade annually excluded. This methodology distances the concept of nullification or impairment from how the violation impacts upon private entities.” (in reference to several WTO Dispute Settlements). *Id.*

7. *Introducing financial compensation adds an element of fairness.*¹⁵¹

According to Bronckers and van den Broek, “fairness” plays an important role in explaining compliance with domestic and international law.¹⁵² Most parties, especially the United States and EC, will be on both sides of the WTO Dispute Settlement process, as both applicants and defendants.¹⁵³ In fact, the EC and the United States are the most active TRIPS-related complainants to the WTO.¹⁵⁴ They have an interest in a system that has integrity and treats both applicants and defendants equitably. DSU 160 represents a situation where both parties have agreed upon a remedy that they find fair, and, as demonstrated above, this remedy is in line with the premise and goals of the WTO system.

B. *Addressing the Difficulties*

The following section examines how DSU 160 addressed the difficulties of financial compensation identified in the Bronckers and van den Broek model. A summary of each argument presented by Bronckers and van den Broek will be presented, followed by an application of the argument to DSU 160.

1. *Monetary damages are too difficult to calculate.*¹⁵⁵

Critics are concerned that calculating the amount of financial compensation would be too difficult and the results could differ dramatically.¹⁵⁶ Bronckers and van den Broek suggest a liquidated damages model that would attach predetermined damages to specific breaches.¹⁵⁷ The amount of damages would increase every year that non-compliance continues to reflect additional damages and the increasing costs of non-compliance, but not enough to make the damages punitive in nature.¹⁵⁸

DSU 160 demonstrates that, at least in some cases, financial compensation is not too difficult to calculate, nor is it too contentious for parties to agree upon. However, if there had been predetermined

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ Robert E. Hudec, *Broadening the Scope of Remedies in WTO Dispute Settlement*, in IMPROVING WTO DISPUTE SETTLEMENT PROCEDURES 369, 377 (Friedl Weis ed., 2000).

¹⁵⁴ Hiaring, *supra* note 102, at 278.

¹⁵⁵ Bronckers & van den Broek, *supra* note 109, at 113.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 125.

¹⁵⁸ *Id.* at 114.

damages for this particular type of breach, the parties might have saved the cost of the second arbitration panel.

2. *Monetary damages are unenforceable.*¹⁵⁹

The enforceability of a particular remedy must be determined in comparison to other remedies. The first question, therefore, is whether financial compensation works as a remedy; and second, whether there are more effective alternatives. In response to the question of whether countries actually pay monetary damages, Bronckers and van den Broek cite DSU 160, state-investor disputes in ICSID or NAFTA, and claims paid by Iran and the United State to private interests on the basis of awards granted by the Iran-United States Claims Tribunal as examples of situations where governments did, in fact, pay.¹⁶⁰ Another way to assess whether a remedy is actually enforceable is to examine whether members are willing to use the remedy. Professor Hudec says that all WTO governments are repeat players in the game, and that most appear as both complainants and defendants.¹⁶¹ Therefore, the optimum legal system is the one that will be most helpful in enforcing one's trade agreement rights as a complainant, while at the same time preserving the desired degree of freedom to deal with adverse legal rulings against one's own behavior.¹⁶² Members will only participate in measures that will benefit them as complainants and do not unduly hinder them as defendants. Remedies that are used by members, therefore, assume an implicit degree of enforceability.

In DSU 160, the parties agreed to financial compensation as a temporary remedy while officially pursuing compliance,¹⁶³ though nine years later there seems to be little if any progress toward a permanent solution. The parties' willingness to agree to compensation covering a defined and retroactive period of non-compliance¹⁶⁴ indicates a willingness to use financial compensation as a remedy, and to honor the obligations such a remedy creates. The financial compensation agreement in DSU 160 was limited to, and not subsequently extended beyond, a three year period during which the United States was to work towards compliance.¹⁶⁵ The limited nature of the agree-

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 115.

¹⁶¹ Hudec, *supra* note 153, at 377.

¹⁶² *Id.*

¹⁶³ European Trade Commission, *WTO Dispute Settlement, Cases Involving the EU, Request for Arbitration under Article 22.6 of the DSU*, Jan. 18, 2003, http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114298.pdf (last visited Feb. 20, 2010).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

ment does not detract from its ability to signal that members are receptive to putting financial compensation on the negotiating table, and that should financial compensation become an official remedy, they would honor their financial obligations.

In terms of comparative enforceability, trade retaliation does not have barriers to enforcement but it does have serious side effects, such as hurting innocent bystanders who were previously unaffected by the breach.¹⁶⁶ Trade concessions face similar barriers to enforcement as financial compensation, namely, the offending country must offer the remedy.¹⁶⁷ In sum, financial compensation is on equal footing in terms of enforceability with trade compensation and though less enforceable than trade retaliation, it has fewer negative side effects.

3. *Financial compensation may not reach rightful recipients.*¹⁶⁸

Under the current structure of the WTO where the only entities with legal personality are member states,¹⁶⁹ payment directly to private parties is impossible.¹⁷⁰ Member governments remain sovereign and any compensation must go to them, and, hopefully, distributed to parties injured by the breach.¹⁷¹ According to Bronckers and van den Broek, experience shows that it is possible to tailor compensation mechanisms to compensate specific parties, even if there are a great number of diverse parties.¹⁷² The logistical problem of paying out money to large groups of people has been addressed in situations like class action suits.¹⁷³

Again, to rightfully ascertain the value of financial compensation, one must compare it to the alternatives. Under trade retaliation or compensation, private parties hurt by the trade breach have no chance to recover the amount of nullification or impairment directly. To reach the rightful recipients, compensation gained through trade retaliation or trade concessions would have to be measured, monetized, and collected from the trade beneficiaries (most likely not those involved in the original breach) and redirected to parties harmed by the breach. Despite the obstacle to direct payments presented by governments, financial compensation has a far better chance to reach the rightful recipients than trade retaliation or trade compensation be-

¹⁶⁶ Davies, *supra* note 123, at 34.

¹⁶⁷ *Id.* at 38.

¹⁶⁸ Bronckers & van den Broek, *supra* note 109, at 116.

¹⁶⁹ With the exception of the European Communities, an entity that functions like a sovereign state in the WTO context. Yang, *supra* note 107, at 457.

¹⁷⁰ Bronckers & van den Broek, *supra* note 109, at n. 25.

¹⁷¹ *Id.* at 116.

¹⁷² *Id.*

¹⁷³ *Id.* at 116–17.

cause financial compensation can be given directly to parties harmed by the breach.

In DSU 160, the EC government chose not to compensate the specific performing rights organizations that were hurt, but rather to fund special programs.¹⁷⁴ This decision was made at the discretion of the EC; nevertheless, it provided the opportunity to use the money to restore the private parties to their pre-breach positions. Should financial compensation be allowed as an official remedy and were the EC to receive annual payments from the United States, it is likely the performing rights organizations would ask for their fair share. This domestic pressure from internal sources is another way to help ensure the compensation reaches those it should.

4. *Financial compensation is more acceptable for certain measures.*¹⁷⁵

Some argue that financial compensation is more acceptable as a remedy for certain kinds of illegal administrative measures than for illegal legislative measures.¹⁷⁶ One reason is that it might be harder to identify the private parties adversely affected by legislative measures than by administrative measures.¹⁷⁷ This distinction proves unconvincing after DSU 160 where the breach was legislative and there was no issue identifying the parties adversely affected. The panel that determined the amount of damages also indicated the DSB's preferred method of calculation—ascertaining the actual injury rather than the potential injury.¹⁷⁸ Further, the Bronckers and van den Broek model suggests that financial compensation be offered as an alternative remedy, meaning if parties felt it was unsuited for their needs they could choose retaliation or trade compensation.¹⁷⁹

5. *Financial compensation has less compliance-inducing effect.*¹⁸⁰

Critics say that financial compensation will have less compliance-inducing effect because the demonstrative nature of retaliation

¹⁷⁴ *U.S. to Pay \$3.3 Million to EU Music Groups in Temporary Settlement of Licensing Dispute*, Patent, Trademark & Copyright Law Daily (BNA), at D-8 (June 25, 2003).

¹⁷⁵ Bronckers & van den Broek, *supra* note 109, at 117.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ Award of the Arbitrators, *United States-Section 110(5) of the US Copyright Act* ¶ 3.33, WT/DS160/ARB25/1 (Nov. 9, 2001).

¹⁷⁹ Bronckers & van den Broek, *supra* note 109, at 117.

¹⁸⁰ *Id.* at 117–18.

sends a powerful message to the breaching government.¹⁸¹ Retaliation often causes domestic industries to lobby for compliance so that the retaliatory measures will end. Financial compensation, on the other hand, can be accomplished more quietly and without creating a domestic lobby. Bronckers and van den Broek, however, point out that given the current financial climate, “It’s only money” is hardly a winning slogan, and that financial compensation is only one choice among three options.¹⁸² If a winning country wanted to make a statement via its remedies, it would still have the opportunity to do so.

Critics in search of a compliance-inducing effect have not accounted for situations where the winning party does not feel strongly enough to invoke trade retaliation to make a statement and risk further damage to its domestic industries, or for smaller countries for whom retaliation is an ineffective measure. In the end, the amount of revenue lost to the performance rights societies in DSU 160 is proportionately small, limited in scope, and ultimately not worthy of trade retaliation.¹⁸³ Absent a U.S. offer of trade compensation or the unlikely event of legislative compliance, the case remains in blatant non-compliance and threatens the integrity of the WTO legal system.¹⁸⁴ Financial compensation offers a third, more muted, but still effective, option.

¹⁸¹ R.E. Hudec, *The GATT Legal System and World Trade Diplomacy*, 199–200 (Butterworth, 2d ed. 1990).

¹⁸² Bronckers & van den Broek, *supra* note 109, at 117.

¹⁸³ In 2001, ASCAP distributed \$511 million in royalties to rights holders. Jim Bessman, *ASCAP Has Record Distribution In 2001*, BILLBOARD BULLETIN, Feb. 7, 2002, <http://www.allbusiness.com/retail-trade/miscellaneous-retail-retail-stores-not/4364487-1.html>. Actual GESAC distributions for 2001 were unavailable, but in 2001, the original complainant in DSU 160, the Irish Music Rights Organization (IMRO), distributed €21million. Irish Music Rights Organization, *Directors Report 2001*, 9, available at <http://www.imro.ie/docs/pdfs/Directors%27%20Report%20&%20Financial%20Statements%202001.pdf>. IMRO is just one of 34 national performing rights organizations that make up Groupment Européen des Sociétés d’Auteurs et Compositeurs (GESAC), the organization that received the financial compensation paid by the U.S. to the EC. GESAC, Introduction, <http://www.gesac.org> (last visited Feb. 11, 2010). If each of the 34 domestic performing rights organizations distributed a similar amount, total GESAC distributions would have been approximately €714 million. The arbitration panel found total nullification and impairment measures to be US\$1.1 million per year, which was the equivalent of .15% of GESAC distributions, indicating the relative insignificance of the nullification or impairment to the GESAC budget.

¹⁸⁴ See *supra* note 136.

6. *Financial compensation does not change the asymmetry that exists between large and small developed and developing countries.*¹⁸⁵

Inequity between large and small, developed and developing countries is a characteristic that plagues the WTO dispute settlement system in general.¹⁸⁶ Small, developing countries have less power to pressure larger countries into compliance.¹⁸⁷ It is true that financial compensation would do little to change this dynamic.¹⁸⁸ On the other hand, financial compensation has the ability to make smaller developing countries whole, and to restore both the country and the private parties to their pre-breach positions while waiting for the longer term goal of compliance.¹⁸⁹ Retaliation cannot make parties whole, and trade concessions might restore a country to its net position, but it still creates winners and losers. Further, if a small, developing country can only rely upon retaliation in the case of non-compliance, it may determine that the expense of bringing the dispute is not worth the potential gain.¹⁹⁰ A member's failure to use prescribed remedies is a loss to the WTO system as a whole as it allows breaches to persist unaddressed. Admittedly, DSU 160 was between two large and powerful entities, the United States and the EC, but it nonetheless demonstrates how financial compensation might replace trade revenue lost because of the breach.

7. *Financial compensation allows rich countries to buy themselves out of violations.*¹⁹¹

One objection is that larger countries with deep pockets will be able to buy themselves the freedom to breach while smaller nations will be stuck either following the rules or using one of the more cum-

¹⁸⁵ Bronckers & van den Broek, *supra* note 109, at 118.

¹⁸⁶ Davies, *supra* note 123, at 34.

¹⁸⁷ *Id.*

¹⁸⁸ Bronckers & van den Broek, *supra* note 109, at 118.

¹⁸⁹ *Id.*

¹⁹⁰ Dispute Settlement Body, *Negotiations on the Dispute Settlement Understanding - Special and Differential Treatment for Developing Countries: Proposals on DSU by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe*, Working Documents of the DSU Negotiations, TN/DS/W/19, Oct. 9, 2002, available at http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm#dsb ("The economic cost of withdrawal of concessions in the goods sector would have a greater adverse impact on the complaining developing-country Member than on the defaulting developed-country Member and would only further deepen the imbalance in their trade relations already seriously injured by the nullification and impairment benefits.").

¹⁹¹ Bronckers & van den Broek, *supra* note 109, at 118–19.

bersome remedies.¹⁹² This contention is based on the assumption that a country will hand over a lump sum and be on its way, much like paying a traffic fine.¹⁹³ Financial compensation, like retaliation, would not be a substitute for ultimate compliance, nor would the compensation be a one time payment—it would last as long as the breach.¹⁹⁴ According to the Broeckers and van den Broek model, the amount due could increase on a yearly basis to reflect the increasing cost of non-compliance.¹⁹⁵ The charge that rich countries can use their deep pockets to achieve impunity from WTO rules ignores or underestimates the ongoing nature of compensation due and the fact that it will remain a stop-gap measure until compliance is achieved. Bronckers and van den Broek also suggest adjusted schemes for developing countries where they either only receive and not pay compensation or pay according to their abilities.¹⁹⁶

The concern that developed countries will buy themselves the freedom to breach also addresses notions of efficient breach, a discussion articulated by Schwartz and Sykes.¹⁹⁷ They first argue that the language used in the Dispute Settlement Understanding in reference to compliance is relatively weak.¹⁹⁸ They next address Article 22.8 of the Dispute Settlement Understanding, which requires that trade remedies be temporary and that the Dispute Settlement Body monitor implementation of adopted recommendations until the member achieves full compliance.¹⁹⁹ Schwartz and Sykes argue that Art. 22.8 could be interpreted to mean that remedies should be monitored to ensure the proper calibration of the remedy used, that continued publicity and oversight may serve to alert other members of a harm for which they might seek compensation, or that the ongoing oversight

¹⁹² *Id.* at 118.

¹⁹³ Yang, *supra* note 107, at 442 (“The proposal of monetary compensation bears no attempt to be the ultimate one-off payment to buy out the defending Member’s obligations imposed by the DSB.”).

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at 124.

¹⁹⁶ *Id.* at 118. Though Bronckers and van den Broek later state: “developed countries are unlikely to accept that they would have to pay financial compensation to all developing countries, without having the right to claim financial compensation from any one of them.” *Id.* at 120.

¹⁹⁷ Warren F. Schwartz & Alan O. Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31 J. LEGAL STUD. 179 (2002).

¹⁹⁸ *Id.* at 190 (“The statement in the first passage that compliance is “preferred” is weak- it does not say that compliance is mandatory, and it seems to us that this provision does not exclude the possibility that noncompliance may in some cases be acceptable.”).

¹⁹⁹ DSU, *supra* note 96, at art. 22.8.

“serves to check periodically on whether the impasse that led to compensation or retaliation may have lifted.”²⁰⁰ Finally, they argue that the Dispute Settlement Understanding text, taken as a whole, “allow[s] a violator to continue a violation in perpetuity, as long as it compensates or is willing to bear the costs of the retaliatory suspension of concessions” and that if full compliance were the mandatory and absolute goal, WTO members could impose greater penalty for noncompliance, such as punitive measures.²⁰¹

A dispute settlement system based solely on the principles of efficient breach would be contrary to the WTO goal of “entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations.”²⁰² Schwartz and Sykes “do not dispute that a ‘preference’ for compliance seems implicit in the system.”²⁰³ However, current trade remedies, as articulated by Dispute Settlement Understanding art. 22.1, recognize that full compliance with recommendations may not be efficient or practical for members and allow them to address their breach through trade remedies without sacrificing the ultimate goal of compliance.²⁰⁴ Financial compensation would be an analogous remedy that could increase the efficiency of the remedy without sacrificing the ultimate goal of compliance.

