

ANNEX C

**RESPONSES AND COMMENTS BY THE PARTIES AND THIRD PARTIES
TO QUESTIONS POSED BY THE PANEL AND OTHER PARTIES**

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ANNEX C-1*

**RESPONSES BY MEXICO TO QUESTIONS POSED BY THE PANEL
AFTER THE FIRST SUBSTANTIVE MEETING**

(20 December 2004)

FOR BOTH PARTIES:

1. Mexico has alluded to the exercise of "judicial economy" as a reference for its argument that panels have certain implied jurisdictional powers that would allow them to decline from exercising substantive jurisdiction. Could Parties please comment on the relevance of the exercise of "judicial economy" in the context of Mexico's request for the present Panel to decline to exercise its jurisdiction.

As discussed in Mexico's oral statement at the first substantive meeting with the Panel, Mexico is not arguing that the Panel could decline to exercise jurisdiction for reasons of judicial economy. The legal base for Mexico's request is broader and derives from the Panel's nature as an adjudicative body. As such, the Panel has inherent powers, as do other international tribunals and bodies, to refrain from taking jurisdiction. The exercise of judicial economy is germane to Mexico's request on at least three different counts.

First, neither the Dispute Settlement Understanding nor any of the WTO agreements explicitly refers to the principle of judicial economy. However, there is no question that WTO panels may apply that principle, and this confirms that they have implied, inherent or incidental powers.¹

Second, the exercise of judicial economy illustrates the fact that panels have refrained from exercising validly established substantive jurisdiction over certain claims before them. In order to ensure the effective settlement of disputes for the benefit of all Members, panels may, by law, decline jurisdiction in respect of certain complaints.

Third, the exercise of judicial economy shows that, notwithstanding Article 7.2 of the DSU, which provides that panels shall address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute, WTO panels may decide to refrain from ruling on certain complaints or arguments brought by the parties in dispute.

2. Could Parties please comment whether they are of the view that there is nothing in the WTO agreements that explicitly spells out the implied jurisdictional power that panels may have that allows them to decline to exercise substantive jurisdiction, as Mexico has suggested. Or do they rather consider that there is nothing in the WTO agreements that explicitly rules out the existence of such power? If there are no such explicit rules in the WTO agreements, then what conclusions, if any, should the present Panel draw in order to respond to Mexico's request to decline to exercise its jurisdiction?

As Mexico explained in its oral statement at the first substantive meeting, international tribunals have certain implied jurisdictional powers that derive from their nature as adjudicative bodies, and there is no provision in the WTO agreements that explicitly rules out or excludes such

* Annex C-1 contains the responses by Mexico to questions posed by the Panel after the first substantive meeting. This text was originally submitted in Spanish by Mexico.

¹ Contrary to what the United States suggests at paragraph 4 of its closing statement at the first substantive meeting with the Panel.

powers. By implicit consent, the Panel may have recourse to and apply the principles of public international law. As international adjudicative bodies, WTO panels too have such incidental jurisdiction.

3. Can Parties please comment whether, in their opinion, it would be appropriate for the Panel to look at the issues concerning bilateral trade in sweeteners between Mexico and the United States which have been raised by Mexico in this case.

Yes. It is not only appropriate but necessary in this case for the Panel to look at the issues relating to the bilateral agreement governing trade in sweeteners between Mexico and the United States. As already explained, the WTO agreements cannot be considered in technical isolation from international law. The circumstances relating to this bilateral agreement do not only explain the factual context in which Mexico's measures arose – to which the United States has omitted all reference – but also demonstrate that the Mexican Congress was prompted by the failure of NAFTA's Annex 703.2 to provide the anticipated access for Mexican sugar to the U.S. market. The United States not only denied trade access but also refused to have the dispute resolved in the forum stipulated in NAFTA Chapter Twenty. This generated an imbalance in the Mexican sugar market, because while the United States prevented Mexican sugar from entering its market, sugar was being displaced by imports of HFCS from the United States and domestic production of HFCS using maize imported from the United States into the Mexican market, thus deepening the crisis in the Mexican sugar sector – as documented by the United States Department of Agriculture.

The issues concerning bilateral trade in sweeteners between Mexico and the United States are legally relevant both to Mexico's request for the Panel to deliver a preliminary ruling and to Mexico's defence under GATT Article XX(d).

As regards Mexico's request for the Panel to deliver a preliminary ruling, the issues concerning bilateral trade in sweeteners show that the United States claims in this case are inextricably linked to a larger dispute outside the scope of the WTO. They also show that the underlying or predominant elements of the dispute between the two countries derive from rules of international law that do not come within the WTO ambit. In short, the issues to which the Panel refers concern claims that fall within the scope of other rules of international law but are at the heart of the dispute between Mexico and the United States. In Mexico's view, the United States claims in these proceedings before the WTO cannot be decided separately from Mexico's claims under NAFTA.

Regarding Mexico's defence under GATT Article XX(d), the issues concerning bilateral trade in sweeteners between Mexico and the United States explain why the Mexican Congress took action to rebalance the situation by adopting the measures in question. In other words, had the United States complied with its NAFTA obligations from the outset, Mexico would not have been compelled to implement measures in order to ensure United States compliance with NAFTA.

4. Can Parties indicate whether, in their opinion, is there anything in the North American Free Trade Agreement (NAFTA) that would prevent the United States from bringing the present case to the WTO dispute settlement system.

No. The relevant provision of NAFTA is Article 2005, which provides that:

"1. Subject to paragraphs 2, 3 and 4, disputes regarding any matter arising under both this Agreement and the *General Agreement on Tariffs and Trade*, any agreement negotiated thereunder, or any successor agreement (GATT), may be settled in either forum at the discretion of the complaining Party.

2. Before a Party initiates a dispute settlement proceeding in the GATT against another Party on grounds that are substantially equivalent to those available to that Party under this Agreement, that Party shall notify any third Party of its intention. If a third Party wishes to have recourse to dispute settlement procedures under this Agreement regarding the matter, it shall inform promptly the notifying Party and those Parties shall consult with a view to agreement on a single forum. If those Parties cannot agree, the dispute normally shall be settled under this Agreement.

3. In any dispute referred to in paragraph 1 where the responding Party claims that its action is subject to Article 104 (Relation to Environmental and Conservation Agreements) and requests in writing that the matter be considered under this Agreement, the complaining Party may, in respect of that matter, thereafter have recourse to dispute settlement procedures solely under this Agreement.

4. In any dispute referred to in paragraph 1 that arises under Section B of Chapter Seven (Sanitary and Phytosanitary Measures) or Chapter Nine (Standards-Related Measures):

- (a) concerning a measure adopted or maintained by a Party to protect its human, animal or plant life or health, or to protect its environment, and
- (b) that raises factual issues concerning the environment, health, safety or conservation, including directly related scientific matters,

where the responding Party requests in writing that the matter be considered under this Agreement, the complaining Party may, in respect of that matter, thereafter have recourse to dispute settlement procedures solely under this Agreement.

5. The responding Party shall deliver a copy of a request made pursuant to paragraph 3 or 4 to the other Parties and to its Section of the Secretariat. Where the complaining Party has initiated dispute settlement proceedings regarding any matter subject to paragraph 3 or 4, the responding Party shall deliver its request no later than 15 days thereafter. On receipt of such request, the complaining Party shall promptly withdraw from participation in those proceedings and may initiate dispute settlement procedures under Article 2007.

6. Once dispute settlement procedures have been initiated under Article 2007 or dispute settlement proceedings have been initiated under the GATT, the forum selected shall be used to the exclusion of the other, unless a Party makes a request pursuant to paragraph 3 or 4.

7. For purposes of this Article, dispute settlement proceedings under the GATT are deemed to be initiated by a Party's request for a panel, such as under Article XXIII:2 of the *General Agreement on Tariffs and Trade 1947*, or for a committee investigation, such as under Article 20.1 of the Customs Valuation Code."

5. If, as requested by Mexico, the Panel were to decline to exercise its jurisdiction in favour of NAFTA, could the Parties please comment how the NAFTA system would deal comprehensively with all the issues that Mexico considers affect the bilateral trade in sweeteners between Mexico and the United States. Could the Parties please also comment whether the NAFTA system could provide the same remedies that the United States is seeking in this case under the WTO.

As Mexico explained in its First Written Submission and its oral arguments at the meeting with the Panel – and as confirmed by the representative of the United States – Mexico's request for the establishment of a NAFTA Chapter Twenty arbitral panel remains valid and the dispute is still pending. The case has not moved forward because the United States has refused to appoint panelists.

The Panel will recall that the United States invokes only Article III of the GATT 1994 in these proceedings and that NAFTA Article 301 expressly incorporates that Article. Therefore, this dispute falls within both the NAFTA and the WTO ambits.