8. *Payments of financial compensation could violate Most Favored Nation status or amount to an illegal subsidy.*²⁰⁵

Most Favored Nation (“MFN”) status, as embodied in TRIPS, says that any advantage, favor, privilege, or immunity granted by one WTO member to nationals of any other country shall be immediately and unconditionally extended to the nationals of all other members.²⁰⁶ The concern is that if one member gives financial compensation to another member, this will constitute an advantage, favor, or privilege such that it should be extended to all members.

Such concerns about MFN status are rebutted, using the Bronckers van den Boek model, on two grounds: (1) financial compensation does not constitute an advantage, favor, privilege or immunity

²⁰⁰ Schwartz & Sykes, *supra* note 197, at 190–91.

²⁰¹ *Id.*

²⁰² Marrakesh Agreement Establishing the World Trade Organization, Preamble, Legal Instruments- Results of the Uruguay Round, 33 I.L.M. 1125 (1994) *available at* http://www.wto.org/english/docs_e/legal_e/04-wto_e.htm.

²⁰³ Schwartz & Sykes, *supra* note 197, at 190–91.

²⁰⁴ *See* DSU, *supra* note 96, at arts. 22.1, 22.8.

²⁰⁵ Bronckers & van den Broek, *supra* note 109, at 119.

²⁰⁶ TRIPS, *supra* note 51, at art. 4.

and (2) the proposal is based upon an amendment to the WTO Dispute Settlement Understanding that would identify and address any inconsistencies such as differing treatment for developing countries.²⁰⁷ On the first ground, financial compensation that makes one party whole does not have the same features as a measure that would violate MFN status.²⁰⁸ The winning country is merely restored to the economic position to which it is entitled; it receives nothing in excess. For similar reasons, financial compensation does not amount to an illegal subsidy.²⁰⁹

Any country that successfully argues it was injured because of the breach, is entitled to compensation.²¹⁰ If compensation is received by trade retaliation or trade concessions, the potential distortions to the WTO trading regime could spiral as more and more countries alter their trading positions. Contrastingly, with financial compensation, breaches are dealt with outside trade obligations, minimizing distortions to the system. In addition, successive complainants may save on the cost of litigation by either bringing a case together, or “piggy-backing” on the elements demonstrated in the first case.²¹¹

There are several countries outside the EC that have shown particular interest in DSU 160.²¹² It is interesting to note that they have not, as of yet, taken similar action against the United States for similar breaches. One reason is that, the amount of music represented by non-U.S. and non-EC performing rights organizations and played on U.S. radio and television is small. A second reason is that the case is currently in a state of limbo, and it does not make sense to initiate further action when the result is unclear. Should DSU 160 be resolved and there be right holders with demonstrable damages claims against the United States, the path to financial compensation would be straightforward and attainable.²¹³ Should other countries piggy-back on the EC claims, the amount due from the United States to other

²⁰⁷ Bronckers & van den Broek, *supra* note 109, at 119.

²⁰⁸ See Davies, *supra* note 123, at 45.

²⁰⁹ *Id.* at 119–20.

²¹⁰ *Id.*

²¹¹ Joel P. Trachtman, *The WTO Cathedral*, 43 STAN. J. INT’L L. 127, 161 (2007) (“[B]arriers include the cost of litigation. The cost of litigation can be reduced by arrangements by which smaller economies arrange to work together, sharing the costs. . . a move to cash remedies might induce more states to join in litigation, perhaps establishing a practice of engaging in ‘class actions.’”).

²¹² Australia, Brazil, Canada, Japan, and Switzerland were all involved in the original panel decision.

²¹³ Trachtman, *supra* note 211 at 142. (“[A]fter one state brings a successful dispute settlement case, other states may follow on through formal dispute settlement, avoiding the problem of uncertainty as to eventual success.”).

members would increase and could increase the urgency of legislative compliance.

9. *Developing countries cannot afford financial compensation.*²¹⁴

The inability of developing countries to pay financial compensation is a legitimate concern under the Bronckers and van den Broek model.²¹⁵ They suggest permitting developing countries to have a special defense against financial compensation, based upon economic difficulties, or cap the amounts for which developing countries could be liable.²¹⁶ In this way, financial compensation could be seen as giving developing countries an added tool to enforce decisions in their favor, while also protecting them from reciprocal obligations. Such an advantage could help balance the systemic inequities faced by developing countries.²¹⁷ Bronckers and van den Broek point out that developed countries are unlikely to agree to a system in which all developing countries may receive financial compensation but are not obligated to pay it.²¹⁸ Limits could be put on the system, such as identifying eligible countries by their percentages of world trade, national budgets, or ranking on the United Nations' Human Development Index.

10. *Financial compensation will never be accepted.*²¹⁹

When all more meaningful objections have been used, some critics cite the "showstopper" of unacceptability.²²⁰ Perhaps DSU 160's most reasonable contribution to the development of WTO remedies is that it shows financial compensation is feasible and determinable, and that members will pay it. Should financial compensation become an official remedy, the EC could immediately request financial compensation for the period of non-compliance from 2005–2009. The success of DSU 160 does not rule out future situations where financial compensation may be hard to determine, where it is impractical, or where countries refuse to pay. Rather, DSU 160 demonstrates there are situations in which financial compensation is a useful addition to the WTO remedy toolkit and therefore should be added.

²¹⁴ Bronckers & van den Broek, *supra* note 109, at 120–21.

²¹⁵ *Id.* at 120.

²¹⁶ *Id.*

²¹⁷ Yang, *supra* note 107 at 452 ("It has been recognized that developing countries can be given better incentives to utilize the WTO dispute settlement system if monetary compensation is allowed.").

²¹⁸ *Id.*

²¹⁹ *Id.* at 121.

²²⁰ *Id.*

CONCLUSION

International law, much like the governments of democratic nations, depends upon the consent of the governed.²²¹ Successful international legal systems respond to the needs of parties involved while maintaining the integrity of the system. The WTO faces a situation, as exemplified in DSU 160, in which its remedies do not meet the needs of the members. Large, powerful nations face difficult political choices, and developing nations struggle to use a dispute settlement system that does not provide them with enforcement strategies. DSU 160 has demonstrated that parties are willing and able to pay for their breaches. WTO members and the Dispute Settlement Body should make financial compensation a remedy alongside trade retaliation and trade concessions. The more diversity there is within the Dispute Settlement Body enforcement toolkit, the greater the chance of compliance within the WTO system.

²²¹ JANIS & KAY, *supra* note 136, at xl. (citing H.L.A. Hart's discussion of international law as a system of primary rules of obligation without secondary rules to efficiently make, recognize or enforce the primary rules).

WORLD TRADE ORGANIZATION AGREEMENTS AND PRINCIPLES AS A VEHICLE FOR THE ATTAINMENT OF ENERGY SECURITY

*Dennis J. Hough Jr.**

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I. INTRODUCTION

A. *Russia + Ukraine = A Cold Europe . . .*

Do you remember how you felt on Wednesday, January 7, 2009? Perhaps you do not. I know how some Europeans felt — cold.¹ That was the day that Russia stopped all natural gas exports to Ukraine.² By itself, this was a serious course of action. However, because Ukraine is the main transmission corridor for natural gas pipelines shipping gas to Europe,³ the situation commanded worldwide attention.⁴

B. *History Tends to Repeat Itself . . .*

The United States experienced two major oil shortages in the 1970s.⁵ First, the Yom Kippur war of 1973⁶ gave Arab oil-exporting countries a pretext for implementing an embargo on the shipment of oil⁷ to the United States. Secondly, in 1979, President Jimmy Carter

¹ Over 100,000 households and hundreds of factories were without natural-gas heat, Andrew E. Kramer, *Russia Restores Gas to Ukraine*, N.Y. TIMES, Jan. 21, 2009. A disagreement between Russia and Ukraine over the price paid by Ukraine for natural gas and the terms of transit was the cause of the shutoff, *id.*

² Stephen Castle & Andrew E. Kramer, *European Union Steps Into Gas Dispute and Will Monitor Flows in Ukraine*, N.Y. TIMES, Jan. 8, 2009, at A6.

³ *Turning the Gas Tap Back On*, ECONOMIST, Jan. 12, 2009, available at http://www.economist.com/agenda/displaystory.cfm?story_id=E1_TNJNTVRJ&source=login_payBarrier. Eighty percent of all gas shipments from Russia to Europe go through Ukraine. *Id.*

⁴ Castle & Kramer, *supra* note 2, at A6.

⁵ DONALD W. JONES & PAUL N. LEIBY, THE MACROECONOMIC IMPACTS OF OIL PRICE SHOCKS: A REVIEW OF LITERATURE AND ISSUES 2 (Oak Ridge National Laboratory Energy Division Jan. 5, 1995) (draft report, on file with author).

⁶ See generally U.S. DEP'T OF STATE, BACKGROUND NOTE: ISRAEL, <http://www.state.gov/r/pa/ei/bgn/3581.htm#history> (last visited Oct. 30, 2009).

⁷ U.S. Dep't of Energy - Fossil Energy: Our History, <http://fossil.energy.gov/aboutus/history> (last visited Oct. 30, 2009).

halted the importation of oil from Iran⁸ after Iran seized the United States Embassy in Tehran on November 4, 1979, taking fifty-two people hostage.⁹

II. NATIONAL SECURITY ASSETS

A. *Energy as a National Security Asset*

Energy, no matter whether it takes the form of petroleum, natural gas, nuclear, coal, or renewable sources, is an economic and strategic asset.¹⁰ Military power is derived from it.¹¹ Naturally it follows that energy is a major national security concern.¹² Energy exporting states (see Russia above) are increasingly able to execute their political and strategic objectives.¹³ At the opposite end of the spectrum, energy importing states—the most dependent being the United States¹⁴—are finding it more difficult to achieve their foreign policy and national security goals.¹⁵

Competition for energy sources among energy importing states creates a tension in international relations and frustrates foreign pol-

⁸ Proclamation No. 4702, 44 Fed. Reg. 65, 581 (Nov. 14, 1979).

⁹ American Experience: Jimmy Carter, PBS.org, http://www.pbs.org/wgbh/amex/carter/peoplevents/e_hostage.html (last visited Jan. 21, 2010).

¹⁰ U.N. Conf. on Trade and Dev. [UNCTAD], *Trade Agreements, Petroleum and Energy Policies*, 14, UNCTAD/ITCD/TSB/9 (2000), http://www.unctad.org/en/docs/itcdtsb9_en.pdf (last visited Oct. 30, 2009) [hereinafter UNCTAD Report].

¹¹ *See id.*

¹² *See* COUNCIL ON FOREIGN RELATIONS, NATIONAL SECURITY CONSEQUENCES OF U.S. OIL DEPENDENCY, INDEPENDENT TASK FORCE REPORT NO. 58, at 3 (2006), http://www.cfr.org/publication/11683/national_security_consequences_of_us_oil_dependency.html?breadcrumb=%2Fpublication%2Fby_type%2Ftask_force_report (last visited Oct. 30, 2009) [hereinafter CFR REPORT].

¹³ *Id.*

¹⁴ U.S. Energy Information Administration, Country Energy Profiles, <http://tonto.eia.doe.gov/country/index.cfm> (last visited Oct. 30, 2009). The top five oil net importing countries in 2008 were (in thousand barrels per day): (1) United States - 10,984; (2) Japan - 4,652; (3) China - 3,858; (4) Germany - 2,418; (5) South Korea - 2,144, *id.* The top five oil consuming countries in 2008 were (in thousand barrels per day): (1) United States - 19,498; (2) China - 7,831; (3) Japan - 4,785; (4) India - 2,962; (5) Russia - 2,916, *id.* The top five total primary energy consuming countries in 2007 were (in quadrillion Btu (British thermal unit)): (1) United States - 101.6; (2) China - 77.8; (3) Russia - 30.4; (4) Japan - 22.5; (5) India - 19.1, U.S. Energy Information Administration, International Energy Statistics, Total Primary Energy Consumption, <http://tonto.eia.doe.gov/cfapps/ipdbproject/iedindex3.cfm?tid=44&pid=44&aid=2&cid=&syid=2005&eyid=2007&unit=QBTU> (last visited Oct. 30, 2009).

¹⁵ CFR REPORT, *supra* note 12, at 3.

icy execution.¹⁶ An example is the recent investment made by China in the African state of Sudan. China is Sudan's most important trading partner, and the China National Petroleum Corporation operates oilfields in Sudan.¹⁷

Sudan, however, is a model of instability and corruption. Since its independence in 1956, it has experienced two civil wars and is currently engaged in a conflict in its Darfur region that has claimed the lives of 200,000.¹⁸ Transparency International's Corruption Perceptions Index 2008 assigns Sudan a score of 1.6 out of 10, designating it as a state with widespread corruption.¹⁹ In response to the violence in Darfur, the United States imposed economic sanctions in May 2007.²⁰ The United States also classifies Sudan as a state sponsor of terrorism.²¹ It is most likely that both China and the United States want peace in Sudan; however, their respective foreign policy approaches could not be farther apart. Whereas China opts to invest in Sudan, the United States imposes sanctions.

B. Energy Security

To reduce the risks that energy dependency imposes on national security objectives, a country must make energy security an essential element of its national security policy.²² Energy security is defined as having an energy supply that meets or exceeds demand, is reliable, and is provided at a reasonable cost.²³ Disruptions and shortages in energy production, transmission, and distribution can arise unexpectedly, making absolute energy security unattainable.²⁴ Therefore, energy security is a form of risk management.²⁵

¹⁶ *Id.*

¹⁷ *There be Dragons*, *ECONOMIST*, Nov. 6, 2008, available at http://www.economist.com/world/asia/displaystory.cfm?story_id=E1_TNVSDVRS.

¹⁸ Central Intelligence Agency, *The World Factbook - Sudan*, <https://www.cia.gov/library/publications/the-world-factbook/geos/su.html> (last visited Oct. 30, 2009).

¹⁹ Transparency International, 2008 Corruption Perceptions Index, http://www.transparency.org/policy_research/surveys_indices/cpi/2008 (last visited Oct. 30, 2009). The scores range from the "highly corrupt" at zero to the "highly clean" at ten, *id.*

²⁰ U.S. DEP'T OF STATE, *BACKGROUND NOTE: SUDAN*, <http://www.state.gov/r/pa/ei/bgn/5424.htm#relations> (last visited Oct. 30, 2009).

²¹ *Id.*

²² See CFR REPORT, *supra* note 12, at 3; INTERNATIONAL ENERGY AGENCY, *WORLD ENERGY OUTLOOK 2007*, 161 (2007), http://www.iea.org/textbase/nppdf/free/2007/weo_2007.pdf [hereinafter IEA OUTLOOK 2007].

²³ See CFR REPORT, *supra* note 12, at 3; IEA OUTLOOK 2007, *supra* note 22, at 161.

²⁴ IEA OUTLOOK 2007, *supra* note 22, at 161.

²⁵ *Id.*

Energy security is a public good which means that as one party benefits from it no other party suffers a corresponding detriment.²⁶ All entities involved in the energy supply chain benefit from energy security, regardless of whether they supported it.²⁷ No individual entity in the energy supply chain, however, has the ability to ensure absolute security.²⁸ Consequently, it is up to governments to ensure that all entities in the energy supply chain are contributing in accordance with its energy security policy.²⁹

Many governments incorporate four core elements into their energy security policy.³⁰ First, the policy must provide for investment in energy infrastructure, to include production, processing, transportation, and storage.³¹ Second, energy efficiency should be encouraged to mitigate demand growth.³² Third, the policy should provide for multiple energy sources and increase the number of market participants to boost the reliability of supply.³³ Fourth, the laws, regulations, and policies that govern and affect the energy market—including the conduct of the energy market itself—must be open to study and inspection by current and potential market participants.³⁴

C. Roadmap for U.S. Energy Security Policy

In 2006, the Council on Foreign Relations issued a report entitled *National Security Consequences of U.S. Oil Dependency*.³⁵ The goal of the report was to analyze how U.S. dependence on imported energy affected its foreign policy.³⁶ The report focused its analysis on petroleum imports,³⁷ but its recommendations apply to energy in general.³⁸

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at 162.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ CFR REPORT, *supra* note 12, at xii.