Since Mexico has requested the Panel to decline jurisdiction in favour of the NAFTA forum, and notwithstanding the Article 2005 requirement to select a forum, Mexico agrees to submit the dispute as a whole, including the United States claims under Article III of the GATT 1994 (and NAFTA Article 301), to a NAFTA Chapter Twenty arbitral panel.

Concerning the question whether the NAFTA dispute settlement system provides the same remedies that the United States is seeking under the WTO, Mexico notes that: (i) The WTO obligation invoked in this case, i.e. Article III, is expressly and fully incorporated in NAFTA, so that the right of action is the same; and (ii) if it is found that a party has breached a NAFTA obligation, Articles 2018 and 2019 relating to implementation and non-implementation of the final report of an arbitral panel, including the matter of suspension of benefits, are equivalent to the WTO provisions and might even prove more effective, since there are fewer stages in NAFTA than under the DSU.

In this connection, it should be pointed out that NAFTA Chapter Twenty is derived from the GATT dispute settlement system and the Uruguay Round document known as the Dunkel text.

6. If, as requested by Mexico, the Panel were to decline to exercise its jurisdiction in favour of NAFTA, could the Parties please comment whether the United States right to request a panel under NAFTA to examine the claims that have been brought to this Panel may be affected by the United States having previously brought this same case to the WTO.

See Mexico's response to question 5.

7. Could the Parties please inform the Panel what is the present state of the dispute that Mexico has brought against the United States under NAFTA concerning the bilateral trade in sweeteners.

In its First Written Submission (see paras. 66 to 77), Mexico gave a detailed account of the development and current state of the proceedings initiated by Mexico under NAFTA Chapter Twenty. The representative of the United States confirmed at the Panel meeting that Mexico's request for the establishment of an arbitral panel remained valid and that the dispute was still pending (it was listed as pending on the website of the Office of the United States Trade Representative until March of this year and, although it was removed from the list shortly before these WTO proceedings began, the United States has confirmed that it remains pending).

The NAFTA proceedings stalled at the stage of constituting the arbitral panel because of the United States' refusal to appoint panelists and to agree on the appointment of a chairperson, in addition to the instructions given to its own Section of the NAFTA Secretariat (an administrative unit answerable to the Department of Trade) not to do so, subsequent to Mexico's insistence. To date, more than four years after Mexico requested the establishment of an arbitral panel – and more than six years after the initiation of the procedure through its request for consultations – the panel has not been established.

Although negotiations between the two Parties have been conducted at various times since NAFTA came into effect, they have proved fruitless.

The Mexican sugar industry underwent a serious crisis during that period. Concern over the financial situation of sugar mills and the economic and social effects that further deterioration might have entailed for the sector compelled the Federal Government to intervene in September 2001 by expropriating 27 of the country's 61 sugar mills. The expropriation process re-established a certain degree of financial stability, but the surpluses remained without finding their way into the United States market and represented a continuing threat to the sector. The Mexican Congress accordingly decided to take measures to rebalance the country's sweeteners sector.

Mexico notes that the adoption of the tax was welcomed with enthusiasm by the United States industry because agreement had been reached between the two countries. Unfortunately but predictably, such enthusiasm dropped off when the United States initiated these proceedings before the WTO and when three firms producing HFCS for the Mexican market brought NAFTA Chapter Eleven claims for damages against Mexico.

8. The Panel has noted that in paragraph 2(g) of the written version of its oral statement dated 2 December, Mexico has stated that it "triggered the dispute settlement mechanism [in NAFTA]" ("activó el mecanismo de solución de controversias") concerning its complaint against the United States related to the bilateral trade in sweeteners. Could the Parties please clarify when are dispute settlement procedures in NAFTA considered to have been triggered ("activados").

The NAFTA dispute settlement mechanism comprises three stages, each stage having to reach completion before the next one can be initiated.

First, Article 2006 provides that any Party may request consultations with any other Party regarding any actual or proposed measure or any other matter that it considers might affect the operation of the Agreement. Mexico formally requested consultations with the United States on 13 March 1998. The consultations took place on 15 April 1998 but failed to resolve the matter.

Second, Article 2007 provides that if the consulting Parties fail to resolve a matter pursuant to Article 2006 within a specified period (45 days at most), any of the Parties may request in writing a meeting of the Free Trade Commission (FTC). The FTC is comprised of the foreign trade ministers of the three Parties to NAFTA. Mexico initially requested a meeting of the FTC on 13 November 1998 and confirmed its request on 5 January 1999. The FTC eventually convened on 15 November 1999, but this too failed to settle the dispute.

Third, Article 2008 provides that if the FTC has convened pursuant to Article 2007(4), and the matter has not been resolved within a specified period, any consulting Party may request in writing the establishment of an arbitral panel. On delivery of the request, the FTC is required to establish an arbitral panel, comprising five members, two of whom are appointed by each Party and the chairperson is selected by agreement among the Parties or chosen by lot among the members of a roster of panelists, which should have been drawn up by the FTC when the treaty entered into force but has not been established to date (basically as a result of the United States' refusal). In the absence of such a roster, there is no mechanism for appointing panelists if a Party refuses to do so. Mexico formally requested the establishment of a panel, in accordance with NAFTA Article 2008, on 17 August 2000. The panel has not been constituted so far.

NAFTA does not regard the consultations stage under Article 2006 as part of the dispute proceedings, and establishes the "initiation of procedures" as of the time of the request to the FTC. The consultations stage must be completed, however, before a meeting of the FTC can be requested.

Thus, when Mexico said that it "triggered" ("activó") the dispute settlement procedures, it was referring to the initiation of the procedure through the submission of its request for consultations on 13 November 1998, that is, more than six years ago.

9. The Panel notes that, in its first submission dated 1 November, Mexico did not present any responses as to the substance of the alleged violations of Article III of the GATT 1994 claimed by the United States in its first submission (except by saying that any violations would be justified under Article XX(d) of the GATT). Could the Parties please comment what conclusions, if any, should the Panel draw from Mexico's lack of response on the claims under Article III. Should the Panel consider the evidence on the record and, drawing the appropriate legal conclusions from the fact that Mexico has not raised any substantive defence against the United States' claims under Article III, undertake an examination of whether the conditions required by the different provisions of Article III are met, before making its findings?

The only conclusion that the Panel should draw from Mexico's decision not to respond on the United States claims under GATT Article III is that (assuming that the Panel takes jurisdiction) Mexico has no objection to the Panel proceeding with consideration of its defence on the basis of the presumption that the measures at issue are inconsistent with Article III of the GATT 1994. This does not mean that Mexico agrees that its measures are in effect inconsistent.

Neither does the above mean that the Panel could make its findings without prior examination of whether the conditions required by the different provisions of Article III are met. In this regard, Mexico notes that the United States, as the complaining party, bears the burden of making a prima facie case that these conditions are met, on the basis of the facts of this case. In accordance with the general principles of international law, the burden of proof rests with the asserting party:

"As for the burden of proof, ... we note that it is for the party asserting a fact, claim or defence to bear the burden of providing proof thereof. Once that party has put forward sufficient evidence to raise a presumption that what is claimed is true, the burden of producing evidence shifts to the other party to rebut the presumption. Thus, in this case, including the claims under Articles III and X, it is for the United States to bear the burden of proving its claims. Once it has raised a presumption that what it claims is true, it is for Japan to adduce sufficient evidence to rebut any such presumption."²

In *Turkey – Textiles*, the Panel summed up the rules on burden of proof as follows:

- "(a) it is for the complaining party to establish the violation it alleges;
- (b) it is for the party invoking an exception or an affirmative defense to prove that the conditions contained therein are met; and
- (c) it is for the party asserting a fact to prove it."³

Mexico's decision not to respond on the United States claims does not release the United States from the obligation to prove the facts it asserts and to establish the alleged violations.

10. In its oral statements, the European Communities raised issues concerning the treatment accorded in Mexico to soft drinks sweetened with beet sugar. Could Parties share

² *Japan – Film*, Report of the Panel, para. 10.372.

³ *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/R, Report of the Panel, adopted on 19 November 1999, para. 9.57.

with the Panel any views they may have regarding the treatment accorded in Mexico to soft drinks and syrups sweetened with products different from cane sugar and High-Fructose Corn Syrup (HFCS), such as, for example, beet sugar and saccharine. Would these soft drinks and syrups (those sweetened with products different from cane sugar and HFCS) be covered by the scope of the United States' claims?

The only soft drinks, syrups or concentrates for preparing soft drinks that are exempt from the IEPS are those sweetened with cane sugar. Soft drinks sweetened with any other sweetener are subject to the tax.

11. Could the Parties please clarify whether, in their opinion, a measure, as applied to a product, may be at the same time an "internal tax measure" for such a product within the meaning of Article III:2 of the GATT, as well as a "law or regulation affecting the use" of such product within the meaning of Article III:4.