³⁶ *Id.* at xi.

³⁷ *Id.* at 3.

³⁸ Peter Mandelson, Former European Union Trade Commissioner, Trade Policy and Stable, Secure and Sustainable Energy, Address at a Conference on Strategic Energy Policy 3 (Nov. 21, 2006), http://ec.europa.eu/commission_barroso/ashton/speeches_articles/sppm133_en.htm (last visited Nov. 21, 2006) (“I know that the energy issue looks different depending on from where you are looking at it. But regardless of whether you are an importer or exporter, whether you work in oil and gas, or in renewables or nuclear energy, the features of energy markets are

The report advocated for a stronger U.S. energy security policy.³⁹ Five recommendations were provided in hopes of strengthening U.S. policy.⁴⁰ First, the report recommended that the United States adjust its domestic energy policy to include efforts to reduce consumption of “petroleum products.”⁴¹ Two ways to reduce consumption are to foster new technologies and to improve existing technologies.⁴² The report also recognized that technology alone is insufficient to adequately reduce consumption.⁴³ Therefore the report suggested the use of a tax-based measure to shift consumer behavior toward the use of public transportation.⁴⁴

Second, the report encouraged the United States to work toward a more fair, efficient, and transparent world energy market.⁴⁵ Regulations, tariffs, and subsidies must be used in a responsible manner so that market operations are uninhibited.⁴⁶ The basic economic laws of supply and demand must be allowed to govern the market.⁴⁷

Third, the report advocated for a reliable and secure energy infrastructure.⁴⁸ Transmission infrastructure is critical in all facets of the energy cycle because energy is useless if one cannot move it from the generator to the consumer.

Fourth, the report called on the United States to insist that energy exporting countries manage revenue derived from energy in a wise and prudent fashion.⁴⁹ Good governance of income will foster political stability and enhance living standards.⁵⁰ The report states that political stability is a prerequisite to attracting investment in the country.⁵¹ Investments benefit the country and its citizens by increas-

essentially the same. Decisions are for the very long term. Consumer demand is price inelastic. And governments are tempted to intervene to protect their national security interests.”).

³⁹ CFR REPORT, *supra* note 12, at 6.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.* at 7.

⁴³ *Id.* at 6–7. The report finds that “no strategy [to reduce petroleum consumption] will be effective without higher prices for transportation fuels or regulatory incentives to use more efficient vehicles,” *id.*

⁴⁴ *Id.* at 6–7.

⁴⁵ *Id.* at 8.

⁴⁶ *Id.*

⁴⁷ *Id.* (stating that “[t]he United States should continue to urge governments in all countries to reduce subsidies and deregulate the prices of oil and gas where they have been held below world market levels.”).

⁴⁸ *Id.* at 9.

⁴⁹ *Id.*

⁵⁰ *Id.* at 10.

⁵¹ *Id.*

ing their social and economic standing.⁵² At the same time, as social and economic reforms plant the seeds of democracy, the United States realizes its foreign policy goal of encouraging democratic governments.⁵³

Finally, the report challenged the United States to revamp its national security staff to include a new energy security directorate that will handle energy specific issues.⁵⁴ The report provided that energy issues are technical and complex; therefore, having qualified personnel to handle such issues, and including these issues in the already broad scope of national security, is a necessity to the policy making process.⁵⁵

D. The Impossibility of U.S. Energy Independence

One misconception that plagues the discussion of energy security and trade is the belief that the United States can avoid this topic simply by becoming energy independent.⁵⁶ Energy independence for the United States is unachievable in the foreseeable future.⁵⁷ The United States produced 10% of the world's oil while consuming more than double (23%) of that amount in 2008.⁵⁸ The reason for this is that transportation needs accounted for over a quarter of the total United States energy consumption in 2008.⁵⁹ Ninety-five percent of the total energy consumed by the transportation sector comes from petroleum.⁶⁰ Seventy-one percent of the total of import and domestic supplies of petroleum go to the transportation sector.⁶¹ The United States

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 10–11.

⁵⁶ *Id.* at 4.

⁵⁷ *Id.*; see also Tom Kenworthy, *Energy Independence May be a Pipe Dream*, USA TODAY, Oct. 24, 2004, available at http://www.usatoday.com/news/politicselections/nation/issues/2004-10-24-energy-independence_x.htm.

⁵⁸ ENERGY INFORMATION ADMINISTRATION, ENERGY IN BRIEF: HOW DEPENDENT ARE WE ON FOREIGN OIL?, http://tonto.eia.doe.gov/energy_in_brief/foreign_oil_dependence.cfm (last visited Oct. 31, 2009).

⁵⁹ ENERGY INFORMATION ADMINISTRATION, FIGURE 2.1A ENERGY CONSUMPTION BY SECTOR OVERVIEW, http://www.eia.doe.gov/emeu/aer/pdf/pages/sec2_4.pdf (last visited Oct. 31, 2009). End-Use Sector Shares of Total Consumption, 2008 graph shows the following: industrial - 31%; transportation - 28%; residential - 22%; commercial - 19%. *Id.*

⁶⁰ ENERGY INFORMATION ADMINISTRATION, U.S. PRIMARY ENERGY CONSUMPTION BY SOURCE AND SECTOR, 2008, http://www.eia.doe.gov/emeu/aer/pecss_diagram.html (last visited Oct. 31, 2009).

⁶¹ *Id.*

imports approximately 58% of its petroleum needs.⁶² It is simply not feasible to use a domestic energy alternative as a substitute for imported petroleum absent a significant reduction in the transportation sector requirement.⁶³

III. PROBLEM STATEMENT

Countries throughout the world have the goal of achieving energy security. The challenge they face is creating the proper legal regime to manage energy—a national security asset—to achieve this goal. This article discusses how the implementation of World Trade Organization (“WTO”) principles and agreements can be a means to promote energy security.

IV. WOLRD TRADE ORGANIZATION

A. *Background and Politics*

The WTO officially became a legally recognized organization on January 1, 1995.⁶⁴ Its roots, however, extend to the period immediately following the Second World War.⁶⁵ In 1947, the United States led a group of countries with the common goal of establishing an institution that would promote free trade.⁶⁶ Although they did not realize their goal of the creation of an international institution, they did draft and implement a new treaty entitled the General Agreement on Tariffs and Trade (“GATT”).⁶⁷ The GATT sought to eliminate protectionist economic practices and set forth a collection of rules to govern international trade in goods.⁶⁸ Forty-eight years after the implementation of the GATT, the Member countries of the GATT, during the Uruguay Round of trade negotiations, transformed their de facto regime under the GATT into the de jure WTO.⁶⁹

⁶² ENERGY INFORMATION ADMINISTRATION, ENERGY IN BRIEF, *supra* note 58.

⁶³ CFR REPORT, *supra* note 12, at 14 (stating that “[l]iquid fuels are essential to the nation’s transportation system. Barring draconian measures, the United States will depend on imported oil for a significant fraction of its transportation fuel needs for at least several decades.”).

⁶⁴ WORLD TRADE ORGANIZATION, UNDERSTANDING THE WTO 10 (4th ed. 2008), http://www.wto.int/english/res_e/publications_e/understanding_wto_e.htm (last visited Nov. 6, 2009) [hereinafter UNDERSTANDING].

⁶⁵ DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL TRADE LAW: PROBLEMS, CASES, AND MATERIALS 20 (2008).

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ UNDERSTANDING, *supra* note 64, at 10.

Although petroleum products are a “good” for the purposes of the GATT,⁷⁰ Member countries have treated petroleum goods as being outside of the GATT scope.⁷¹ At the time the GATT was negotiated, most of the world’s petroleum fields were under the control of corporations owned by the citizens of the United States, the United Kingdom, the Netherlands, and France.⁷² Because these countries had just emerged from the Second World War, they were reluctant to include strategic assets, namely petroleum products, within the scope of the GATT.⁷³ This special treatment, that is, non-treatment under the GATT, was because the contracting parties did not want to politicize such a strategic asset.⁷⁴

B. Doha Development Agenda

For approximately fifty years, the issue of trade in energy goods and services was avoided based on its strategic-asset classification. In 2001, however, the WTO took a major step toward the inclusion of energy as an officially recognized sector of trade.⁷⁵ The Doha Development Agenda (DDA),⁷⁶ a structured negotiations program in which WTO Member governments discussed trade issues, expressly included the topic of trade in energy services.⁷⁷ These negotiations began in 2001 and were originally set to close on January 1, 2005.⁷⁸ Disagreements over agricultural issues prevented the WTO from

⁷⁰ See Pascal Lamy, Dir.-Gen., World Trade Org., Address at the 20th World Energy Congress in Rome: Doha Round Will Benefit Energy Trade (Nov. 16, 2007), available at http://www.wto.int/english/news_e/sppl_e/sppl80_e.htm (last visited Nov. 6, 2009).

So the rules of the WTO do not deal with energy as a distinct sector. Yet since our basic rules are applicable to all forms of trade, they also apply to trade in energy goods and services. And these rules can be enforced through the WTO dispute settlement mechanism even if they were not negotiated with energy in mind.

Id.

⁷¹ UNCTAD Report, *supra* note 10, at 14–15.

⁷² *Id.* at 14.

⁷³ *See id.*

⁷⁴ *Id.* at 14–15.

⁷⁵ Lamy, *supra* note 70 (stating “[t]he first area where energy stands explicitly on the Doha [Development] agenda is the services negotiations. For the first time Members are discussing energy as a specific services sector.”).

⁷⁶ For background information on the DDA, see generally UNDERSTANDING, *supra* note 64, at 77.

⁷⁷ *See* Special Session of the Council for Trade in Services, *Report by the Chairman to the Trade Negotiations Committee*, TN/S/23, at annex B, § 11 (Nov. 28, 2005).

⁷⁸ *See* UNDERSTANDING, *supra* note 64, at 77.

meeting this deadline.⁷⁹ In September 2009, trade ministers from Member governments stated that it was their goal to finalize the DDA in 2010.⁸⁰

The DDA is particularly important because it represents an opportunity to adopt specific energy services activities under the General Agreement on Trade in Services (GATS). For the purposes of GATS, the WTO Services Sectoral Classification List⁸¹ (W/120) contains all the services activities eligible for market access and national treatment protections. While this list includes sectors such as business and transportation, it does not include a sector for energy services.⁸² A separate energy services sector may be added through the DDA.⁸³

The United States,⁸⁴ Canada,⁸⁵ the European Communities,⁸⁶ Venezuela,⁸⁷ Japan,⁸⁸ and Cuba⁸⁹ have each submitted a communication containing their proposed energy services additions to the W/120. The United States' proposal is the most detailed and comprehensive out of the group.⁹⁰ It proposes to add an energy sector to the W/120. The energy sector is divided into five broad categories; each category will contain subcategories with corresponding energy services.⁹¹ It is important to note that the energy services listed in the proposal apply to all energy sources (unless otherwise noted) to include oil, natural gas, coal, renewables, nuclear, and electricity.⁹²

⁷⁹ See *id.*

⁸⁰ Vikas Bajaj, *Trade Talks to Resume, But Divides Remain*, N.Y. TIMES, Sept. 5, 2009, available at <http://www.nytimes.com/2009/09/05/business/global/05trade.html>.

⁸¹ See generally GATT Secretariat, *Services Sectoral Classification List*, MTN.GNS/W/120 (July 10, 1991).

⁸² See *id.*

⁸³ See generally Special Session of the Council for Trade in Services, *supra* note 77.

⁸⁴ See Communication from the United States, *Classification of Energy Services*, S/CSC/W/27 (May 18, 2000).

⁸⁵ See Communication from Canada, *Initial Negotiating Proposal on Oil and Gas Services*, S/CSS/W/58 (Mar. 14, 2001).

⁸⁶ See Communication from the European Communities and their Member States, *GATS 2000: Energy Services*, S/CSS/W/60 (Mar. 23, 2001).

⁸⁷ See Communication from Venezuela, *Negotiating Proposal on Energy Services*, S/CSS/W/69 (Mar. 29, 2001).

⁸⁸ See Communication from Japan, *Negotiation Proposal on Energy Services Supplement*, S/CSS/W/42/Suppl.3 (Oct. 4, 2001).

⁸⁹ See Communication from Cuba, *Negotiating Proposal on Energy Services*, S/CSS/W/144 (Mar. 22, 2002).

⁹⁰ See Communication from the United States, *supra* note 84.

⁹¹ See *id.* ¶ 3.

⁹² *Id.* at Attachment A, n.1.

There are three main reasons for the initiation of WTO negotiations on energy. First, governments realized that the lack of trade agreements on energy restrict their foreign policy options.⁹³ Without uniform trade rules, petroleum exporting states can impose their foreign policy goals with greater success—especially where their goals are counter to those of the United States. Secondly, it is well accepted that market economies are very good at the efficient allocation of resources.⁹⁴ WTO rules contribute to market effectiveness by governing these markets in a transparent and predictable manner.⁹⁵ Third, before the 1990s, most energy utilities were state-owned and vertically integrated.⁹⁶ The state owned the complete energy system from generation to transmission to distribution.⁹⁷ Liberalization of these state-owned utilities has opened up numerous opportunities for private companies to compete for projects in generation, transmission, and distribution.⁹⁸

C. WTO Trade Agreements

Three WTO trade agreements govern the main areas of trade regulated by the WTO.⁹⁹

1. General Agreement on Tariffs and Trade

The first agreement is the GATT.¹⁰⁰ The GATT is the oldest of all the WTO agreements. It was signed in October 1947 as a result of an effort to promote economic cooperation among its Member states.¹⁰¹

⁹³ See CFR REPORT, *supra* note 12, at 3 (stating that “[m]ajor energy consumers—notably the United States, but other countries as well—are finding that their growing dependence on imported energy increases their strategic vulnerability and constrains their ability to pursue a broad range of foreign policy and national security objectives.”).

⁹⁴ UNDERSTANDING, *supra* note 64, at 14.

⁹⁵ At the 20th World Congress on Energy in 2007, WTO Director General Lamy stated that “[a]s noted by your in-coming Council Chairman, markets remain the most efficient way to allocate resources. But markets must be governed by transparent and predictable rules. And this may be where the WTO, as a forum for the negotiation and enforcement of multilateral trade rules has a role to play,” Lamy, *supra* note 70.

⁹⁶ GATS Secretariat, *Energy Services: Background Note by the Secretariat*, ¶¶ 3, 20, S/C/W/52 (Sept. 9, 1998).

⁹⁷ *Id.* ¶ 3.

⁹⁸ *Id.* ¶¶ 3–4.

⁹⁹ UNDERSTANDING, *supra* note 64, at 10.

¹⁰⁰ See generally General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 187, available at <http://www.jurisint.org/pub/06/en/doc/05.htm> [hereinafter GATT].

¹⁰¹ UNDERSTANDING, *supra* note 64, at 15.

The venerable GATT focuses on trade in goods, where trade in goods is the most prevalent channel of trade.¹⁰² Prior to the establishment of the WTO in 1995, the GATT was the only multilateral agreement governing international trade.¹⁰³

2. *General Agreement on Trade in Services*

The second agreement is the General Agreement on Trade in Services (GATS).¹⁰⁴ The GATS came into effect in 1995.¹⁰⁵ The GATS is the only international trade agreement covering trade in services.¹⁰⁶ The significance of the GATS cannot be understated because it covers all types of services.¹⁰⁷ The services trade sector is the fastest growing sector of the world economy.¹⁰⁸

3. *Trade-Related Aspects of Intellectual Property Rights*

The third agreement of the WTO framework is the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS),¹⁰⁹ which was also adopted in 1995.¹¹⁰ As knowledge and advanced technology products constitute a greater share of international trade, the need for adequate protection of the ideas and expertise embodied in these products increases.¹¹¹

V. WTO FUNDAMENTAL PRINCIPLES

WTO agreements rest on a foundation of fundamental principles including: (1) trade without discrimination; (2) free trade; (3) predictability in trade; (4) fair competition; and (5) economic development.¹¹² Non-discriminatory trade is pursued through the use of two core obligations: (1) the most-favored-nation (MFN) principle; and (2) the national treatment principle.¹¹³ The MFN principle stands for the requirement that a WTO Member state must afford to all of its WTO Member state trading partners the same, or equal, treatment

¹⁰² See CHOW & SCHOENBAUM, *supra* note 65, at 354.