Mexico understands this question as stemming from the United States contention regarding the consistency of the measures at issue with Article III:2 and III:4 of the GATT 1994. Mexico believes that the United States, as the complaining party, bears the burden of establishing that the measures are covered by both Article III:2 and Article III:4. Mexico has already indicated that it does not intend to respond on the United States claims in this respect, but it wishes to emphasize that prior WTO findings suggest that "internal taxes or other internal charges" should be examined in the light of Article III:2.

In *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, the Panel considered whether the measures at issue, in establishing a mechanism for the collection of certain taxes, were covered by Article III:2. The Panel found that the measures imposing charges generated a pecuniary burden and, as such, fell within the scope of Article III:2:

"We consider that RG 3431 and RG 3543 are properly viewed not as taxes in their own right, but as mechanisms for the collection of the IVA and IG. What is special, however, about RG 3431 and RG 3543 as mechanisms for the collection of the IVA and IG is that they provide for the imposition of charges. We recall that Article III:2 covers "charges of any kind" (emphasis added). The term "charge" denotes, *inter alia*, a "pecuniary burden" and a "liability to pay money laid on a person...". There can be no doubt, in our view, that both RG 3431 and RG 3543 impose a pecuniary burden and create a liability to pay money. Moreover, the charges provided for in RG 3431 and RG 3543 represent advance payments of the IVA and IG. RG 3431 and RG 3543 in effect impose on importers part of their definitive IVA and IG liability. It is clear to us, therefore, that the charges in question qualify as tax measures. As such, they fall to be assessed under Article III:2."⁴

This suggests that if the measure is a tax it should be assessed under Article III:2.

12. Could the Parties please comment whether, in their opinion, the Panel could accept the contentions made by the United States of the issues regarding their claims under Article III of the GATT and at what level. Is there any difference in the manner in which the Panel should treat facts and legal arguments in the case?

Please refer to Mexico's response to question 9.

⁴ *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/R and Corr.1, Report of the Panel, adopted on 16 February 2001, paras. 11.143 and 11.144.

13. Are any soft drinks or sweetened syrups other than those sweetened with cane sugar exempted from the tax? Are soft drinks or sweetened syrups from any particular origin exempted from the tax?

The only soft drinks, syrups or concentrates for preparing soft drinks that are exempt from the IEPS are those sweetened with cane sugar, regardless of their country of origin.

14. Does the difference in the treatment between "transfers" and "importations", if there is such a difference, also apply to the tax imposed by Mexico on the "agency, representation, brokerage, consignment and distribution" of imported soft drinks and sweetened syrups?

No. The agency, representation, brokerage, consignment and distribution tax is determined in the same manner for both domestic and imported products.

15. In the view of the Parties, are sweeteners, when they are used as inputs in the preparation of soft drinks and syrups, subject to the tax measures at issue in this case, or are taxes only applied to the soft drinks and syrups?

The tax applies to soft drinks, syrups or concentrates as final products, whether for direct consumption or for addition of only natural or mineral water for consumption. In other words, if the above-mentioned products are prepared with different raw materials, these will not be subject to the IEPS because they are not included in the scope of the law.

16. In paragraph 17 of the written version of its oral statement dated 3 December, the European Communities stated that "the Panel may take into account that at the time [the] Mexican measure was imposed, a certain percentage of soft drinks produced in Mexico were equally sweetened with HFCS, and thus affected by the higher taxation." Could Parties please share with the Panel any comments they may have on this assertion and what consequences, if any, should this fact have for the Panel's analysis.

The statement by the European Communities is broadly correct. When the measure was imposed, both sugar and HFCS were being used as sweeteners by the Mexican soft drinks industry. The decision by the Mexican Congress to impose the IEPS was prompted by the fact that HFCS was displacing Mexican sugar away from the soft drinks market segment while Mexico was impeded, as a result of the actions and omissions of the United States, from exporting its surplus sugar to the United States. The issue raised by the European Communities to which the Panel refers is therefore relevant to the Panel's analysis of the underlying purpose of Mexico's measures.

17. China expressed in its oral statement of 3 December that "when the tax law says that it is applicable to a product... the scope of taxation will not extend to the components of the taxed product." Do Parties have any comment on this assertion?

Please refer to the response to question 15.

18. Could the Parties please inform the Panel whether they agree that imported soft drinks and sweetened syrups are "alike" to Mexican domestic soft drinks and sweetened syrups. Do the Parties consider that imported soft drinks and sweetened syrups are "directly competitive or substitutable" with Mexican domestic soft drinks and sweetened syrups.

Mexico repeats that it has not taken any position on the issues whether imported soft drinks and sweetened syrups are "like" Mexican domestic soft drinks and sweetened syrups, or imported soft drinks and sweetened syrups are "directly competitive or substitutable" products in respect of Mexican soft drinks and sweetened syrups. As Mexico states in its response to question 41, it has no

objection to the Panel proceeding on the basis of the presumption that the measures at issue are inconsistent with Article III of the GATT 1994.

However, Mexico recalls that it is for the United States, as the complaining party in this dispute, to adduce sufficient evidence to raise the presumption that each of its claims is true, including its claims that imported soft drinks and sweetened syrups are "like" domestic soft drinks and sweetened syrups and imported soft drinks and sweetened syrups are "directly competitive or substitutable" products in respect of Mexican soft drinks and sweetened syrups.

19. Could the Parties please also inform the Panel whether they agree that High-Fructose Corn Syrup (HFCS) is "alike" to cane sugar, for the purpose of Article III:4.

Mexico repeats that it has taken no stand on the question whether HFCS is "like" cane sugar for the purposes of Article III:4. As Mexico argued at paragraph 112 of its First Written Submission, HFCS and cane sugar are substitutable products in certain applications.

Moreover, Mexico emphasizes that in order to establish a violation of Article III:4, three elements have to be shown, i.e., that the imported and domestic products at issue are "like products"; that the measure at issue is a "law, regulation or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution or use"; and that the imported products are afforded treatment no less favourable than that accorded to like products of national origin.

As the complaining party in this dispute, it is for the United States to show each one of those elements. This means that the United States must come forward with sufficient evidence to raise a presumption, including that HFCS is "like" cane sugar for the purposes of Article III:4.

20. China expressed in its oral statement of 3 December its opinion that the question of "whether the conclusion that cane sugar and HFCS are 'like products' under Article III:4 [cannot] be exclusively established by referring to the analysis on 'directly competitive and substitutable product' in the meaning of Article III:2 second sentence." Do Parties have any comment on this assertion?

Mexico has no particular comments to make on China's assertion. It would merely recall that in *Japan – Taxes on Alcoholic Beverages*, the Appellate Body explained the possible differences in the "likeness" of products, depending on the provisions in question. In order to show that the meaning of the term "like products" varies according to different provisions of the WTO Agreements, the Appellate Body evoked the image of an accordion:

"No one approach to exercising judgement will be appropriate for all cases. The criteria in *Border Tax Adjustments* should be examined, but there can be no one precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply. We believe that, in Article III:2, first sentence of the GATT 1994, the accordion of "likeness" is meant to be narrowly squeezed."⁵

The Appellate Body also found that "directly competitive or substitutable" is a broader category and that "[h]ow much broader that category of "directly competitive or substitutable

⁵ WT/DS8, DS10 & DS11, Report of the Appellate Body, adopted on 1 November 1996, p. 21.

products" may be in any given case is a matter for the panel to determine based on all the relevant facts in that case".⁶

21. If the tax measures imposed by Mexico have any effect on High-Fructose Corn Syrup (HFCS), in the view of the Parties, should they be more properly examined in this regard – with respect to their effect on HFCS – under Article III:2 or under Article III:4 of the GATT 1994?

Mexico's position is that the Panel should decline jurisdiction and refer consideration of the merits of the United States claims under Article III:2 and III:4 of the GATT 1994 to a NAFTA arbitral panel. Mexico stresses that NAFTA Article 301 expressly incorporates Article III of the GATT 1994. Should the Panel reject Mexico's request for a preliminary ruling, Mexico considers that the burden of proving that the measures at issue apply to and have an effect on HFCS rests with the United States as the complaining party. Furthermore, since the United States has raised both Article III:2 and Article III:4 in respect of the effects on HFCS of the measures at issue, it is for the United States to make a prima facie case that meets all the criteria in both provisions, based on the facts of this case.

22. Could the Parties please comment whether, in their opinion, the bookkeeping and reporting requirements identified by the United States inter alia in paragraph 4.(2) of its first submission should be considered as separate measures from the tax on soft drinks and the distribution tax. In the opinion of the Parties, should the Panel make a separate determination on the consistency of those bookkeeping and reporting requirements with the provisions of the GATT 1994, even if it found that the tax on soft drinks and the distribution tax were inconsistent with the GATT 1994?