¹⁰³ *Id.* at 11.

¹⁰⁴ The General Agreement on Trade in Services, Apr. 15, 1994, Annex 1B, 33 I.L.M. 1167 (1994) [hereinafter GATS].

¹⁰⁵ UNDERSTANDING, *supra* note 64, at 37.

¹⁰⁶ *Id.* at 33.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Annex 1C, 33 I.L.M. 1197 (1994).

¹¹⁰ UNDERSTANDING, *supra* note 64, at 39.

¹¹¹ See *id.*

¹¹² *Id.* at 10–12.

¹¹³ CHOW & SCHOENBAUM, *supra* note 65, at 143.

regarding trade advantages.¹¹⁴ MFN produces a result where all WTO Members receive the same treatment; therefore, no Member state has an advantage over the other.¹¹⁵ Article I of the GATT enumerates the MFN principle.¹¹⁶ The national treatment principle stands for the requirement that a WTO Member state cannot afford more favorable trade treatment to its domestic products and producers as compared to other WTO Member states.¹¹⁷ Both the MFN principle and the national treatment principle were first included in the GATT but continue to play a major role in the GATS and TRIPS.¹¹⁸

A. *Most-Favored-Nation Principle*

1. *Origins*

From its origin in the twelfth century through the nineteenth century, the MFN principle had an opposite effect than its current effect under the WTO.¹¹⁹ During its history, certain trading partners received favorable treatment due to the friendly relations between two states.¹²⁰ As a result, a limited number of trading partners enjoyed such trade advantages.

2. *Current Operation and Elements*

Today, as used in the WTO framework, the MFN principle gives all WTO trading partners the same treatment; equal treatment is the norm and any treatment varying from the norm is the exception.¹²¹ The MFN principle, as embodied in Article I of the GATT, contains two distinct elements.¹²² The first element is that the MFN principle applies to any trade advantage that a Member country may afford to any *other* country, where the other country need not be a WTO Member.¹²³

The second element is that the Member country affording such an advantage must immediately and unconditionally grant the same advantage to WTO Member countries that produce like products.¹²⁴ Some of the advantages of the MFN principle include the protection of

¹¹⁴ *Id.*; GATT, *supra* note 100, pt. I, art. I, ¶ 1; *see also* GATT, *supra* note 100, pt. II, art. III, ¶¶ 1–2.

¹¹⁵ CHOW & SCHOENBAUM, *supra* note 65, at 143.

¹¹⁶ *See* GATT, *supra* note 100, pt. I, art. I, ¶ 1, pt. II, art. III, ¶¶ 1–2.

¹¹⁷ CHOW & SCHOENBAUM, *supra* note 65, at 143.

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 144.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.* at 145.

¹²³ *Id.*

¹²⁴ *Id.*

trade concessions against a reduction in value, promotion of free and fair trade, and protection against corruption within a multilateral trading system.¹²⁵ Along with these advantages come some disadvantages, which include the opportunity for other states to act as free riders on the concessions of other countries, that is, the absence of a guarantee of reciprocity of concessions where one country may be affording a greater advantage than it receives in return.¹²⁶

One may distinguish the MFN principle from the national treatment principle by the end result of their application.¹²⁷ The MFN principle affects external trade practices (e.g., tariffs, customs duties) while national treatment affects internal trade practices (e.g., internal taxes).¹²⁸ Although the language of the MFN principle and the national treatment principle varies in the GATT, GATS, and TRIPS, the effect is the same.¹²⁹

3. Scope

a. Border and Internal Charges

It is important for any party to a trade transaction to understand the scope of the MFN principle.¹³⁰ The GATT Panel Report, *Belgian Family Allowances*, is illustrative of the reach of the MFN principle.¹³¹ In *Belgian Family Allowances*, trade delegations from Norway and Denmark filed a complaint with the GATT Panel alleging a violation of the MFN principle by Belgium.¹³² Certain goods that had been imported into Belgium and cleared customs were subsequently charged a levy at the time of purchase of the goods by certain Belgian public bodies.¹³³ This charge was disguised as an internal charge rather than an import charge.¹³⁴ Belgium, however, did not apply this levy in a uniform manner, but rather provided an exception to the levy for a limited number of states.¹³⁵ The panel considered whether this internal charge placed upon certain products violated the GATT.¹³⁶ The Panel held that the levy violated the GATT's MFN prin-

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.* at 143.

¹²⁸ *Id.*

¹²⁹ *Id.* at 144.

¹³⁰ *Id.* at 147.

¹³¹ Report of the Panel, *Belgian Family Allowances (Allocations Familiales)* (Nov. 7, 1952), GATT B.I.S.D. (1st Supp.) at 59 (1953); see also CHOW & SCHOENBAUM, *supra* note 65, at 147-49.

¹³² Report of the Panel, *supra* note 131, ¶ 1.

¹³³ *Id.* ¶¶ 1-2.

¹³⁴ *Id.* ¶ 2.

¹³⁵ *Id.* ¶ 3.

¹³⁶ See *id.* ¶¶ 3-7.

principle.¹³⁷ The Panel ruled that the levy must be either completely removed or applied in a non-discriminatory manner to comply with the MFN principle.¹³⁸ The Panel decision stands for the rule that the MFN principle applies to both charges upon imported goods at the time of importation and to any subsequently applied internal charges.¹³⁹

b. Like Products

Another important element of the MFN principle is the “like product” designation.¹⁴⁰ The MFN principle applies only where the products are considered to be like products and, accordingly, products that do not qualify as like products do not enjoy MFN treatment.¹⁴¹ The GATT Panel explored the issue of like product designation in the Report of *Treatment by Germany of Imports of Sardines*.¹⁴² The issue before the Panel was whether Germany violated the MFN principle with its application of non-uniform duties on certain types of fish.¹⁴³

In order to address this issue, the Panel had to decide whether the three types of fish involved were like products and, if so, only then would MFN treatment be required.¹⁴⁴ The Panel held that the three types of fish in question were not like products for purposes of determining MFN treatment.¹⁴⁵ In making its determination, the Panel recognized Germany’s consistent treatment of the three types of fish as separate and distinct.¹⁴⁶ A determination of like product status must be performed on a case-by-case basis where, as the Panel illustrated in this instance, both the treatment of the products by the states in the dispute, along with the products themselves, must be taken into consideration.¹⁴⁷

¹³⁷ *Id.* ¶ 8.

¹³⁸ *Id.* ¶ 3.

¹³⁹ See CHOW & SCHOENBAUM, *supra* note 65, at 147–49.

¹⁴⁰ *Id.* at 150.

¹⁴¹ *Id.*

¹⁴² Report of the Panel, *Treatment by Germany of Imports of Sardines* (Oct. 31, 1952), GATT B.I.S.D. (1st Supp.) at 53 (1953); see also CHOW & SCHOENBAUM, *supra* note 65, at 150.

¹⁴³ Report of the Panel, *Treatment by Germany of Imports of Sardines*, *supra* note 142, ¶ 10.

¹⁴⁴ *Id.* ¶ 11.

¹⁴⁵ *Id.* ¶ 13.

¹⁴⁶ *Id.*

¹⁴⁷ See *id.* ¶ 12.

c. *De Facto Discrimination*

The MFN principle also operates to prevent de facto discrimination.¹⁴⁸ De facto discrimination was the subject of the WTO Appellate Body Report of *Canada—Certain Measures Affecting the Automotive Industry*.¹⁴⁹ De facto discrimination occurs where a Member country imposes certain criteria that allow for exceptions to duties or import charges where such exceptions are not expressly based on a country of origin, but rather some economic criteria.¹⁵⁰ Canada instituted an import duty exception, the Motor Vehicle Tariff Order, which applied to the importation of automobiles.¹⁵¹

The issue before the Panel was whether Canada's automobile tariff exception, which was expressly origin-neutral in application, may have operated inconsistent with MFN principles.¹⁵² The Panel found, and the Appellate Body agreed, that the actual use of the import duty exemption produced a discriminatory effect where only a very small number of automobile manufacturers were afforded the exemption and because of this, enjoyed an advantage over the vast majority of other automobile manufacturers.¹⁵³ Therefore, MFN treatment also applies to origin-neutral import charges that, once implemented, have a de facto discriminatory effect by affording certain products an advantage over other like products.

B. *National Treatment Principle*

1. *Operation*

The second core WTO principle is the national treatment principle¹⁵⁴ which is found in GATT Article III.¹⁵⁵ The national treatment principle means that no less favorable treatment can be afforded to imported goods as compared to domestic goods by the importing state.¹⁵⁶ This principle prevents an importing state from implement-

¹⁴⁸ CHOW & SCHOENBAUM, *supra* note 65, at 156.

¹⁴⁹ Appellate Body Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, 142/AB/R (June 19, 2000); *see also id.* at 153.

¹⁵⁰ Appellate Body Report, *Canada—Certain Measures Affecting the Automotive Industry*, *supra* note 149, ¶ 78 (stating that the words of Article I:1 do not restrict its scope only to cases in which the failure to accord an 'advantage' to like products of all other Members appears on the face of the measure. . . . [W]e cannot accept Canada's argument that Article I:1 does not apply to measures which, on their face, are 'origin-neutral.'").

¹⁵¹ *Id.* at ¶¶ 7, 9.

¹⁵² *Id.* at ¶ 77.

¹⁵³ *Id.* ¶ 81.

¹⁵⁴ *See* GATT, *supra* note 100, pt. I, art. I.

¹⁵⁵ *See* GATT, *supra* note 100, pt. II., art. III.

¹⁵⁶ *See* GATT, *supra* note 100, pt. I, art. I.

ing discriminatory measures upon imported goods after the goods have passed customs and been subject to the applicable tariffs.¹⁵⁷ Without the national treatment principle, a state could impose few or no tariffs on imports, and then could assess large fees against the imported goods at a later time.¹⁵⁸ Every state has an inherent and reasonable interest in promoting domestic goods and products because their success is a key component in the prosperity of the state itself.¹⁵⁹

2. *Elements of Paragraph Two*

The WTO Appellate Body Report for *Japan – Taxes on Alcoholic Beverages* interprets the national treatment principle as it applies to domestic taxes and charges.¹⁶⁰ The Panel had to determine whether a Japanese Liquor Tax Law violated the national treatment principle.¹⁶¹ In making this determination, the first issue confronted by the Panel was whether shochu, a Japanese alcoholic beverage, and vodka are like products, and therefore whether the higher domestic taxes on imported vodka as compared to shochu constituted a violation of GATT Article III:2, first sentence.¹⁶² The second issue was whether the non-uniform taxes placed on shochu, as compared to other imported alcoholic beverages, violated GATT Article III:2, second sentence.¹⁶³

The Panel reasoned that if the domestic and imported goods are like products and the domestic goods are taxed at a rate lower than the imported products, then the tax violated GATT Article III:2, first sentence.¹⁶⁴ The Panel also determined that the criteria required to violate GATT Article III:2, first sentence, is different from that of the second sentence.¹⁶⁵ The first sentence is to be construed to encompass a more narrow range of products where the products in question must be like products.¹⁶⁶ The second sentence is to be construed to encompass a broader range of products because the like product requirement is not present.¹⁶⁷

¹⁵⁷ CHOW & SCHOENBAUM, *supra* note 65, at 159.

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at 159–60.

¹⁶⁰ Appellate Body Report, *Japan—Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (Oct. 4, 1996); *see also* CHOW & SCHOENBAUM, *supra* note 65, at 161.

¹⁶¹ Appellate Body Report, *Japan—Taxes on Alcoholic Beverages*, *supra* note 160, at 3–4.

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.* at 17.

¹⁶⁵ *Id.* at 24.

¹⁶⁶ *Id.* at 19.

¹⁶⁷ *Id.* at 24.

The Appellate Body held that the Panel correctly determined that imported vodka and domestically produced shochu are like products and that the taxes on the vodka exceeded those of the shochu, thereby constituting a violation of GATT Article III:2, first sentence.¹⁶⁸ The excess amount need not be large and may be of the slightest amount to constitute a violation.¹⁶⁹

In taking up the second issue, the Panel listed three elements that are required to make up a violation of GATT Article III:2, second sentence.¹⁷⁰ The first element is that the imported goods and the domestic goods must be either “directly competitive or substitutable products” that are in competition with each other.¹⁷¹ The second element is that such products are “not similarly taxed.”¹⁷² The third element is that the non-uniform taxation must be applied in a manner which results in the protection of the domestic product.¹⁷³ Although the Appellate Body disagreed with the Panel’s method of a combined analysis of the second and third elements, the Appellate Body nevertheless agreed with the Panel’s final decision that the Japanese Liquor Tax Law was inconsistent with GATT Article III:2, second sentence.¹⁷⁴

3. *Internal Regulations*

A sovereign state has an inherent right to regulate its internal affairs including the regulation of domestic and imported goods.¹⁷⁵ Energy products and services are, in general, subject to extensive governmental regulation.¹⁷⁶ The regulations are in place to ensure that the government’s national security and public policy objectives, such as consumer health and safety, reliable service, and environmental

¹⁶⁸ *Id.* at 23–24.

¹⁶⁹ *Id.* at 24.

¹⁷⁰ *Id.* at 25.

¹⁷¹ *Id.* at 25. The evaluation of whether two products are directly competitive or substitutable products must be evaluated on a case-by-case basis where the characteristics to be evaluated include the physicality, uses, tariff classifications, and the market of the product. *Id.* at 25–26.

¹⁷² *Id.* at 25. The second element of dissimilar taxation requires that the imported product be taxed at a higher rate than the domestic product where the difference must be greater than a de minimis amount. *Id.* at 28.

¹⁷³ *Id.* at 25. The third element does not require intent to confer an advantage upon the domestic product; it is a question of whether some advantage did result from the application of the tax. *Id.* at 28–29.

¹⁷⁴ *Id.* at 32–33.

¹⁷⁵ CHOW & SCHOENBAUM, *supra* note 65, at 177.

¹⁷⁶ GATS Secretariat, *supra* note 96, ¶ 62.

protection, are met.¹⁷⁷ In certain circumstances, however, where regulations affect domestic and imported products differently, internal regulation may be inconsistent with the national treatment principle under GATT, Article III:4.¹⁷⁸

In *Italian Discrimination Against Imported Agricultural Machinery*, the GATT Panel took up the issue of whether loans that provided more favorable terms for purchases of domestic (Italian) farm machinery as opposed to imported machinery were a violation of the national treatment principle.¹⁷⁹ The Panel recognized that the intention of Article III was to ensure that imported products, once they passed customs and were placed on the importing state's market, were to remain free from discrimination.¹⁸⁰ The text of Article III indicates that its application is not limited to laws that directly regulate the sale of goods but it is also applicable to laws that may have a negative impact on the internal market conditions, such as loan interest rates that are related to the goods in question.¹⁸¹ The Panel found that the favorable interest rate was a form of protection for domestically manufactured agricultural machinery by the Italian government, and therefore it was inconsistent with the national treatment principle.¹⁸²

Another example of the how government regulation may conflict with the national treatment principle is contained in the Appellate Body Report of *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*.¹⁸³ The issue before the Panel was whether Korea's regulation of beef, which required domestic and imported beef to each have its own retail facility, was a violation of the national treatment principle.¹⁸⁴ The Panel held that the Korean system was a violation of Article III:4.¹⁸⁵

¹⁷⁷ "The energy sector is generally highly regulated in order to protect important policy objectives such as health and safety, environmental protection, universal service and consumer protection." *Id.*

¹⁷⁸ CHOW & SCHOENBAUM, *supra* note 65, at 177; GATT, *supra* note 100, pt. II, art. III, ¶ 4.