The bookkeeping requirements are laid down in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* (Regulations of the Law on the Special Tax on Products and Services) published on 15 May 1990, the *Resolución Miscelánea Fiscal Para 2003* (Miscellaneous Tax Decision For 2003, Title 6) published on 31 March 2003, and the *Miscelánea Fiscal Para 2004* (Miscellaneous Tax Decision For 2004, Title 6) published on 30 April 2004. These instruments are regulations of the Law on the IEPS and relate to the administration of various aspects of the IEPS.

As such, they are elements of the same measure and are inseparably linked to it.

23. Could the Parties please comment whether, in their opinion, the bookkeeping and reporting requirements identified by the United States, inter alia in paragraph 4.(2) of its first submission, should be considered as internal measures which affect the internal use of High-Fructose Corn Syrup (HFCS).

Please refer to the response to question 22.

24. In paragraph 6 of the written version of its oral statement dated 3 December, Guatemala stated that "the Panel should respond to Mexico's request and consider, in its deliberations, the importance that the sugar activity has in Mexico and the implications for the country of the reforms undertaken in this sector". Could Parties share any views they may have regarding Guatemala's statement and, particularly, in what manner, if any, should the Panel consider it in its deliberations the factors highlighted by Guatemala.

The Panel should consider the factors highlighted by Guatemala in considering Mexico's defence under Article XX(d) of the GATT 1994. These are relevant factors for the interpretation and application of Article XX in the circumstances of this dispute. For example, given the importance of the Mexican sugar industry, the Panel, in weighing up and assessing whether the measures at issue are

⁶ *Id.*, p. 25.

"necessary" within the meaning of Article XX(d), should consider that implementation of the United States NAFTA market access commitments regarding sugar is a vital interest of Mexico. To paraphrase the words of the Appellate Body in *Korea – Various Measures on Beef*, the more vital or important those common interests or values are, the easier it will be to accept as "necessary" a measure designed as an enforcement instrument.⁷ The measures are also relevant in light of Mexico's status as a developing country.

25. Could the Parties please confirm whether they consider that Article XX(d) of the GATT 1994 would justify measures adopted by one Member which are "necessary to secure compliance" by another Member with international obligations arising from a treaty which is not part of the WTO "covered agreements". Are there any WTO or GATT precedents which could be relevant for this question?

Mexico considers that, in the circumstances of this case, the Mexican measures are justifiable under Article XX(d) as "necessary to secure compliance" by another Member with its international obligations arising from a treaty which is not part of the WTO "covered agreements". As far as Mexico is aware, there are no WTO or GATT precedents for this question. Mexico also underscores that there are no prior WTO or GATT findings that exclude such an interpretation. However, as discussed in the response to question 26, Article XX should be interpreted in an organic manner, in keeping with developments on the international playing field.

As regards the United States position that, although a "law", NAFTA is not part of the "laws" of the kind contemplated in Article XX(d), Mexico notes that this finds no basis either in the text of the Article itself or the covered agreements, or in the negotiating history or case law. Article 38 of the Statute of the International Court of Justice includes among the sources of international law "(a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states".⁸

The United States routinely labels its papers and arguments in the NAFTA context as "legal submissions". To illustrate this point, Mexico refers the Panel to the United States NAFTA Chapter Eleven argumentation in *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*. A few extracts from the U.S. Counter-Memorial show that the United States refers to its "legal argument"⁹; submits that, "as a legal matter", the claimants in this case did not attempt to meet "the requisite elements of the national treatment standard"¹⁰; and agrees that an Article invoked by the claimants stipulates a "standard of treatment established by customary international law" and that a certain phraseology in respect of this standard has been incorporated by the United States "into its various bilateral investment treaties"¹¹. There is no doubt whatsoever that NAFTA, as an international treaty that is to be interpreted in accordance with the rules of customary international law, is a law.¹²

As regards prior WTO or GATT findings, Mexico is of the view that Article XX should be interpreted in conformity with the rules of customary international law, having regard to developments on the international legal scene since the negotiation of Article XX in 1947. In particular, the community of States is more concerned today about the protection of trade interests than it was when the GATT was negotiated. A review of Article XX exceptions shows that only three

⁷ WT/DS169/AB/R, Report of the Appellate Body, adopted on 10 January 2001, paras. 161-163.

⁸ Article 38(1) of the Statute of the International Court of Justice.

⁹ Exhibit MEX-32. Extracts from the Counter-Memorial of the United States of America in *The Loewen Group, Inc. and Raymond L. Loewen v. The United States of America*, footnote 1.

¹⁰ *Id.*, p. 118.

¹¹ *Id.*, p. 172.

¹² See NAFTA Article 102:2.

expressly or implicitly concern an activity that could arise *within* the territory of the Member seeking to justify its measures.¹³ There is nothing in the other exceptions to suggest territorial delimitation of their application, and it can be assumed that the GATT negotiators foresaw that Article XX would be able to respond to developments on the international scene.

A good example of such developments is the *US – Shrimp* case, in which the United States was able to justify measures inconsistent with Article XI of the GATT 1994 on the grounds that they were measures "necessary to protect animal life or health" and "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption". Nothing in the wording of the relevant Article XX exceptions establishes territorial delimitation, and the United States considered that it was entitled to adopt trade restrictions with regard to activities carried out in the territorial waters or exclusive economic zones of other Members.¹⁴

If subparagraphs (b) and (g) can involve measures by other States or activities conducted outside the territory of the Member that invokes Article XX, then the same logic obviously applies to subparagraph (d), which can be interpreted along similar lines.

US – Shrimp illustrates another point already raised by Mexico in its First Written Submission, namely the Appellate Body's readiness to permit the United States to justify a measure under GATT Article XX without this requiring the conclusion of an international agreement on fisheries resources. Specifically, the Appellate Body stated:

"Under the chapeau of Article XX, an importing Member may not treat its trading partners in a manner that would constitute 'arbitrary or unjustifiable discrimination'. With respect to this measure, the United States could conceivably respect this obligation, and the conclusion of an international agreement might nevertheless not be possible despite the serious, good faith efforts of the United States. Requiring that a multilateral agreement be *concluded* by the United States in order to avoid 'arbitrary or unjustifiable discrimination' in applying its measure would mean that any country party to the negotiations with the United States, whether a WTO Member or not, would have, in effect, a veto over whether the United States could fulfill its WTO obligations. Such a requirement would not be reasonable. For a variety of reasons, it may be possible to conclude an agreement with one group of countries but not another. The conclusion of a multilateral agreement requires the cooperation and commitment of many countries. In our view, the United States cannot be held to have engaged in 'arbitrary or unjustifiable discrimination' under Article XX solely because one international negotiation resulted in an agreement while another did not."¹⁵ [Emphasis added.]

The Appellate Body was not prepared to prevent a Member from adopting measures that would otherwise have been contrary to the GATT, on the grounds that the *bona fide* efforts by that Member to negotiate an international agreement had proved fruitless.

The same principles should apply with regard to Article XX(d). Mexico has provided ample evidence of its *bona fide* efforts, throughout the relevant period, to resolve the dispute before being compelled to adopt the measures now being complained of. (In this connection, Mexico notes that the United States has formally acknowledged that it has "a dispute with Mexico over the precise terms of

¹³ I.e., subparas. (c), (g,) and (i).

¹⁴ Not only in the *Shrimp* case but also in *US – Tuna* the United States considered that Article XX entitled it to respond under that Article to actions by other States relating to its natural resources.

¹⁵ *US – Shrimp (Article 21.5 – Malaysia)*, para. 123.

those NAFTA obligations"¹⁶, although it was quick to add that, in its view, it has been "acting in full conformity with our obligations regarding sugar under the NAFTA").

The United States' consistent thwarting of Mexico's efforts to constitute an arbitral panel to decide whether the United States has met its international obligations under NAFTA contradicts the firmness with which the latter assertion was made. A State which affirms that it fully complies with its obligations under a given treaty has nothing to fear from submitting to the jurisdiction of an arbitral panel.

26. Do Parties consider that the manner in which the US – Shrimp case was resolved in the WTO, and particularly the manner in which efforts at international cooperation were taken into account in the analysis of the defence under Article XX of the GATT, is relevant for the present case?

Mexico considers that the manner in which *US – Shrimp* was resolved in the WTO is highly relevant for the present case. In its response to question 25, Mexico gave its views on the relevance of two matters at issue in *US – Shrimp* which this Panel should address.

The *US – Shrimp* case also provides an example of the Appellate Body's evolutionary interpretation of WTO law in considering rules of international law which lie outside the ambit of the WTO. For instance, the Appellate Body interpreted the chapeau of Article XX, "seeking additional interpretative guidance, as appropriate, from the *general principles of international law*", particularly the principle of good faith and the doctrine of *abus de droit*.¹⁷ [Emphasis added.] It also found that the term "exhaustible natural resources" in Article XX(d) "must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment [not as it was understood in 1947]".¹⁸ To Mexico's mind, that same reasoning applies in the case of Article XX(d). Given the importance of international law and treaty compliance in present-day international relations, a restrictive interpretation should be dismissed.

Comments on questions for the United States

Mexico reserves the right to comment in its second written submission on the responses by the United States. Nevertheless, it respectfully submits the following preliminary remarks.

Mexico would be interested to see and examine the United States response to question 32. Mexico wishes to emphasize that, notwithstanding the apparent simplicity of the United States claim, it believes that the United States intends to remain in breach of its international obligations and once again to disrupt the balance in bilateral trade in sweeteners achieved through application of the IEPS.

Mexico would be interested to see the response of the United States to question 33. In the NAFTA Chapter Twenty case, Mexico has so far:

- held informal consultations with the United States;
- held formal Article 2006 consultations with the United States;
- twice requested meetings of the Free Trade Commission with a view to reaching agreement under Article 2007;

¹⁶ Closing statement of the United States at the first substantive meeting, para. 9.

¹⁷ Report of the Appellate Body, WT/DS58, adopted on 6 November 1998, para. 158.

¹⁸ *Id.*, para. 130.

- requested the establishment of an arbitral panel and has sought to appoint panelists to that end;
- given the United States' refusal, attempted to have the U.S. Section of the NAFTA Secretariat nominate the panelists who had not been appointed;
- after the United States stalled the procedure, held numerous consultations and negotiations with U.S. officials with a view to resolving the problem; and
- urged industries in both countries to negotiate an agreement that could serve as a basis for an accord between the two governments.

In the meantime, as HFCS continued to displace sugar in the Mexican market, the United States allowed only small quantities of Mexican sugar to enter its own market. The only options for Mexico's sugar mills – at a time when pressure from sugar surpluses (largely generated by competition with HFCS) exacerbated the serious economic crisis affecting the sector – were either to undergo vast losses by disposing of surplus production in the global market at extremely low prices compared to those in the United States and Mexican markets, or to place the sugar in storage and bear the high costs and the price pressures that might ensue. As regards the latter option, Mexico points out that the Government *inter alia* subsidized the storage of 600,000 tonnes of sugar. Meanwhile, the United States is seeking to maximize the economic benefits – by restricting access for Mexican sugar to its market and attempting to disrupt the balance achieved through the IEPS – for its own sugar, HFCS and maize industries, so that the Mexican market alone would suffer the effects, regardless of the potential economic and social consequences. Penetration of HFCS in the Mexican market resulted solely from NAFTA, just as Mexico's rights to access the United States sugar market arise only from NAFTA. The United States' refusal to honour its international commitments entitles Mexico to take measures to restore the *status quo ante*.

FOR MEXICO:

34. Mexico has stated in paragraph 94 of its first submission that "this Panel has certain implied jurisdictional powers that derive from its nature as an adjudicative body". This implied or incidental jurisdiction would include the power to decide whether it should refrain from exercising substantive jurisdiction that has been validly established. At the same time, Mexico seems to recognize that the United States has the right to bring this case to the WTO dispute settlement system. Could Mexico please confirm whether it indeed believes the United States has this right.

Mexico does not dispute the fact that the United States is entitled to recourse under the WTO dispute settlement mechanism and may request the establishment of a panel. Nonetheless, the right of a WTO Member to resort to WTO dispute settlement does not preclude another WTO Member from requesting the Panel to decline jurisdiction. Mexico's request is perfectly legitimate in the extraordinary circumstances of this case, especially in view of the existence of a forum that is in a better position to address the whole of the dispute between the two countries.

Furthermore, the right of the United States to bring this case before the WTO is not absolute. Any panel clearly has discretion to refrain from exercising substantive jurisdiction in certain circumstances. Mexico refers to such powers at paragraphs 30 to 36 of its oral statement at the first substantive meeting with the Panel. It also does so in its response to question 35, in connection with its responses to questions 1 and 2.

35. Could Mexico please clarify, in its opinion, what would be the legal base for these specific jurisdictional powers and for the discretion that the Panel may have under those powers to abstain from exercising its jurisdiction. Could Mexico please clarify what bearing, if any, would Articles 7 and 11 of the WTO Dispute Settlement Understanding have on its reply. Would Mexico's request affect in any way the terms of reference for this Panel approved by the WTO's Dispute Settlement Body on 6 July 2004?

Mexico has already explained the legal base for its request for a preliminary ruling in paragraphs 30 to 36 of its oral statement at the first substantive meeting and in its responses to questions 1 and 2. Mexico believes that the implied or incidental jurisdiction mentioned earlier is also inherent in the terms of reference of panels, which are international tribunals within the meaning of international law.

Articles 7 and 11 of the DSU laying down the terms of reference and function of WTO panels do not prevent panels from exercising such implied or incidental powers to decline substantive jurisdiction in certain circumstances, in particular the extraordinary circumstances of this case.

As regards Article 7, Mexico does not argue that the Panel has jurisdiction to decide the claim brought by the United States. Mexico's request for a preliminary ruling lies at a different level. Only once substantive jurisdiction has validly been established does a panel have implied discretion, as does any other international tribunal, to refrain from taking jurisdiction in certain circumstances. Article 7 of the DSU does not specifically address the matter.

Article 11 of the DSU requires panels to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. It also provides that a panel should "make an objective assessment of the matter before it, including an objective assessment of the facts" and "make such other findings" as may be appropriate. The Appellate Body used the phrase "make such other findings" as the basis for confirming that panels may exercise judicial economy – a legal principle applied by international tribunals that is not expressly referred to in the WTO Agreements.¹⁹ In Mexico's view, this phrase also confirms the right of panels to abstain from exercising validly established jurisdiction in certain circumstances, such as those of this case, once they have made "an objective assessment of the matter" and have found that it would be possible and more constructive in the interests of securing a fairer and more positive solution for the case to be heard by another international tribunal with jurisdiction over all of the claims at issue.

Mexico believes that its request does not in any way affect this Panel's terms of reference, because, in considering Mexico's request, the Panel would be assessing the matter submitted to the DSB by the United States and, in issuing the preliminary ruling requested by Mexico, the Panel would be making "such other findings" as would assist the DSB in discharging its responsibilities..

Lastly, Mexico notes that the United States has failed to identify any other provision or cite any other legal source in rebuttal to Mexico's argument that the Panel indeed has implied discretion to decline jurisdiction.

36. Mexico has referred in its first submission and in its oral statement to its preoccupation that findings made by this Panel could eventually have an effect on claims that in other fora are being brought against the Mexican state. Could Mexico please clarify what are these claims in other fora? In what manner does Mexico believe that the findings made by this Panel could eventually have an effect on those claims.

¹⁹ See *US – Wool Shirts and Blouses*, pp. 17-19.

As stated in its First Written Submission, Mexico is presently facing three NAFTA Chapter Eleven claims for monetary damages, involving four separate claimants, i.e., *Corn Products International, Inc.* (CPI), *Archer Daniels Midland Co.* (ADM), *A.E. Staley Manufacturing Co.* (Staley) and *Cargill*, all of which are producers of HFCS. With the exception of *Cargill*, each of these producers has submitted its claim to arbitration; *Cargill* has notified its intention to do so but has not yet been able to formally file its claim for procedural reasons. All the claimants argue that the IEPS – i.e. the very same measure that is being considered by this Panel – violates Mexico's obligations in respect of United States investors under the NAFTA chapter on investment.

The request for arbitration filed by CPI is representative of all these claims, in that it argues that the IEPS violates Articles 1102 (National Treatment), 1106 (Performance Requirements), and 1110 (Expropriation and Compensation).

Mexico would like to provide the Panel with specific information regarding these claims and the manner in which they could be affected by these WTO proceedings. As the Panel will see, Mexico cannot jeopardize its litigating position through speculation about the various ways in which the WTO proceedings could interact with Chapter Eleven proceedings and influence the tribunals concerned. Evidently, the claimants in these cases would use any finding that this Panel might make in connection with a violation of Article III as evidence that Mexico denied national treatment in breach of NAFTA Article 301 (since it incorporates GATT Article III) and would probably argue that Mexico also denied national treatment to United States investors producing HFCS for sale in the Mexican market. Mexico will have a great deal to say about the interaction between Articles 301 and 1102. However, should this Panel find a violation of Article III that is not justifiable under Article XX, the claimants will clearly demand that the Chapter Eleven tribunals base their findings on those made by the Panel.