¹⁷⁹ Report of the Panel, *Italian Discrimination Against Imported Agricultural Machinery*, ¶¶ 1–2, L/833 (Oct. 23, 1958), GATT B.I.S.D. (7th supp.) at 60 (1959); see also CHOW & SCHOENBAUM, *supra* note 65, at 178.

¹⁸⁰ Report of the Panel, *Italian Discrimination Against Imported Agricultural Machinery*, *supra* note 179, ¶ 11.

¹⁸¹ *Id.* ¶ 12.

¹⁸² *Id.* ¶ 16.

¹⁸³ Appellate Body Report, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R (Dec. 11, 2000); see also CHOW & SCHOENBAUM, *supra* note 65, at 182.

¹⁸⁴ Appellate Body Report, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, *supra* note 183, ¶ 3.

¹⁸⁵ *Id.* ¶ 148.

There are three elements that make up a violation of Article III:4 of the national treatment principle.¹⁸⁶ The first element is that both the domestic and imported goods must satisfy the classification of “like products.”¹⁸⁷ The second element is that the law or regulation in question, as applicable to the imported or domestic goods, must affect the sale, purchase, or other related market activity concerning such goods as conducted within the importing state.¹⁸⁸ The third element is that the law or regulation must impose less favorable treatment on the imported good.¹⁸⁹

The Appellate Body first highlights the fact that a mere difference in treatment between the imported good and domestic good does not, by itself, constitute less favorable treatment.¹⁹⁰ The separate retail systems, as imposed by law, do not alone constitute a violation of Article III:4.¹⁹¹ To determine whether the conduct of the importing state is inconsistent with the national treatment principle, the focus must be on the “conditions of competition” in which the goods are sold.¹⁹² If the state’s law or regulation imposes unequal conditions of competition, then the law or regulation is inconsistent with Article III:4.¹⁹³ The Korean law here results in a less favorable condition of competition for imported beef, and therefore violated Article III:4.¹⁹⁴

C. Transparency

The MFN and national treatment principles constitute the two main columns supporting the GATT and the GATS.¹⁹⁵ Another attribute worth noting here is that a trade system should be predictable.¹⁹⁶ A predictable market allows market participants to trade confidently and plan out their investments and business activities.¹⁹⁷

Two essential elements required for a stable and predictable trade system are that its Member states must be bound by it and it must be transparent.¹⁹⁸ The first element requires that a Member state honor or be bound by its tariff rate limitations.¹⁹⁹ Such limita-

¹⁸⁶ *Id.* ¶ 133.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.* Korea appeals only the third element. *Id.*

¹⁹⁰ *Id.* ¶ 135.

¹⁹¹ *Id.*

¹⁹² *Id.* ¶ 137.

¹⁹³ *Id.*

¹⁹⁴ *Id.* ¶¶ 146, 148.

¹⁹⁵ CHOW & SCHOENBAUM, *supra* note 65, at 143.

¹⁹⁶ UNDERSTANDING, *supra* note 64, at 10.

¹⁹⁷ *Id.* at 11.

¹⁹⁸ *Id.* at 12.

¹⁹⁹ *Id.*

tions may be changed only through negotiations with its trading partners and not unilaterally.²⁰⁰ The second element is transparency, which includes a Member state's disclosure of its laws, regulations, and practices affecting trade.²⁰¹

GATT Article X, titled "Publication and Administration of Trade Regulations," plays a leading role in ensuring transparency.²⁰² While the publishing requirement of Article X:1 is self-explanatory, paragraph 3(a) requires some explanation. The Panel Report of *United States—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, provides a description of the operation and scope of Article X.²⁰³ The dispute centered on anti-dumping measures implemented by the United States against Japan concerning Japanese hot-rolled steel.²⁰⁴ The issue was whether the United States violated Article X:3(a) by implementing its anti-dumping measures.²⁰⁵ The Panel found that the United States did not violate Article X:3(a).²⁰⁶

This Report included a good description of the operation of Article X. The scope of Article X is limited to those laws or regulations that are "of general application."²⁰⁷ For example, an import license concerning a specific company or specific shipment is not of general application.²⁰⁸ Additionally, in following previous Appellate Body decisions, the Panel explained that Article X:3(a) does not apply to a Member country's laws, regulations, and decisions in themselves, instead it applies to the administration of such laws.²⁰⁹

VI. GENERAL AGREEMENT ON TRADE IN SERVICES

A. Overview

The GATS will play a leading role in national security challenges. Indeed, GATS' role may be larger than that of GATT because

²⁰⁰ *Id.*

²⁰¹ *Id.* at 12.

²⁰² GATT, *supra* note 100, pt. II, art X ¶¶ 1, 3(a).

²⁰³ Panel Report, *United States—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, WT/DS184/R (Feb. 28, 2001).

²⁰⁴ *Id.* ¶ 2.1.

²⁰⁵ *Id.* ¶ 7.262.

²⁰⁶ *Id.* ¶ 7.277.

²⁰⁷ *Id.* ¶ 7.266 (citing Panel Report, *European Communities—Measures Affecting the Importation of Certain Poultry Products*, ¶¶ 269–70, WT/DS69/R (July 13, 1998)).

²⁰⁸ *Id.* (citing Panel Report, *European Communities—Measures Affecting the Importation of Certain Poultry Products*, ¶ 114, WT/DS69/R (July 13, 1998)).

²⁰⁹ *Id.* ¶ 7.266 (citing Appellate Body Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, ¶ 200, WT/DS27/AB/R (Sept. 25, 1997)).

of the inclusion of energy services in the DDA.²¹⁰ It is well-known that United States is dependent on imported energy goods.²¹¹ Many are not aware, however, that the United States maintains a trade surplus; it is a net exporter, of services.²¹² The GATS, like the GATT, imposes obligations on Member states to include the MFN, national treatment, and transparency principles.²¹³

Differences arise in the manner in which these two trade agreements apply such principles.²¹⁴ The GATT applies all three obligations against any discriminatory trade measure.²¹⁵ In contrast to the GATT, the GATS contains two categories of obligations: (1) general obligations in Part II; and (2) specific commitments in Part III.²¹⁶

B. Part II General Obligations

The MFN and transparency principles lie within the general obligations.²¹⁷ These obligations are unconditionally and automatically afforded to other Member countries.²¹⁸ The MFN principle as contained in GATS Article II:1 contains a like services requirement.²¹⁹ The Panel Report for *Canada—Certain Measures Affecting the Automotive Industry*, provides guidance as to this like services requirement.²²⁰ The Panel stated that the like services requirement is satisfied with respect to the actual services provided.²²¹ The characteristics of the entity actually providing the services are not to be considered.²²²

²¹⁰ See Special Session of the Council for Trade in Services, *Report by the Chairman to the Trade Negotiations Committee*, TN/S/23, at annex B, § 11 (Nov. 28, 2005).

²¹¹ See text accompanying *supra* note 14.

²¹² The United States had exports of services totaling \$479,150,000,000 and imports of services of \$372,296,000,000 for a surplus of 106,854,000,000, U.N. Conf. on Trade and Dev. [UNCTAD], *Handbook of Statistics Online*, <http://stats.unctad.org/Handbook/ReportFolders/ReportFolders.aspx> (last visited Nov. 12, 2009).

²¹³ UNDERSTANDING, *supra* note 64, at 10–11.

²¹⁴ CHOW & SCHOENBAUM, *supra* note 65, at 282, 284.

²¹⁵ See *id.* at 282.

²¹⁶ *Id.* at 281–82.

²¹⁷ GATS, *supra* note 104, pt. II, art. II:1–3; GATS, *supra* note 104, pt. II, art. III:1.

²¹⁸ CHOW & SCHOENBAUM, *supra* note 65, at 282.

²¹⁹ See GATS, *supra* note 104, pt. II, art. II:1–3, pt. art. III: 1.

²²⁰ Panel Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R (Feb. 11, 2000).

²²¹ *Id.* at ¶ 6.843.

²²² *Id.* at ¶ 6.842.

[T]he nature and the characteristics of wholesale transactions as such, as well as of each of the different subordinated services mentioned in the headnote to section 6 of the [UN Central Prod-

Unlike the GATT MFN principle, Article II:2-3 allows Members to limit the reach of this provision.²²³ These exemptions prevent free riding by other Member countries.²²⁴ Free riding is a two-step process that begins when country A affords favorable treatment to all other Member countries.²²⁵ The second step occurs when one of the other Member countries receiving the favorable treatment, say country C, may not afford country A equal favorable treatment.²²⁶ Therefore, country C is receiving a benefit while country A is subject to a detriment.²²⁷ Using this example, country A may take advantage of Article II:2-3, to mitigate the detriment it suffers at the hands of country C.²²⁸

C. Part III Specific Commitments

Obligations within the specific commitments section are afforded to only those services designated as committed on a country's GATS Schedule.²²⁹ Market access and national treatment obligations are classified as specific commitments under GATS.²³⁰

1. National Treatment

National treatment is the most important free trade principle pertaining to services.²³¹ National treatment requirements are substantially the same under both GATT and GATS; however, GATS allows its Members to limit and condition the reach of the obligation.²³² Article XVII provides that the services sectors listed on a Member country's Schedule may be subject to the conditions and qualifications

uct Classification system], are "like" when supplied in connection with wholesale services, *irrespective* of whether these services are supplied with respect to bananas of EC and traditional ACP origin, on the one hand, or with respect to bananas of third-country or non-traditional ACP origin, on the other.

Id. at ¶ 6.842 (quoting Panel Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, ¶ 7.322, WT/DS27/R/USA (May 22, 1997)) (emphasis added).

²²³ CHOW & SCHOENBAUM, *supra* note 65, at 282.

²²⁴ *Id.*

²²⁵ *Id.*

²²⁶ *Id.* at 283.

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.* at 284.

²³⁰ GATS, *supra* note 104, pt. III, arts. XVI & XVII.

²³¹ CHOW & SCHOENBAUM, *supra* note 65, at 285; GATS, *supra* note 104, pt. III, art. XVII:1.

²³² CHOW & SCHOENBAUM, *supra* note 65, at 285.

also included on its Schedule.²³³ Therefore, for Member country A to enjoy full national treatment in country C, country C must first include the applicable services sector on its Schedule. Second, country C must refrain from exercising its right to subject the sector to conditions and qualifications.

2. Market Access

While trade in goods, (i.e., the importation and exportation of items such as bananas or shoes) is generally straightforward, trade in services is more ambiguous. Article I defines trade in services as the supply of a service in terms of four different scenarios or modes.²³⁴ The first mode, a cross-border transaction, occurs where the service provider, located in country A, provides a service to a consumer in country B, while both provider and consumer remain present in their respective countries.²³⁵ Such services may be provided through electronic communications, postal, or parcel services.²³⁶ The second mode occurs where the service provider, located in country A, provides a service to a service consumer from country B, and the provider and consumer are both located in country A.²³⁷ The third mode applies to the situation where a service provider from country A establishes a commercial presence in the country of the service consumer, country B, and then the commercial entity performs the service.²³⁸ The fourth mode describes the circumstances where a service provider from country A travels to the country of the service consumer, country B, and then performs the service.²³⁹ Because market access is a specific com-

²³³ *Id.*

²³⁴ CHOW & SCHOENBAUM, *supra* note 65, at 279; GATS, *supra* note 104, pt. I, art. I:1–2.

²³⁵ See GATS, *supra* note 104, pt. I, art. I:2(a).

²³⁶ CHOW & SCHOENBAUM, *supra* note 65, at 279. Example services include the receipt of “consultancy or market research reports, telemedical advice, distance training, or architectural drawings,” *id.* at 280.

²³⁷ See GATS, *supra* note 104, pt. I, art. I:2(b). This scenario occurs when “[n]ationals of [country B] have moved abroad as tourists, students, or patients to consume the respective services,” CHOW & SCHOENBAUM, *supra* note 65, at 280.

²³⁸ See GATS, *supra* note 104, pt. I, art. I:2(c). “The service is provided . . . [in country B] by a locally-established affiliate, subsidiary, or representative office of a foreign-owned and –controlled company (bank, hotel group, construction company, etc.),” CHOW & SCHOENBAUM, *supra* note 65, at 280. This also includes a representative of an energy company.

²³⁹ See GATS, *supra* note 104, pt. I, art. I:2(d). A foreign national [from country A] provides a service within [country B] as an independent supplier (e.g., consultant, health worker) or employee of a service supplier (e.g., consultancy firm, hospital, construction company), CHOW & SCHOENBAUM, *supra* note 65, at 280. This also includes an independent supplier or employee of an energy company.

mitment, for Article XVI obligations to apply to their fullest extent, the service (1) must be included on the country's Schedule and (2) the country must not exercise its right to place terms, limitations, and conditions on the modes of supply associated with that service.²⁴⁰

When market access obligations are uninhibited by terms, limitations, or conditions, the obligations prohibit a country from placing limits on: the number of service suppliers; the value of service transactions; the amount of services' output; the number of natural persons employed; the type of legal entity required for operation; and the value of foreign capital.²⁴¹

VII. PROPOSED SOLUTION—THE WAY FORWARD

WTO agreements, if used properly, are the means by which the United States can lead a global trek toward energy security. The WTO provides the foundation and infrastructure for multilateral representation,²⁴² open communication channels,²⁴³ and an established dispute resolution forum²⁴⁴ on which energy security can be built. The GATT and GATS provide the tools and guidelines necessary to shape multilateral agreements to promote energy security.

A new entity dedicated to energy security is not required when we have the necessary vehicle already available. Perhaps we need to ask ourselves: would a carpenter want to invent a new type of hammer when the one he already uses is time-tested and proven through experience? Immediate action using the tools at our disposal is required.²⁴⁵ Returning to the Council on Foreign Relations Task Force Report²⁴⁶ (CFR Report) and the International Energy Agency's ("IEA") elements²⁴⁷ of energy security, the following discussion uses GATT and GATS to support these elements.

²⁴⁰ CHOW & SCHOENBAUM, *supra* note 65, at 285; GATS, *supra* note 104, pt. III, art. XVI.

²⁴¹ CHOW & SCHOENBAUM, *supra* note 65, at 285.

²⁴² UNDERSTANDING, *supra* note 64, at 10.

²⁴³ *See id.* at 9.

²⁴⁴ *Id.* at 10.

²⁴⁵ *See* CFR REPORT, *supra* note 12, at 4; *see also* Mandelson, *supra* note 38 (advocating for trade policy to take a leading role in energy security); Susan L. Sakmar, *Bringing Energy Trade Into the WTO: The Historical Context, Current Status, and Potential Implications for the Middle East Region*, 18 *IND. INT'L & COMP. L. REV.* 89, 90 (2008) (stating that "a push for freer trade in those energy services already within the current Doha Development Agenda (Doha Round) has already occurred.").

²⁴⁶ *See generally* CFR REPORT, *supra* note 12.

²⁴⁷ *See generally* IEA OUTLOOK 2007, *supra* note 22, at 161–62.

A. *Reduce Energy Consumption Through Trade*

First, the IEA and the CFR Report recommend that the United States adjust its domestic energy policy to include efforts to mitigate demand growth and reduce energy consumption.²⁴⁸ One way to reduce consumption is to foster new technologies and to improve existing technologies. Through the MFN and national treatment principles, the GATT works to encourage trade in goods. If products that contain new and energy-conserving technologies are subject to GATT, it follows that such products will have the best chance for widespread use by consumers. As more of these products enter the marketplace, competition among products will lead to innovation. New products born out of the competition will subsequently enter international commerce. Member countries have the responsibility to include energy products on their tariff Schedules and to keep tariff rates low to promote fair trade and the free flow of such products.

Working in conjunction with GATT, GATS will ensure the availability of the many diverse services required for this innovation. GATS market access commitments are a key component of the liberalization of trade in services.²⁴⁹ Education services are required to grow students into the next generation of engineers, researchers, and scientists. Training is required to ensure the proper use of available technologies. Research and development are needed to foster new products and technologies. Manufacturing, construction, and product implementation are necessary to bring the technology and products to the user. These services activities are exactly what the GATS drafters had in mind when composing the four modes of supply.