For prudential reasons, Mexico will not go into further detail on these cases but would draw the Panel's attention to a recent instance in which it was insisted before a Chapter Eleven tribunal that a WTO ruling makes a prima facie case of breach of one or more obligations under this chapter of NAFTA. In *Canfor Corporation v. United States of America*, the claimant argues *inter alia* that the United States, in refusing to implement the DSB decision in the well-known Byrd Amendment case (formally entitled *United States – Continued Dumping and Subsidy Offset Act of 2000*), has breached NAFTA Chapter Eleven.²⁰

37. The Panel has noted that in paragraph 38 of the written version of its oral statement, Mexico has stated that the WTO case on Argentina – Poultry differs from the present case in several important aspects and that it may not be used as a precedent. Could Mexico please explain, in its opinion, in what ways do the two cases differ and why should the Argentina – Poultry case not be relevant as a precedent.

Mexico agrees that *Argentina – Poultry* differs from this case in several major respects and is therefore not a relevant precedent. First, the measure before the WTO Panel in *Argentina – Poultry* had previously been the subject of a dispute under MERCOSUR. In this case, the situation does not involve two successive claims in two separate forums in respect of the same measure adopted by a WTO Member against another WTO Member. The key difference in this case is that a WTO Member (Mexico) is seeking to secure compliance with a regional free trade agreement (NAFTA), because the regional trade treaty's dispute settlement mechanism has proved ineffective as a result of the intransigence of another WTO Member (United States).

²⁰ The United States challenged the jurisdiction of this tribunal and a hearing on jurisdiction was held from 7 to 9 December 2004. The documents and transcripts are available on the U.S. Department of State website at: <http://www.state.gov/s/c7424.htm>.

Second, as far as Mexico is aware, the measures at issue in *Argentina – Poultry* were not adopted in response to actions or omissions of the complaining party in a regional trade context. This is a crucial distinctive factor: In *Argentina – Poultry*, the claims before the WTO were not brought in the framework of a broader dispute on matters lying beyond the scope of the WTO. In other words, the disagreement between the parties did not stem from rules of international law that cannot be judicially enforced in the WTO.

To Mexico's knowledge, no WTO panel or Appellate Body has ever addressed a situation in which a WTO Member brought a claim before a WTO panel concerning a measure adopted by another Member, without the panel having jurisdiction to consider the counterclaim for breach of another international agreement. The extraordinary circumstances of this case were not present in *Argentina – Poultry*.

38. The Panel has noted that in paragraph 35 of the written version of its oral statement, Mexico has stated that it does not simply ask for the Panel to decline its jurisdiction, but that it decline its jurisdiction in favour of NAFTA? Could Mexico comment in what manner could the Panel decline its jurisdiction in favour of NAFTA. What would be, in practical terms, the significance of that action, if taken by the Panel?

The purpose of the statement in paragraph 35 was to specify that – unlike the action taken by the United States – Mexico's request for a preliminary ruling is not aimed at evading the dispute settlement system. On the contrary, Mexico is seeking to ensure that all the claims, including those before this Panel, are resolved in the appropriate forum. Mexico submits that the NAFTA Chapter Twenty dispute settlement mechanism is the only available forum that is appropriate to hear the claims of both parties in the light of all the facts and relevant rights and obligations.

Mexico considers that the Panel could decline jurisdiction in favour of NAFTA simply by deciding in favour of Mexico's request for a preliminary ruling. With such a decision, NAFTA would inevitably become the only appropriate forum for addressing the claims of both parties. However, the Panel could include in its findings the recommendation that the parties take steps to settle the dispute on trade in sweeteners under NAFTA.

In practice, the United States would not suffer any prejudice, since the claims of violation of Article III of the GATT 1994 would be heard as claims of violation of NAFTA Article 301, while Mexico could submit its own claim of breach of NAFTA provisions.

39. The Panel notes that in paragraph 105 of its first submission, Mexico has indicated that "the Panel, in the course of its deliberations, [should] give the fullest weight to Mexico's status as a developing country". The Panel has also noted that in paragraph 10 of the written version of its oral statement, Mexico has stated that "the Panel must consider [Mexico's] condition as a developing country". Could Mexico please clarify in what manner should the Panel consider Mexico's condition as a developing country in its consideration of the case. Does Mexico furthermore consider that there are any "special and differential treatment" provisions in the WTO agreements which are relevant to the present case and which should be taken into account by the Panel?

The relevant provisions of the WTO Agreements are designed to afford the developing countries more favourable treatment and specify the parameters necessary for their economic advancement. These are summed up at paragraphs 106 to 108 of Mexico's First Written Submission. Mexico considers that these provisions establish broader and more flexible parameters so that the developing countries can adopt measures to prevent or address social crises. Mexico submits that the actions taken to rebalance the situation of trade in sweeteners with the United States are consistent with the principles and objectives in the WTO provisions relating to special and differential treatment

for the developing countries. Mexico points out, moreover, that lifting the measures at issue would adversely affect the lives of millions of Mexicans and to that extent would be inconsistent with the objectives and principles of the WTO Agreements.

40. The Panel has noted that in paragraph 96 of its first submission, Mexico stated that "if the Panel does take jurisdiction, Mexico intends... to defend its actions in WTO terms". Could Mexico please elaborate on this assertion and advance, for the Panel's benefit, information on how would it defend its actions in WTO terms.

Mexico considers it inappropriate to discuss the measures at issue solely in GATT terms, since the underlying or predominant elements of this dispute derive from rules of international law that cannot be judicially enforced in the WTO. As Mexico has already explained, the United States claims cannot be divorced from the broader context of the NAFTA dispute between the parties. This is why Mexico has raised a preliminary objection that the Panel has jurisdiction over only part of the dispute, namely that part which the United States considers might be to its advantage to present.

Nevertheless, should the Panel decide to take jurisdiction, Mexico's defence is based on Article XX(d) of the GATT 1994. The statement by Mexico to which the Panel refers was merely intended to advise the Panel that, as an alternative defence, the measure being challenged is justifiable in WTO terms, that is, under Article XX(d) of the GATT 1994.

Mexico's arguments in this respect are contained in paragraphs 115 to 138 of Mexico's First Written Submission. Mexico reserves the right to expand on these arguments in its second written submission.

41. Can Mexico explain if, in its view, the tax measures challenged by the United States are consistent with Article III of the GATT.

As Mexico explained in its response to questions from the Panel at the first substantive meeting, Mexico has decided not to respond to the United States claims that the measures at issue are inconsistent with GATT Article III. Therefore, Mexico has no objection to the Panel proceeding with consideration of its defence on the basis of a presumption that the measures being challenged are inconsistent with Article III of the GATT 1994, without prejudice to Mexico's response to question 9.

42. Could Mexico provide figures on the Mexican market of sweeteners for the production of soft drinks and sweetened syrups for the most recent ten years of available information. In particular, could Mexico provide information on: (a) yearly Mexican production of High-Fructose Corn Syrup (HFCS), of cane sugar and of other sweeteners, in value and kilograms; (b) yearly Mexican consumption of HFCS, of cane sugar and of other sweeteners, in value and kilograms, by the Mexican producers of soft drinks and sweetened syrups; (c) yearly Mexican exports, if any, of HFCS, of cane sugar and of other sweeteners Could Mexico please provide figures on the Mexican market for soft drinks and on the Mexican market for sweetened syrups; and, (d) yearly Mexican imports (by origin), if any, of HFCS, of cane sugar and of other sweeteners for the production of soft drinks and sweetened syrups.

Please refer to Exhibit MEX – 33 for Mexico's responses to questions 42(a) and (b).

Please refer to Exhibit MEX – 34 for Mexico's response to question 42(c).

Mexico is trying to obtain the data requested in question 42(d).

43. Could Mexico identify the main producers of soft drinks and sweetened syrups in the Mexican market. Could it also clarify whether, for each producer, the products are sweetened with High-Fructose Corn Syrup (HFCS), cane sugar or other sweeteners.

Mexico is trying to put this information together. It has not yet been able to do so, largely because of the holiday period.

44. Could Mexico provide figures on the imports of soft drinks and sweetened syrups into Mexico and indicate which of those soft drinks and sweetened syrups are sweetened with High-Fructose Corn Syrup (HFCS), which are sweetened with cane sugar, and which are sweetened with other sweeteners.

Since all soft drinks are imported under the same tariff heading, there are no figures available to distinguish between imported soft drinks sweetened with cane sugar and imported soft drinks sweetened with HFCS.

45. Could Mexico please clarify whether the expression "transfers" ("enajenaciones") used in Article 8.I. of the Law on the Special Tax on Production and Services (Ley del Impuesto Especial sobre Producción y Servicios), includes the importation of goods. Are all imported soft drinks and sweetened syrups covered by the tax?

The term "*enajenación*" does not include importation, because the Law is divided into Chapters, one of which deals with transfer and another with importation.