Two events must happen to allow GATS to be used to its fullest extent. First, the energy services negotiations currently held under the DDA must incorporate a wide range of energy services. The United States proposal of W/120 energy service sector additions should be adopted because it is the most comprehensive proposal available.²⁵⁰ Such categories and services must be available to Member countries to include on their GATS Schedules. Second, as countries include energy services on their Schedules, they must keep the modes of supply as unencumbered as possible. To be sure, the modes of supply play a crucial role within the trade in services. Exceptions and limitations that may be placed on the modes must be kept to a minimum. The road to energy security is already arduous; each limitation placed on the modes acts to make the road steeper.

²⁴⁸ See CFR REPORT, *supra* note 12, at 6; IEA OUTLOOK 2007, *supra* note 22, at 162.

²⁴⁹ See GATS, *supra* note 104, pt. II, art. IV.

²⁵⁰ See generally Communication from the United States, *supra* note 84.

In addition to market access, the national treatment principle plays a leading role. The principle must be enforced to prevent internal taxes and internal charges that act as trade barriers to imported goods and services. While the GATT prohibits a Member country from imposing conditions and qualifications on the national treatment principle,²⁵¹ the GATS has no such rule. Therefore, it is up to Member countries to refrain from imposing these conditions and qualifications.

B. *Transparent and Predictable Energy Markets*

Second, the IEA and the CFR Report encourage the United States to work toward a more efficient, transparent, and fair world energy market. Regulations, tariffs, and subsidies must be used in a responsible manner so that market operations are uninhibited. The WTO does not advocate for the complete elimination of trade barriers (such as tariffs and subsidies) but it does support efforts to reduce trade barriers, ensure non-discrimination, and increase market transparency and predictability. The basic economic laws of supply and demand must be allowed to govern the market.

Transparency of Member countries' laws, regulations, rules, and procedures governing trade will bring fairness to the market. The GATT and GATS already incorporate articles addressing transparency of laws, policies, and regulations. Member countries must support these articles through the openness of their lawmaking, rulemaking, and enforcement mechanisms.

The United States Federal Energy Regulatory Commission (FERC) has set the bar for transparency. FERC is an independent agency within the federal government whose overall mission is to ensure the availability of reliable, efficient, and sustainable energy services to consumers.²⁵² Its duties include the regulation of the transmission and wholesale sale of electricity, the regulation of natural gas transmission and interstate sales, and the regulation of energy markets.²⁵³ Its guiding principles include due process, transparency, and regulatory certainty.²⁵⁴ In support of its principles, the FERC

²⁵¹ See GATT, *supra* note 100, pt. II, art. III.

²⁵² United States Federal Energy Regulatory Commission, About FERC, <http://www.ferc.gov/about/about.asp> (last visited Nov. 16, 2009) [hereinafter FERC].

²⁵³ FERC, About FERC - What FERC Does, <http://www.ferc.gov/about/ferc-does.asp> (last visited Nov. 16, 2009).

²⁵⁴ FERC, *supra* note 252. The agency's Guiding Principles include:

Due Process and Transparency – Paramount in all of its proceedings is the Commission's determination to be open and fair to all participants.

Regulatory Certainty – In each of the thousands of orders, opinions and reports issued by the Commission each year, the Com-

makes its rules, regulations, statutes, court opinions, and orders available through its website “eLibrary” application to anyone, free of charge.²⁵⁵ Member countries may use FERC as a template for their own energy regulatory agencies.

C. *Reliable and Secure Infrastructure Through Trade*

Third, the IEA and the report advocate for a reliable and secure energy infrastructure. Infrastructure is critical in all facets of the energy cycle because energy is useless if one cannot move it from the seller to the consumer. The application of GATT and GATS here is similar to the first recommendation. Products and services are required to make infrastructure improvements and therefore the free movement of such products and services is necessary.

The electricity transmission and distribution grid is one example of an infrastructure improvement that requires immediate attention. The goal is to remake the current transmission and distribution grid into a “Smart Grid.”²⁵⁶ In simple terms, the Smart Grid is defined as the incorporation of information technology concepts into the grid.²⁵⁷ So-called smart meters will be able to collect data regarding electricity usage, down to the individual household appliance, and present this information to both the consumer and utility provider.²⁵⁸ Distribution systems will notify the utility of an outage without the utility relying on customer complaints.²⁵⁹ The grid will be able to reroute electricity around interruptions to minimize outages.²⁶⁰ One other major advantage of the smart grid will be its ability to incorporate and manage electricity generation from highly-variable generation resources such as wind turbines and solar power facilities.²⁶¹ These non-constant sources of electricity are valued for their low environmental impact but can stress the grid in that there may be capacity but no demand and vice versa.²⁶² When implemented, the

mission strives to provide regulatory certainty through consistent approaches and actions.

Id.

²⁵⁵ FERC, eLibrary, <http://www.ferc.gov/docs-filing/elibrary.asp> (last visited Nov. 16, 2009). Other statutes and orders are located on the FERC website under the “Legal Resources” webpage, *see* FERC, Legal Resources webpage, <http://www.ferc.gov/legal/legal.asp> (last visited Nov. 16, 2009).

²⁵⁶ FERC, Smart Grid, <http://www.ferc.gov/industries/electric/indus-act/smart-grid.asp> (last visited Nov. 16, 2009).

²⁵⁷ *Id.*; *see also* *Wiser Wires; Smart Grids*, *ECONOMIST*, Oct. 10, 2009, at 71.

²⁵⁸ *Wiser Wires; Smart Grids*, *supra* note 257, at 71–72.

²⁵⁹ *Id.* at 71.

²⁶⁰ *Id.*

²⁶¹ *Id.* at 72.

²⁶² *Id.*

smart grid will allow consumers, electric utilities, transmission operators, and generators to combine their efforts to ensure the availability of safe, reliable, reasonably priced, and environmentally friendly electricity.²⁶³

D. Political Stability Through Energy Security and Trade

Next, the CFR Report calls on the United States to insist on energy-exporting countries to manage revenue derived from energy in a wise and prudent fashion.²⁶⁴ Good governance of income will foster political stability and enhance living standards.²⁶⁵ One argument made in the report is that increased transparency of government accounting of energy revenues will make corruption easier to recognize.²⁶⁶ As corruption is recognized and eliminated, a more responsible government will emerge.²⁶⁷

Another comparable argument can be made that trade in energy products and services will foster a less corrupt and more stable government. It is well known that trade promotes economic development.²⁶⁸ Power, especially electricity, is the lifeblood of economic development because without it most factories cannot operate.²⁶⁹ By opening up the trade in energy and energy services, adequate and reliable electricity can be made available to those developing countries that need it.²⁷⁰ A reliable supply of electricity invites investors to invest their capital in developing countries.²⁷¹ Investments and energy security are a condition precedent to job growth; job growth leads to a more stable political situation.²⁷²

²⁶³ *Clever, but Unprincipled; Smart Grids*, ECONOMIST, Oct. 10, 2009, at 15–16.

²⁶⁴ CFR REPORT, *supra* note 12, at 10.

²⁶⁵ *Id.*

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ See UNDERSTANDING, *supra* note 64, at 12.

²⁶⁹ Emily Wax, *Developing World's Energy Needs Set Stage for Fight*, WASH. POST, Sept. 9, 2009, at A01 (stating that “[a] factory in Nigeria was forced to relocate because the cost and scarcity of electricity made it impossible to turn a profit.”).

²⁷⁰ *Id.* (stating that “[d]eveloping nations’ urgent need for more energy has become a central issue this year . . .”).

²⁷¹ A lack of reliable electricity causes “[f]oreign investors [to] become wary of parking their money in Africa . . .,” *id.*

²⁷² “The shortage of power stymies industrial growth and the resultant job opportunities, which can destabilize fragile governments in some of the poorest parts of the world,” *id.*; see also THE ORGANIZATION FOR SECURITY AND CO-OPERATION IN EUROPE, ENERGY SECURITY AS A PREREQUISITE FOR POLITICAL STABILITY 1, July 9, 2005, http://www.osce.org/documents/fry/2005/09/16189_en.pdf (last visited Nov. 16, 2009) (stating that “[t]he political stability of a country is linked with the sustainability of its economic development, which is closely related to the reliability of

E. Personnel Knowledgeable in Trade Policy

Last, the CRR Report challenges the United States to revamp its National Security Staff to include a new energy security directorate that will handle energy specific issues.²⁷³ Energy issues are both technical and complex and having the personnel with the expertise to handle such issues will greatly help the policy making process.²⁷⁴ These same personnel need to have an understanding of the primary role that trade can play in achieving our energy security goals.

Another challenge facing the United States is the domestic implementation of WTO agreements.²⁷⁵ The executive and legislative branches of the federal government must find a way to coordinate their efforts. Trade negotiations, headed by the United States Trade Representative,²⁷⁶ and any energy policy legislation must complement each other to be effective.

VIII. CONCLUSION

Energy security remains an elusive goal for not only the developing countries, but also the developed countries. Energy, while it still claims its national security asset status, is manageable under the correct legal regime. WTO agreements and principles are the tools at our disposal that must be employed to implement a legal regime for energy goods and services. This legal regime gives a country the best chance at achieving energy security. Energy security, economic prosperity, and political stability are within reach.

access to energy resources. This implies that access to stable sources of energy is one prerequisite for state stability.”).

²⁷³ CFR REPORT, *supra* note 12, at 10.

²⁷⁴ *Id.*

²⁷⁵ CHOW & SCHOENBAUM, *supra* note 65, at 103.

²⁷⁶ “[The United States Trade Representative] is the chief official of the Executive Branch with respect to international trade,” *id.*

REFORMING FAIRNESS: THE NEED FOR LEGAL PRAGMATISM IN THE WTO DISPUTE SETTLEMENT PROCESS

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The World Trade Organization (“WTO”) dispute settlement system is intended to be the central pillar of the international trade system by which trade disputes involving WTO member states are adjudicated,¹ whether regarding trade in goods, services, or in intellectual property rights.² However, an innocuous statement such as this, when closely considered, indicates potential problems for the system. The WTO is an international treaty-based organization, established in

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¹ World Trade Organization, Understanding the WTO: Settling Disputes A Unique Contribution, http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm (last visited Jan. 26, 2010).

² See Multilateral Agreements on Trade in Goods, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 33 I.L.M. 1125, 1154 (1994); General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 33 I.L.M. 1125, 1167 (1994); Trade-Related Aspects of Intellectual Property Rights, Annex 1C, 33 I.L.M. 1125, 1197 (1994).

1994 by 123 countries in Marrakesh, Morocco.³ In addition to settling disputes in international trade, the WTO is also a negotiating forum and a set of rules.⁴ The organization is more than a “table” for its member states, as the WTO website implies: the set of rules includes common principles, which translate into purposes for the organization.⁵ These include non-discrimination (*i.e.*, treating domestic products no more favorably than imported products), free trade, predictability, fair competition, and the encouragement of economic development.⁶

Yet, as a voluntary political organization, any judicial enforcement of its actions will not come without controversy.⁷ Thus, the dispute settlement mechanism of the WTO cannot act in a traditional judicial sense since such judicial decisions are binding only because autonomous member states have agreed that they be binding.⁸ Even the process by which the system was established was inherently political, and such politics are expected to, and do, permeate the system’s functioning.⁹

The WTO functions with an understanding of its own limitations. The dispute settlement mechanism’s actions are administrative and decided by a system of arbitration. It is not an international equivalent of a domestic common (or civil) law court, but an economic creation with a political end. Considering the natural autonomy of its members and the ends of the organization, including the disposal of disputes, natural inequities will not be easily resolved. If the WTO intends to pursue its stated principles, then it should be aware of these natural inequities and appropriately deal with them.¹⁰ This is the problem of fairness, and it reveals itself in the dispute settlement

³ World Trade Organization, Understanding the WTO: Uruguay Round, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact5_e.htm (last visited Jan. 26, 2010) [hereinafter Uruguay Round].

⁴ World Trade Organization, Understanding the WTO: What is the WTO?, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm (last visited Jan. 26, 2010).

⁵ *Id.*

⁶ World Trade Organization, Understanding the WTO: Principles of the Trading System, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm (last visited Jan. 26, 2010).

⁷ Debra P. Steger, *The Future of the WTO: The Case for Institutional Reform*, 12 J. INT’L. ECON. L. 803, 803–04 (2009).

⁸ *Id.* at 806.

⁹ *Id.*

¹⁰ Chad P. Bown & Bernard M. Hoekman, *WTO Dispute Settlement and the Missing Developing Country Cases: Engaging the Private Sector*, 8 J. INT’L. ECON. L. 861, 862 (2005), available at <http://jiel.oxfordjournals.org/cgi/content/full/8/4/861?ijkey=sctstP41iBTuveY&keytype=ref> (last visited Jan. 26, 2010).

mechanism, particularly in the treatment of developed versus developing nations.

The system as it stands intends simply to “deal with” natural inequities within the system, mitigating unfair advantages, rather than structuring the system so that inequities do not translate into advantage and disadvantage.¹¹ The Dispute Settlement Understanding (“DSU”), the guiding document for the dispute settlement system, allows for “special procedures involving least-developed country members” in certain areas.¹² Philosophically, the DSU reveals intent to balance two competing tendencies, egalitarian liberalism and libertarian liberalism, in trying to reach an optimal agreement for the system to function. An examination of this system reveals problems and the need for a solution.

I. THE SYSTEM AS IT STANDS

A. *The WTO Dispute Settlement System*

The DSU, signed on April 15, 1994, along with other documents, decisions, and understandings, was part of the finalizing act of the Uruguay Round of trade negotiations.¹³ The Uruguay Round, named for the country in which the first meeting was held in 1986, was the set of trade negotiations that formally created the WTO.¹⁴ The idea for the Uruguay Round began in 1982 at a ministerial meeting of GATT members in Geneva.¹⁵ Up to that point, the organization had been called the General Agreement on Tariffs and Trade, or GATT, and its jurisdiction extended only to trade in goods.¹⁶ With the establishment of the WTO, the organization agreed to negotiate trade in other areas, particularly in services and intellectual property.¹⁷ Politically, the organization was restructured, and the dispute settle-

¹¹ See generally Kristin Bohl, *Problems of Developing Country Access to WTO Dispute Settlement*, 9 CHI. KENT. J. INT'L. & COMP. L. 130 (describing why developing countries shy away from participating in disputes or are unable to access the dispute settlement system).

¹² Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments—Results of the Uruguay Round, 33 I.L.M. 1125 (1994), available at http://www.wto.org/english/docs_e/legal_e/28-dsu_e.htm [hereinafter DSU].

¹³ Uruguay Round, *supra* note 3.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ World Trade Organization, *Understanding the WTO, The GATT Years: From Havana to Marrakesh*, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm (last visited Jan. 26, 2010).

¹⁷ Uruguay Round, *supra* note 3.

ment system underwent changes as prescribed by the DSU.¹⁸ Under GATT, dispute settlement was largely another negotiation function of the body, and decisions were products of political capital.¹⁹ That process was based on diplomacy, and the system that emerged from the DSU was rule-based.²⁰ Particularly, decisions made were automatically binding, and countries were given an automatic right of review to the Appellate Body.²¹ Such measures were intended to be helpful to developing nations who had less to bargain with in terms of political or economic capital under the GATT system.

By partially judicializing the system, the WTO “table,” at least as far as dispute settlement matters relating to developing countries, was thought to have been made more equitable. Although such measures wrongly assumed developing nations would be willing to use the system to resolve their trade disputes, the DSU’s new measures can be viewed as an attempt to mitigate natural inequities. It assumes that if efforts are taken to put developing nations in the same place at the beginning of a dispute as developed nations, they have no reason to act differently. There are two problems that arise in evaluating the fairness of the dispute settlement system as it stands. First, it does not do enough to fully mitigate obstacles developing nations face when entering the international trade regime. Second, its philosophical underpinnings do not allow it to alleviate more essential problems, including the problem of participation and the consequences that result from the way trade disputes work out for developing nations, given their special circumstances. If the system is reformed according to a legal pragmatism model, basing its function on a non-philosophical and goal-oriented meaning of fairness and targeting those more essential issues (particularly participation), secondary issues will take care of themselves.