Under the Law as it stands, all imported soft drinks, syrups and concentrates for preparing soft drinks are subject to taxation, regardless of whether or not they are sweetened only with cane sugar.

However, as of 1 January 2005, imported soft drinks, syrups and concentrates for preparing soft drinks will be exempt from payment of the IEPS, as long as they are sweetened only with cane sugar.

46. Does Mexico agree that, under the Law on the Special Tax on Production and Services (Ley del Impuesto Especial sobre Producción y Servicios), all soft drinks and sweetened syrups are subject to the payment of taxes, but domestic transfers of soft drinks and syrups sweetened with cane sugar are exempted?

Mexico does not agree, because transfers of soft drinks, syrups or concentrates for preparing soft drinks of Mexican origin are afforded the same treatment as domestic transfers of imported soft drinks syrups or concentrates for preparing soft drinks.

The Law on the IEPS makes no distinction in respect of the origin of the product (imported or domestic) when it comes to determining whether transfer within the national territory is subject to or exempt from the tax. The criterion for determining whether a soft drink, syrup or concentrate for preparing a soft drink is subject to or exempt from the tax at the time of transfer is whether or not the product is sweetened only with cane sugar.

47. If the answer to the question in the preceding paragraph is "yes", would the Panel be correct in its understanding that the exemption under Article 8.I.(f) of the Law on the Special Tax on Production and Services only applies to the transfer of domestic soft drinks and syrups sweetened with "cane sugar" and that it does not apply to imported soft drinks and syrups, regardless of the sweetener used (including cane sugar)? Conversely, if the answer to the question in the preceding paragraph is "no", could Mexico please provide the legal basis for

including importations within the term "transfers" and information on documented cases where importations have been granted the exemption contained in Article 8.I.?

The provision in subparagraph (g) of the Law on the IEPS regulates only the exemption concerning the transfer of soft drinks, syrups and concentrates. It does not cover the importation of such products, which is not part of the Chapter in question.

The Law on the IEPS does not provide any exceptional treatment for imports of XXX sweetened only with cane sugar.

The exception provision concerning importation of soft drinks, syrups or concentrates for preparing soft drinks sweetened only with cane sugar will come into effect on 1 January 1995.

48. Could Mexico please explain the practical manner in which the Special Tax on Production and Services (Impuesto Especial sobre Producción y Servicios) is imposed on transfers (including the importation) of soft drinks and sweetened syrups. Are all transfers subject to the tax? Which transfers, if any, are exempted? Who pays the tax at each transfer? Are there any rebates, refunds or tax credits provided for persons who pay the tax?

The IEPS is incurred in respect of all transfers or imports of soft drinks, syrups and concentrates for preparing soft drinks. The only exception in the current Law concerns the transfer of soft drinks, syrups and concentrates for preparing soft drinks which are sweetened only with cane sugar.

The tax is calculated on the sales price of soft drinks, syrups or concentrates for preparing soft drinks, at the applied (*ad valorem*) rate, and is paid by the buyer to the individual or entity effecting the transfer, the latter being required to inform the Ministry of Finance and Public Credit (SHCP) of tax payments on a monthly basis, using the appropriate official form.

There is a crediting mechanism available to taxpayers in respect of the tax incurred on the purchase of soft drinks, syrups or concentrates for preparing soft drinks and of the tax paid on imports of such goods. To trigger the crediting mechanism, the tax must have been expressly incurred by the taxpayer and be recorded separately in the supporting documentation, in accordance with the requirements of Article 29 and 29A of the Federal Tax Code.

Given that the tax is calculated on a monthly basis, and only for taxpayers with a positive balance for the relevant month, the balance may be used for the sole purpose of offsetting taxes due in the coming months, until such amount is exhausted.

There is no "tax credit" of any kind for those paying the IEPS applicable to soft drinks.

49. In paragraph 19 of the written version of its oral statement dated 3 December, the European Communities stated that "HFCS is a 'syrup or concentrate for preparing soft drinks' falling under Article 2.I(H) [of the Law], which is therefore subject to the 20% tax". Could Mexico please clarify to the Panel whether the statement made by the European Communities is correct.

Under Article 2.I(H) of the Law on the IEPS, the tax applies to syrups and concentrates for preparing soft drinks expended in open containers using automatic, electrical or mechanical devices.

In the case at hand, HFCS as such cannot be considered to be a syrup or concentrate for obtaining a soft drink, as it contains no flavouring and is used as a raw material of the final product (i.e. the soft drink).

The best example of the above is soft drinks expended in movie theatres, in which the concentrate or syrup is mixed, usually with mineral water, to produce the soft drink.

50. Could Mexico please explain the practical manner in which the bookkeeping and reporting requirements identified by the United States are imposed. Are all economic agents involved in the importation, production, distribution, sale of soft drinks and sweetened syrups subject to these requirements? Which persons or transactions, if any, are exempted?

All IEPS taxpayers are subject to the bookkeeping requirements in the Federal Tax Code, its Regulations and the Regulations of the Law on the IEPS, including a breakdown of operations by rate. Accounting records must be kept at the taxpayer's fiscal domicile for as long as may be stipulated in the Federal Tax Code.

The Regulations of the Law on the IEPS stipulates that taxpayers are to record:

- I. The value of operations or activities liable to the tax, according to the respective rates;
- II. the amount of refunds, rebates or tax credits, according to the respective rates;
- III. for producers, details of volume and value of raw materials purchased, production volumes and losses.

For the time being, only transfers of soft drinks, syrups and concentrates for preparing soft drinks sweetened only with cane sugar are exempt from payment of the IEPS. As of 1 January 2005, imports of soft drinks, syrups and concentrates for preparing soft drinks sweetened with cane sugar will be also exempt on importation.

51. The Panel has noted that in paragraph 48 of the written version of its oral statement dated 2 December, Mexico has stated that "Mexico considers that, in any event, its measures are legitimate according to international law". Could Mexico please elaborate on that assertion? Is Mexico referring in particular to its defence under Article XX of the GATT.

The assertion does not only refer to Mexico's defence under Article XX of the GATT 1994. Mexico's measures are also legitimate under customary international law, which includes the right to take action when a State impedes the operation of a regional treaty's dispute settlement mechanism.

In Mexico's view, WTO law (that is, the covered agreements) is part of the much broader corpus of rules of public international law. To that extent, the rules of customary international law continue to operate, including with respect to the obligations of each WTO Member; they are not excluded from its scope by the WTO Agreements. In other words, WTO obligations are not the only rules of international law governing relations among WTO Members. WTO obligations can always be supplemented by or vary according to the WTO Member because of other rules of international law.

The Panel needs to address these issues, however, since Mexico's measures are justified under Article XX(d) of the GATT 1994. Article XX(d) is a general exception to the disciplines of the GATT 1994 (including Article III) that is expressly provided for in the WTO Agreements. The Panel should consider these matters because of the applicability of Article XX(d) and for the reasons explained at paragraph 48 of Mexico's oral statement.

In sum, Mexico's position is that the Mexican measures are justified both under the GATT 1994 and by virtue of Mexico's international rights beyond the scope of the WTO Agreements. However, in these proceedings Mexico is not requesting the Panel to consider its measures outside the WTO ambit.

ANNEX C-2

**RESPONSES BY THE UNITED STATES TO QUESTIONS
POSED BY THE PANEL AND MEXICO AFTER
THE FIRST SUBSTANTIVE MEETING**

(20 December 2004)

QUESTIONS POSED BY THE PANEL

FOR BOTH PARTIES:

1. Mexico has alluded to the exercise of "judicial economy" as a reference for its argument that panels have certain implied jurisdictional powers that would allow them to decline from exercising substantive jurisdiction. Could Parties please comment on the relevance of the exercise of "judicial economy" in the context of Mexico's request for the present Panel to decline to exercise its jurisdiction.

Mexico is confusing two wholly separate concepts – "judicial economy" is distinct from "substantive jurisdiction."¹ Judicial economy is not a concept whereby panels decline to exercise substantive jurisdiction either over a dispute or certain claims forming the basis of a dispute. Rather, judicial economy is a concept under which panels – *recognizing that they have substantive jurisdiction and in their exercise of that jurisdiction* – decline to make findings on certain claims when resolution of such claims is not necessary in order for the panel to fulfill its mandate. A panel's mandate is to make findings to "assist the DSB in making the recommendations and providing the rulings provided for in the covered agreements."² This mandate is found in Article 11 of the DSU as well as in the standard terms of reference provided in Article 7.1 of the DSU and this Panel's terms of reference in particular. Judicial economy is a well-recognized and common-sense concept under the DSU. However, there is no basis in the DSU for a panel to decline to carry out the functions for which the DSB established it nor to disregard the tasks that the DSB assigned to it. Accordingly, the concept of "judicial economy" does not support Mexico's position that panels have certain implied jurisdictional powers to decline to exercise substantive jurisdiction.