B. Developing Nation Special and Differential Treatment

The DSU gives “special and differential treatment” to developing nations in a number of ways. These privileges occur at various stages of the dispute resolution process and are intended to alleviate some of the problems that naturally occur for developing nations, including the lack of experts on particular trade issues and the long-

¹⁸ World Trade Organization, Understanding the WTO, The GATT Years: From Havana to Marrakesh, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm (last visited Jan. 26, 2010).

¹⁹ Timothy Stostad, Note, *Trappings of Legality: Judicialization of Dispute Settlement in the WTO, and Its Impact on Developing Countries*, 39 CORNELL INT’L L.J. 811, 812 (2006).

²⁰ *Id.*

²¹ *Id.*

term financial strain of dedicating resources to resolving disputes.²² First, the DSU provides for special and differential treatment during consultations. This is the first stage of the dispute resolution process, where parties are required to negotiate a resolution to the dispute before a panel is involved. The DSU instructs members (of the WTO) to give “special attention” to the particular problems and interest of developing countries if they are involved in the dispute.²³ The parties are required to indicate on a form exactly how these special considerations were made. The DSU also provides two ways that the period for consultation may extend beyond its normal length of sixty days:²⁴ The parties may mutually agree to extend the period or the Dispute Settlement Body (“DSB”) chairperson may extend the period.²⁵

Normally, the panel stage comes after consultation, assuming parties are not able to reach a consensus on how to dispose of the dispute. The DSB, comprised of all members of the WTO, has the authority to establish panels to hear disputes. If a developing country is a party to the dispute, at least one of the three panel members must be from a developing country.²⁶ If the respondent is a developing country, the DSU instructs the panel to ensure the nation has sufficient time to prepare and present its defense, though there is no provision for the time period provided to be extended.²⁷ The panel is required to explicitly indicate on a form if a developing nation raises issues of special and differential treatment and how consideration was made.²⁸

Special and differential treatment also extends to the implementation stage after the panel has reached a decision. Implementation includes guaranteeing that the “losing” party acts upon the panel’s decision as well as the withdrawal of violative trade mechanisms, compensation for loss, and, as a last resort, the suspension of an obligation of the opposing party equivalent to the loss of that party as was adjudged by the dispute body.²⁹ Here again, the DSU requires special consideration be given to issues of developing nations.³⁰ The DSB is required to give consideration to the way implementation is

²² World Trade Organization, Dispute Settlement System Training Module: Developing Countries in WTO Dispute Settlement, http://www.wto.int/english/tratop_e/dispu_e/disps_settlement_cbt_e/c11s1p1_e.htm (last visited Jan. 26, 2010).

²³ DSU, *supra* note 12, art. 4.10.

²⁴ *Id.* art. 4.7.

²⁵ *Id.* art. 12.10.

²⁶ *Id.* art. 8.10.

²⁷ *Id.* art. 12.10.

²⁸ *Id.* art. 12.11.

²⁹ *Id.* art. 3.7.

³⁰ *Id.* art. 21.2.

managed in a developing nation, what measures would be appropriate, and their impact on the member state's economy.³¹

The previously mentioned provisions are primarily intended for developing nations that are respondents in a dispute and need additional time to defend themselves. When developing nations are complainants, they have the right to invoke Article 3.12, which allows for accelerated procedures through the entire process as prescribed by the WTO decision of April 5, 1966.³² These special procedures allow for additional considerations available to developing nations, including post-consultation dispute facilitation by the WTO Director-General, the consideration of special circumstances of the developing nation at the panel stage, and a shortened time period for the panel to submit its report.³³

Beyond these provisions, additional allowances are set out in the DSU for the least-developed countries. Special circumstances must be considered at all stages, not just at the panel and implementation stages, and developed states are urged to use restraint in seeking compensation.³⁴ The Director-General must also be available at all stages of the dispute settlement process to consult and facilitate equitable resolutions.³⁵

Finally, the WTO provides assistance for developing countries' lack of legal expertise. The organization Secretariat provides legal assistance because they are required to provide developing nations a legal expert if requested.³⁶ But, there are conflict of interest issues, and therefore, limitations for WTO employees consulting for developing nations, so the WTO allows for private legal counsel to be employed in cases of a dispute.³⁷ The WTO also has established the Advisory Centre on WTO Law, an agency independent from the WTO that can provide assistance in dispute matters.³⁸

³¹ *Id.* arts. 21.7–21.8.

³² Decision of 5 April 1966 on Procedures under Article XXII, GATT B.I.S.D. (14th Supp.) at 18 (1967).

³³ *Id.*

³⁴ DSU, *supra* note 12, art. 24.1.

³⁵ *Id.* art. 24.2.

³⁶ *Id.* art. 27.2.

³⁷ World Trade Organization, Dispute Settlement System Training Module: Developing Countries in Dispute Settlement—Special and Differential Treatment, http://www.wto.int/english/tratop_e/dispu_e/dispu_settlement_cbt_e/c11s2p2_e.htm (last visited Jan. 26, 2010).

³⁸ *Id.*

II. IS THE SYSTEM FAIR?

Do these provisions serve their purpose? The intent of this special and differential treatment of developing nations is to mitigate natural, and thus “unfair,” advantages of developed nations. If the goal is to make the proceedings fair, or as fair as possible, then what do we mean by fair? Are there external goals to be accomplished by fairness? Traditionally, the fairness of these provisions has been evaluated using the opposing standards of egalitarian liberalism and libertarian liberalism.

Why liberalism? WTO academic study has all but assumed that “liberal” would be an appropriate philosophical characterization of the organization and its purpose. When considering the issue of fairness of the dispute resolution mechanism, the characterization takes on a strikingly more active meaning than might be assumed. Scholars have viewed liberalism, in this context, as a “theory of justice, a view about the justifications of social arrangements.”³⁹ What justifications are appropriate would then be the main point of contention between differing views of liberalism, particularly egalitarian and libertarian liberalism.⁴⁰ The form of this justification would take that of the consent of the governed, following a social contract theory. To what have the people agreed,⁴¹ or, in the case of the WTO, to what have the members agreed? This is what the philosophical approaches strive to answer.

The two approaches have been criticized, however, on several grounds. By evaluating fairness using a philosophical standard, there is a natural presumption of neutrality as to any favoring of developed or developing states.⁴² The philosophical approaches also do not consistently take into account the consequences of WTO actions by its members.⁴³

A. *What is Fair?*

1. *Egalitarian and Libertarian Liberalism*

Egalitarian liberalism stands on one end of the spectrum in evaluating what it means for the WTO dispute settlement system to be fair concerning the special treatment of developing nations. This eval-

³⁹ Frank J. Garcia, *Trade and Inequality: Economic Justice and the Developing World*, 21 MICH. J. INT'L L. 975, 996 (1999).

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² JAMES GATHII, FAIRNESS AS FIDELITY TO MAKING THE WTO FULLY RESPONSIVE TO ALL ITS MEMBERS 1, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=594485.

⁴³ *Id.*

uation originates from the thought of John Rawls, an American philosopher, and would see the benefits and burdens of the trading system equally disbursed, bearing in mind what Rawls called the “difference principle,” which would give special consideration to vulnerable members.⁴⁴ This principle, derived from his thought that inequitable distribution of what he called “social primary goods,” was not justified and must be undone.⁴⁵ Thus, the egalitarian liberal approach would favor developing nations in doling out benefits and burdens, eliminating any natural advantages of developed nations and disadvantages of developing nations. The approach appears ends-focused, considering non-trade issues that might affect a developing country’s ability to respond to a dispute settlement proceeding.⁴⁶ Members are thus viewed as rights holders, not just economic bodies.⁴⁷ The egalitarian liberal would demand that developing nations receive equal benefits in the end. The current system would be criticized for not doing enough to mandate removal of all advantages of developed nations. Frank Garcia, an egalitarian proponent, notes, “[I]f . . . the principle of special and differential treatment is key to the justification of inequality, then adequate implementation of the principle . . . is equally important for the creation of a just trading system.”⁴⁸ The opportunity to succeed is not justice or fairness; success is.

Libertarian liberalism, on the other hand, considers WTO members solely economic beings, and considerations are all self-contained.⁴⁹ Non-trade issues are not considered in dispensing fairness.⁵⁰ Rather than being ends-focused, libertarian liberalism demands fairness be accomplished by procedural equality and by equality of opportunity.⁵¹ This is because morality to the libertarian is a matter of rights, not of equality.⁵² Rights would demand a return of developing and developed nations to their original positions, not their end positions as egalitarianism might demand, because it is not equality itself that is in need of repair; it is the right to equality and the opportunity of equality, not the guarantee of it. In looking at the WTO, the libertarian liberal would believe that developing nations should have the right to compete equally with developed nations, not the guarantee of

⁴⁴ *Id.* at 2. See generally JOHN RAWLS, A THEORY OF JUSTICE (Harvard Univ. Press 1972).

⁴⁵ Garcia, *supra* note 39, at 998.

⁴⁶ GATHII, *supra* note 42, at 2.

⁴⁷ *Id.*

⁴⁸ Garcia, *supra* note 39, at 1042.

⁴⁹ GATHII, *supra* note 42, at 3.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² Garcia, *supra* note 39, at 1007.

or right to equal results. Thus, a proponent would favor ways the developing nation could better its position if it so chooses.⁵³

In practice, the two philosophies lead the WTO dispute resolution mechanism to be crafted in two directions. Egalitarian liberalism so benefits developing nations that it eliminates any incentive to develop further economically because, in the end, all nations are on the same level. Libertarian liberalism does not consider external factors that show up in the consequences of a WTO action, and nations are not able to preemptively act to avoid disputes. Thus, both philosophies blind the actors to an extent, and a position of compromise would simply result in equalizing disadvantages and advantages. The problem is that balancing advantages and disadvantages needs to be done subjectively, on a case-by-case basis, but such a structural balance must be set out objectively.

The consequences of the problem of philosophical approaches can be illustrated by the following situation. Philosophical dependence has left a gaping hole in WTO treaty interpretation; there is no judicial precedent for a rule for the DSB.⁵⁴ The Appellate Body has adopted a rule, *in dubio mitius*, or “the less onerous meaning controls,” but it would only apply if a case were reviewed on the point.⁵⁵ As a result, the DSB has had no guidance in interpreting treaty language, and the Appellate Body is left with a broad rule with questionable application. Both bodies’ decisions have led to contradictions, including in the case of Article Fifteen of the Anti-Dumping Agreement.

The Agreement, an implementation of the GATT Treaty in 1994, left open the question of whether developed nations must implement alternate measures against a developing country before applying anti-dumping duties.⁵⁶ The agreement says: “Possibilities of constructive remedies provided for by this Agreement shall be explored before applying anti-dumping duties where they would affect the essential interests of developing country Members.”⁵⁷ In a 2002 decision against the United States, the Panel found that Article Fifteen did not impose any “specific or general obligation on Members to undertake any particular action.”⁵⁸ This is an example of a “disempowering characterization”⁵⁹ that finds a violation based on a non-trade issue, where

⁵³ *Id.* at 1042.

⁵⁴ GATHII, *supra* note 42, at 6.

⁵⁵ *Id.*; see also Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, ¶ 107, WT/DS58/AB/R (Oct. 12, 1998).

⁵⁶ Agreement on Implementation of Article VI of GATT, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, 33 I.L.M. 13 (1994).

⁵⁷ *Id.*

⁵⁸ Panel Report, *United States—Antidumping and Countervailing Measures on Steel Plate From India*, ¶ 7.110, WT/DS206/R (June 28, 2002).

⁵⁹ GATHII, *supra* note 42, at 8.

an alternate interpretation would not have found one. Despite the *in dubio mitius* precedent, the disempowering characterization approach has become the more commonplace interpretation. In a 2000 case involving the European Union and India, however, a panel found otherwise, requiring the European Union to explore potential outcomes of implementing alternatives to anti-dumping duties.⁶⁰ It did not confirm the existence of an actual duty under which a violation could be brought.⁶¹ Even assuming that the lack of clear judicial precedent has not yielded contradiction in this case, a reconciling view is not much comfort. The lack of a clear judicial precedent renders a measure attempting to assist developing nations entirely impotent.

2. *Legal Pragmatism: Theory, Purpose, and Practice*

If the two WTO decisions are indeed without contradiction and are attempting to reach a middle ground, the dependence upon warring philosophies has resulted in policies that fail to assist developing nations, yet still create additional hurdles through which developed nations must jump. Essentially, the WTO has perfected finding the unhappy medium, one that is both unfair and ineffective. The philosophical approach has resulted in simply mitigating inequities so long as they do not overly burden the other side, and has thus failed to remedy root problems. A pragmatic approach, whose goal is to make a system that performs at a predictable and efficient level, stands as an alternative to a philosophically-guided approach. Rather than trying to reconcile opposing philosophical views and producing policies, laws and standards that are the sum of all equals, a pragmatic approach would be free to embrace an entirely egalitarian consideration of non-trade issues without mandating the employment of certain privileges, a libertarian preference.

A third philosophical approach, mentioned less often, that might be confused with legal pragmatism is utilitarianism. Utilitarianism is based on the thought of Jeremy Bentham and John Stuart Mill.⁶² Unlike egalitarianism, it advocates redistribution of inequities based on a morality of consequence, not equality.⁶³ Unlike libertarianism, it is concerned with equality of ends, not just equality of opportunity.⁶⁴ However, as with egalitarianism, utilitarianism does not satisfy a tangible goal. Legal pragmatism recognizes that the two

⁶⁰ Panel Report, European Communities—*Antidumping Duties on Imports of Cotton-Type Bed Linen from India*, WT/DS141/R (Oct. 30, 2000).

⁶¹ *Id.*

⁶² See Garcia, *supra* note 39, at 1002–03.

⁶³ *Id.* at 1003.

⁶⁴ *Id.* at 1007.

models often diverge, and that in such a case it would be better to follow the latter.

B. Systematic Unevenness

Legal pragmatism must address several systematic problems to decide whether the dispute settlement system works fairly. The dispute settlement system is underutilized because costs are too high, the process functions opaquely, and its decisions are difficult to predict. Legal standards are nearly impossible to articulate, as evidenced by the Article Fifteen anti-dumping problem.⁶⁵ It is harder to determine whether issues are causes or consequences, because the system's inherent problems are simultaneously mitigated and aggravated by the "special and differential treatment" of developing nations.⁶⁶ Examination of the resulting unevenness reveals a central problem, one that should be targeted to alleviate the negative results in other issues.

1. Participation in the System

Timothy Stostad examined the impact the dispute settlement mechanism's level of judicialization has on developing nations' participation in the system.⁶⁷ He concludes that there is evidence of systematic biases within the WTO dispute resolution process that have led to underutilization by developing nations.⁶⁸ The question of utilization of the system must examine not one year, but the trend of participation since the WTO establishment overhauled the system in 1994. Overall, developing nations have been using the dispute resolution system more often, though the raw numbers seem to have plateaued. There were nineteen disputes in 2008, with developing nations as complainants in eleven of those and as respondents in eight.⁶⁹ This trend was established in 2005, when developing nations participated in four out of eleven disputes as complainant or respondent.⁷⁰ For the past four years, developing nations have participated in about half the disputes, equally as complainant and respondent. In 2004, however, developing nations comprised just over a quarter of the disputes.⁷¹ This is striking considering about three-quarters of WTO members consider

⁶⁵ See *supra* notes 54–61 and accompanying text.

⁶⁶ See Dispute Settlement System Training Module, *supra* note 22.

⁶⁷ Stostad, *supra* note 19, at 812.

⁶⁸ *Id.* at 834.

⁶⁹ World Trade Organization, Dispute Settlement: Chronological List of Disputes Cases, http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm (last visited Jan. 26, 2010).

⁷⁰ *Id.*

⁷¹ *Id.* (developing nations participated as five out of nineteen complainants and five out of nineteen respondents).

themselves a developing nation.⁷² At the same time, the total number of disputes has noticeably decreased. In 2002, there were thirty-seven disputes, followed by twenty-six in 2003, nineteen in 2004, eleven in 2005, and they have remained relatively stable through 2008.⁷³

Regarding the relative increase in the participation of developing nations in the dispute system, Stostad notes that the difference with the GATT years is actually negligible once one considers such factors as the number of WTO members, the increasing number of areas in which the WTO regulates, and a general increased trade dependency.⁷⁴ Eric Posner and John C. Yoo calculated that the total number of disputes has not increased since GATT, averaging 0.0044 complaints per state per year, compared with 0.0037 complaints per state per year under GATT, a negligible difference.⁷⁵ They based their calculation on the number of state pairs possible, using factorial analysis and eliminating outlier years.⁷⁶ Regarding the gross decrease in the amount of cases since 2005, Stostad hypothesizes that nations have been saving up disputes, anticipating new and better rules at the end of the Doha Round of negotiation.⁷⁷

If developing nations are participating at rates relatively equal to developed nations, though both have dropped off in the past four years, are they participating enough? Is peaking at nearly half of WTO cases fair considering, as a whole, they share less of a trade burden than most developed nations? The conclusion seems to be no. Despite the fact that they trade less than developed nations, as three-quarters of the WTO membership, developing nations underutilize the WTO dispute resolution mechanism. As a basic calculation, the costs do not outweigh the benefits. There are a number of reasons why this is the case.

Naturally, the costs are comparatively higher for developing nations. First, in terms of human capital, developing nations are far less represented at the WTO.⁷⁸ Stostad estimates that nearly 60% of

⁷² World Trade Organization, Understanding the WTO, Principles of the Trading System: http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm (last visited Jan. 26, 2010).

⁷³ World Trade Organization, Dispute Settlement: Chronological List of Disputes Cases, http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm (last visited Jan. 26, 2010).

⁷⁴ Stostad, *supra* note 19, at 824.

⁷⁵ Eric A. Posner & John C. Yoo, *A Theory of International Adjudication* 40 (Univ. Chi. Law Sch., John M. Olin Law & Econ. Working Paper Series, Paper No. 206, 2004), available at <http://www.law.uchicago.edu/files/206-eap-jy.tribunals.pdf>.

⁷⁶ *Id.*

⁷⁷ Stostad, *supra* note 19, at 824.

⁷⁸ *Id.* at 825.

WTO members are inadequately represented.⁷⁹ The cost of legal services is higher per dollar (or peso or dong) for developing nations because litigation costs do not increase proportionally according to the value of the trade barrier.⁸⁰ For this reason, partially judicializing the dispute resolution system has increased the costs on developing nations, having to advance the costs of formal litigation. Are the benefits also higher as to counterbalance the costs? No; in fact, they are lower than developed nations because of the risk they will be unable to reap the benefits of winning a dispute. Because the implementation and enforcement of decisions are not guaranteed, developing nations have less political capital to force a nation in violation to comply. Thus, it is less likely that a developing nation will be able to benefit from a successful dispute decision.

If these are barriers, do developing nations actually underutilize the WTO dispute resolution system as a result? The answer is yes. Despite the fact that the number of disputes brought by developing nations has increased, it is counterbalanced by the gross increase in the amount of trade done by developing nations.⁸¹ Even though developing nations such as China are trading more, their disputes are still being resolved at a lesser rate than developed nations. “[A] large poor country doing lots of trade is as likely to be a [disputant] as a small rich one with the same trade value.”⁸² The simple dichotomy of developing and developed nations entirely eliminates any shade of gray, pigeonholing countries and erasing incentives for gradual growth. Beyond this, there is no way to determine the extent to which developing nations are underutilizing the dispute process because there is no external point of comparison.⁸³

2. *Transparency and Predictability of the System*

There are consequences that follow underutilization as one analyzes the fairness of the special and differential treatment of developing nations in the system. While special and differential treatment attempts to mitigate some of the natural problems for developing nations, such as the costs of legal representation, it does not solve those problems. At the same time, it makes some natural inequities more visible and more likely to affect the developing nation’s participation in the system. Partial judicialization of the system, as will be dis-

⁷⁹ *Id.* at 826.

⁸⁰ *Id.*

⁸¹ *Id.* at 828.

⁸² Peter Holmes et al., *Emerging Trends in WTO Dispute Settlement: Back to the GATT?* 13 (World Bank, Policy Research Working Paper Series, Paper No. 3133, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=636553.

⁸³ Stostad, *supra* note 19, at 831.

cussed later, was intended to assist the developing nations with limited political capital. Rather than eliminating the problem of limited political capital, it instead made the problem a lack of economic capital.

Beyond underutilization, other issues and complications arise, particularly transparency and predictability. As the Antidumping Agreement Article Fifteen problem illustrates, if countries do not bring disputes to the DSB, no judicial precedent is created. Without judicial precedent, countries do not know the law and cannot avoid a dispute preemptively, the ultimate goal of the system. It is a problem of predictability. Without participation in the system, the system will not become predictable.

Transparency is another complementary complication. Without transparency, nations are unable to understand prior case law to avoid disputes. The developed nations, interestingly, have most notably pushed for transparency reform. The United States has pushed for the dispute resolution process to be opened to the public eye, both during the process and after, in document requests.⁸⁴ The proposal was presented to the WTO after pressure from Non-Governmental Organizations (“NGOs”) with particular concern for the issues of developing nations, including labor and environmental rights.⁸⁵ Private attorneys have also advocated such a change so that they can better prepare for disputes.⁸⁶ That is where transparency becomes predictability. Additionally, such change would help with the public view of the legitimacy of the WTO, which is likely to encourage future participation.⁸⁷

III. REFORMING FAIRNESS

A. *Where: Procedurally*

1. *Participation and Regularization*

Partial judicialization is to blame for a lack of participation and has made the dispute resolution process less accessible to poorer member states.⁸⁸ In 2006, Stostad wrote that the root of the problem of participation lies in the limited judicialization of the dispute settlement system.⁸⁹ Problems for developing nations in the world of partial judicialization include the increased complexity of the substantive law,

⁸⁴ Robert E. Hudec, *The New WTO Dispute Settlement Procedure: An Overview of the First Three Years*, 8 MINN. J. GLOBAL TRADE 1, 43 (1999).

⁸⁵ *Id.* at 44.

⁸⁶ *Id.*

⁸⁷ *Id.* at 46.

⁸⁸ Stostad, *supra* note 19, at 813–14.

⁸⁹ *Id.*

a more formal litigation process, and extraordinary costs on the litigants.⁹⁰ Increased complexity of the law is a result of growing case law that has begun to stack up as the sum of singular decisions, not in drawing a picture of the greater law, in the common law sense. This is the problem with the DSB's hesitancy to use set standards in evaluating disputes, instead depending on case-by-case compromises. It would not be a problem if it were not coupled with a formal process and high costs to use the system.⁹¹ Stostad paints a picture of a schizophrenic system: an expensive, formal process that produces binding compromises.⁹² The problem with participation results from the confused system that only exists because the DSB is intended to compromise the interests of developing and developed nations and mitigate natural inequities.⁹³ Philosophical compromise does not solve the problem of nature; it aggravates it by institutionalizing new inequities. The WTO needs to address these problems to find a proper solution.

One potential solution is full judicialization of the dispute process.⁹⁴ Full judicialization would increase the power of the DSB. Such a recommendation is commendable, but room remains for caution. Judicialization should not proceed if it is merely to make the system work like a court in the domestic common or civil law sense. To make the dispute settlement mechanism more effective, the WTO must address the problems that directly affect the principle of predictability.⁹⁵ A more promising solution is increased regularization of the dispute process. The DSB is not a court, and it does not, nor should it, dispense justice; however, by regularizing legal standards and increasing the transparency of its procedures and decisions, both developed and developing nations may be better able to avoid disputes and trade freer and fairer on their own.

Strengthened enforcement of the DSB's decisions may cause controversy. Although the consequences of strong enforcement encourage nations to avoid disputes, overzealous enforcement can discourage participation in the system. If the consequences of losing a dispute become disproportionate to the dispute itself, nations would be encouraged to work outside of the system. Working outside of the system would undermine confidence in the system as a whole, and an increase in cloudy, back-room deals would be adverse to the rule of law.

⁹⁰ *Id.* at 814.

⁹¹ *Id.*

⁹² *Id.*

⁹³ World Trade Organization, Dispute Settlement System Training Module: Introduction to the WTO Dispute Settlement System, http://www.wto.org/english/tratop_e/dispu_e/dispu_settlement_cbt_e/c1s1p1_e.htm (last visited Jan. 26, 2010).

⁹⁴ Stostad, *supra* note 19, at 834.

⁹⁵ *Id.* at 812.

Here, the difference between the philosophical approaches and legal pragmatism becomes clear. The balance struck from a compromise between making countries more equal and making countries more free does not make the system effective. The balance between freedom and equality is an inescapable problem; the balance struck at a given time is a product of the values of a society at that time. If the WTO wants to be a stable force promoting the rule of law in international trade disputes, fairness should not depend on the relativistic interpretation of the sum of the world's values. It must look inward and rely on the principles it seeks to uphold, including predictability.

There are several specific ways to accomplish the above goals. First is a mechanism for compulsory compensation.⁹⁶ Potential developing nation complainants are often dissuaded by initial costs, so compulsory compensation would require respondents to pay a minimal "benefit-of-the-bargain" amount retroactive to the beginning of litigation.⁹⁷ This would encourage developed nation respondents to be conservative and measured in their defenses and prevent them from drowning developing nation complainants in expensive details.⁹⁸

As for the panel process, the establishment of an independent prosecutorial system to separate the administrative and judicial aspects could lead to more equitable treatment of issues.⁹⁹ The current system is more administrative than judicial, and consequently, there is no reason for it to be treated as a civil litigation system, in which a private party brings the suit.¹⁰⁰ Some might argue that the DSB might produce more equitable results if an independent party brings the action; however, as seen in the United States, "[a]dministrative agencies . . . conduct quasi-judicial hearings in which both the prosecutor and the administrative law judge ("ALJ") are technically within the agency's chain of command but in which neither is permitted to influence the court of the other's work."¹⁰¹ In fact, because of the growing interconnectedness of the global trading world, it has become harder to characterize an improper trade mechanism as harmful only to the complaining nation. Furthermore, the creation of public defenders could lead to more equitable solutions for developing country respondents in dispute settlement actions.¹⁰² Rather than replacing the respondent party, this suggestion would simply assist in the great need

⁹⁶ *Id.* at 835.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.* at 837–38.

¹⁰⁰ *Id.* at 839.

¹⁰¹ *Id.*

¹⁰² *Id.* at 839.

to lessen the financial and time burdens faced by the respondent developing nations.

The other end of the process could use reform as well. Stostad argues that the DSU should require mandatory removal of trade barriers deemed improper by the WTO.¹⁰³ Currently, a winning complainant might not win the removal of a harmful mechanism or even the payment of appropriate compensation; instead, the WTO may give them permission to implement an equally harmful mechanism against the losing respondent.¹⁰⁴ Other proposals have circulated, including a mutual agreement among WTO members to cooperatively act against a nation found in violation of a WTO agreement.¹⁰⁵ As the WTO is not an entity of its own but a collection of parts, it is important that these parts are active enough to “[give] the WTO teeth.”¹⁰⁶

2. *Substantive Development and Transparency*

Increasing participation by further regularizing the dispute settlement process will clear up other issues in the pursuit of predictability. Regularization of the process should extend to the substantive law of the WTO, with decisions made less on a case-by-case basis and more by established legal standards. By letting WTO principles more freely develop as a common law rather than returning to the GATT system of diplomatic decision-making, regularization would allow nations to more easily predict the results of the procedure and act preemptively to avoid a dispute. Additionally, regularization would decrease the need to cloud and hide the decisions of the DSB and increase the need to publish and explain results, thus increasing the transparency of the proceedings and increasing the predictability of WTO proceedings.

Robert Hudec emphasizes the need for transparency to complement reform in other areas, particularly participation and better management of the DSB process.¹⁰⁷ He notes that there have been proposals put forward eliminating the confidentiality of many documents, opening DSB hearings to the general public, and those permitting private individuals to submit briefs to both the panels and the Appellate Body.¹⁰⁸ For the United States and other advocates of increased transparency, these proposals are important because they would bring further legitimacy to the proceedings.¹⁰⁹

¹⁰³ *Id.* at 836.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 842.

¹⁰⁶ *Id.* at 841.

¹⁰⁷ Hudec, *supra* note 84.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

B. How: Politically

The WTO is, at heart, a political entity, not a judicial one.¹¹⁰ It is not a government, but a collection of governments, and implementing any reform should proceed with a view toward this existence. Forgetting it is a political entity can create problems, but remembering this can offer novel solutions. The United States' push for greater transparency is but one example of the ways in which the dispute settlement process can be reformed pragmatically, giving developing nations tools to compete as equals. In fact, if legal reform is going to work, developing nations must reform politically.¹¹¹ Asif Qureshi suggests scrapping the DSU entirely and drafting a new agreement where decisions are binding and where the WTO is authorized to monitor compliance with such decisions.¹¹² He suggests other reforms as well, to ensure the procedures reach just results.¹¹³

Though this comment is about reforming the WTO, developing nations should be aware of other ways to access the market and compete fairly. Regional and bilateral mechanisms are important to complement participation in the international regime. Whether it is participation in the Asia-Pacific Economic Cooperation forum discussions or a free trade agreement with a fellow developing country, such development not only increases the nation's trade, but also helps develop political capital that it can take to the world stage. For instance, in making economic allies regionally, a developing nation might have more success in getting a decision of a dispute resolution panel implemented if there are other nations that will support the developing nation against a larger nation in violation of an international trade obligation. It should be cautioned that dependence on unilateral trade policies is inherently illiberal and the policies unstable.¹¹⁴ Unilateral policies should complement a multilateral approach.

Finally, the key pragmatic approach would allow choice application of key philosophical reforms, but not for philosophical reasons. The WTO should open the conversation about non-trade issues and emphasize them, not only in dispute resolution proceedings, but within the Doha Round negotiations. Inclusion of non-trade issues within formal WTO considerations is fair because it allows policies and decisions to be created with greater foresight and lasting effect. At the same time, the WTO should resist the temptation to treat developing nations differently because they characterize themselves as "develop-

¹¹⁰ That goes for the Dispute Resolution system as well.

¹¹¹ Asif H. Qureshi, *Participation of Developing Countries in the WTO Dispute Settlement System*, 47 J. AFR. L. 174 (2003).

¹¹² *Id.* at 195–96.

¹¹³ *Id.*

¹¹⁴ Garcia, *supra* note 39, at 1031–32.

ing.” Outside philosophical concerns, such an approach would appreciate the short-term effects of trade policies much more than the long-term effects (considering current conditions without any incentive to grow), and it does not appropriately treat poorer developed nations or wealthier developing nations. The proposed approach is fair because it looks forward and appreciates the details.

IV. CONCLUSION

Where did this notion of fairness originate? Because the WTO dispute resolution system is a pseudo-adjudicative system, it dispenses justice to the extent that the DSB acts as a court. Courts apply the law when it controls, and they do what is equitable, or fair, when the law does not control. Traditionally, fairness has been viewed *a priori*, as a notion gaining its definition from outside the particular, subjective circumstances of a dispute. Viewing the WTO and its dispute resolution system as a dispenser of a philosophical fairness is a consistent view, but it is not concerned with what works best when formula and reality divide. What is misguided about a philosophical view is that it puts the system in a vacuum and ignores all other political, economic, and social forces that affect how the WTO can and does work. Pragmatic legalism views the WTO as merely one cog in the international political economy—one that insists upon doing what works, not just what should work.

To return to a question posed earlier, of what the members of the WTO have consented to, it should be self-evident that the members consented to a particular philosophical point of view. It is likely that the WTO and its dispute resolution process is intended to be a way of predictably and efficiently resolving disputes where, hopefully, in the future, panels might no longer be needed and nations could self-govern knowing both how a dispute would come out if challenged and how to avoid a problem becoming a dispute.

[N]o judicial system, no matter how well run, can avoid the inevitable messiness of politics, and no system will ever replace diplomacy. Nor should it . . . The WTO must therefore . . . figure out how to improve its mechanisms for negotiated solutions, and not automatically resort to its judges.¹¹⁵

If liberalism is what the WTO strives for, then it is freedom in self-governance that is its essence.

¹¹⁵ Susan Esserman & Robert Howse, *The WTO on Trial*, 82 FOREIGN AFF., 130, 140 (2003).