The Appellate Body's examination of judicial economy in *Australia – Salmon* is illustrative. In that dispute, the Appellate Body accepted that panels may exercise judicial economy, but it considered the concept in keeping with the purpose of WTO dispute settlement and a panel's mandate. This is in contrast to Mexico's request for the Panel to decline jurisdiction which even Mexico admits finds no basis in the DSU or elsewhere in the WTO Agreement. The Appellate Body in *Australia – Salmon* stated:

"The principle of judicial economy has to be applied keeping in mind the aim of the dispute settlement system. This aim is to resolve the matter at issue and "to secure a positive solution to a dispute". To provide only a partial resolution of the matter at issue would be false judicial economy. A panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member

¹ The United States notes that "substantive jurisdiction" is not a term used in the DSU or the WTO agreements. Accordingly, the United States assumes that by "substantive jurisdiction" Mexico is referring to carrying out the terms of reference of the Panel.

² DSU, Art. 11.

with those recommendations and rulings in order to ensure effective resolution of disputes to the benefit of all Members.³

The Appellate Body's finding in *US – Wool Shirts* is also instructive: "A panel need only address those claims which must be addressed in order to resolve the matter in issue in the dispute."⁴ "The 'matter in issue' is the 'matter referred to the DSB' pursuant to Article 7 of the DSU."⁵ The Panel cannot resolve the matter in dispute – *i.e.*, the US claims that Mexico's tax measures are inconsistent with Article III of the GATT – unless it exercises jurisdiction over that matter and issues findings thereon.

2. Could Parties please comment whether they are of the view that there is nothing in the WTO agreements that explicitly spells out the implied jurisdictional power that panels may have that allows them to decline to exercise substantive jurisdiction, as Mexico has suggested. Or do they rather consider that there is nothing in the WTO agreements that explicitly rules out the existence of such power? If there are no such explicit rules in the WTO agreements, then what conclusions, if any, should the present Panel draw in order to respond to Mexico's request to decline to exercise its jurisdiction?

Under the provisions of the WTO Agreement, a panel lacks the power to decline to "exercise substantive jurisdiction" over a matter which has been properly brought before it. For the reasons that follow, Mexico's request not only lacks any basis in the WTO Agreement but is, in fact, incompatible with it. Specifically, Mexico's request for the Panel to decline to exercise jurisdiction over this dispute is incompatible with Articles 11 and 7 of the DSU and the Panel's terms of reference. Mexico is simply inviting the Panel to breach its obligations under the DSU just as (or perhaps because) Mexico has breached its own WTO obligations.

Article 11 of the DSU provides that panels shall make "findings as will assist the DSB in making the recommendations and in giving the rulings provided for in the covered agreements." The Panel's terms of reference provide that the Panel shall "make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in [the GATT 1994]."⁶ For the Panel to decline to exercise jurisdiction over this dispute would mean that the Panel would make no findings on the US claims that Mexico's tax measures are inconsistent with Article III of the GATT 1994. This in turn would leave the DSB unable to make any recommendations or rulings in accordance with the rights and obligations under the DSU and the GATT 1994. Such a result is incompatible with the text of the DSU. As noted above, it would require a panel to disregard the reason for its existence and the mandate given it by the DSB.

Mexico's request is also incompatible with Article 7 of the DSU and the Panel's terms of reference. Article 7.1 of the DSU states that panels (with standard terms of reference as this Panel has) are required "to examine ... the matter" referred to the DSB by the complaining party and "to make such findings as will assist the DSB" in making recommendations and rulings. Article 7.2 of the DSU further states that panels "*shall address* the relevant provisions in any covered agreement or

³ Appellate Body Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/AB/R, adopted 6 November 1998, para. 223. In *Australia – Salmon*, while the Appellate Body recognized the use of judicial economy, it did not accept that particular panel's exercise of it.

⁴ Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India (US – Wool Shirts)*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, p. 19; *see also* Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (US – Lead Bismuth II)*, WT/DS138/AB/R, adopted 7 June 2000, para. 70 (quoting the Appellate Body in *Wool Shirts*).

⁵ Appellate Body Report, *US – Wool Shirts*, p. 19, n. 30.

⁶ WT/DS308/5.Rev.1.

agreements cited by the parties" to a dispute.⁷ The Panel's own terms of reference in this dispute instruct the Panel "to examine ... the matter referred to the DSB by the United States" – the consistency of Mexico's tax measures with Article III of the GATT – and "to make such findings as will assist the DSB in making" the recommendations and rulings provided for under that Agreement.⁸

These conclusions with respect to Articles 11 and 7 of the DSU are supported by the context provided by other provisions of the DSU. Article 3.3 of the DSU provides that "[r]ecommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter *in accordance with the rights and obligations under [the DSU] and under the covered agreements.*"⁹ Article 3.7 provides that the "aim of the dispute settlement system is to secure a positive solution to a dispute,"¹⁰ and Article 3.2 states that the dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements."¹¹ Article 12.7 provides that where the parties have not resolved the dispute, "the report of the panel shall set out the findings of fact, the applicability of relevant provisions and the basic rationale behind any findings and recommendations that it makes." An approach that would permit a panel to decline to exercise jurisdiction over a dispute would be contrary to the ordinary meaning of those provisions and fail to preserve the rights and obligations at issue in the dispute.

The text of the DSU cannot be rendered *inutile*, as it would be were a panel to grant a party's request for the panel to decline to exercise jurisdiction over a dispute. As the Appellate Body recognized in the earlier case regarding Mexico's antidumping measures on HFCS, "as a matter of due process, and the proper exercise of the judicial function, panels are required to address issues that are put before them by the parties to a dispute."¹²

The United States also refers the Panel to the Appellate Body report in *India – QRs* cited by the United States in its oral statement and the panel's findings in *United States – FSC* and *Turkey – Textiles*.¹³ In the FSC dispute, for example, the United States argued that text in the SCM Agreement stating that "Members shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms" "expressly directs WTO Members to resolve certain issues raised by exemptions from direct taxes in an appropriate tax forum before resorting to WTO dispute settlement."¹⁴ The panel disagreed, stating that the text cited by the United States did not provide "a clear and unambiguous basis for circumscribing the right to resort to WTO dispute settlement at any time."¹⁵ The panel explained:

⁷ DSU Art. 7.2 (emphasis added).

⁸ WT/DS308/5/Rev.1.

⁹ DSU Art. 3.3 (emphasis added).

¹⁰ DSU Art. 3.7.

¹¹ DSU Art. 3.2.

¹² Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States (Mexico – Corn Syrup (21.5))*, WT/DS132/AB/RW, adopted 21 November, para. 36.

¹³ Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/AB/R, adopted on 22 September 1999, para. 84; Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, adopted as modified on 20 March 2000, paras. 7.12-7.19; Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products (Turkey – Textiles)*, WT/DS34/R, adopted as modified 19 November 1999, paras. 9.15-9.17 (rejecting Turkey's argument that the appropriate forum for resolution of India's claims under the GATT 1994 was in the first instance the WTO Textile Monitoring Body (TMB) and, therefore, that the panel lacked jurisdiction over the dispute until India's remedies under the TMB had been exhausted).

¹⁴ Panel Report, *US – FSC*, para. 7.12.

¹⁵ Panel Report, *US – FSC*, para. 7.19.

"Under Article XXIII of GATT 1994, the DSU and Article 4 of the SCM Agreement, a Member has the right to resort to WTO dispute settlement at any time by making a request for consultations in a manner consistent with those provisions. This fundamental right to resort to dispute settlement is a core element of the WTO system. Accordingly, we believe that a panel should not lightly infer a restriction on this right into the WTO Agreement; rather, there should be a clear and unambiguous basis in the relevant legal instruments for concluding that such a restriction exists."¹⁶

Finally, we note that Mexico does not contest that the US claims have been properly brought before this Panel and even concedes that this Panel has "*prima facie* jurisdiction" over those claims.

For all the foregoing reasons, there is absolutely no basis for the Panel to grant Mexico's request.

3. Can Parties please comment whether, in their opinion, it would be appropriate for the Panel to look at the issues concerning bilateral trade in sweeteners between Mexico and the United States which have been raised by Mexico in this case.

To the extent the Panel's question is directed at knowing whether it may interpret the provisions of the NAFTA and determine whether certain obligations thereunder have or have not been met, the answer is no. Such an examination would clearly exceed the Panel's mandate. The DSB established this Panel to "examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."¹⁷ The relevant provision of the covered agreements cited by the United States is Article III of the GATT 1994 and the matter referred to the DSB by the United States is the consistency of Mexico's tax measures with Article III of the GATT 1994.¹⁸ These terms of reference define the limited mandate for which this Panel was established. The Panel's mandate simply does not extend to examining the issues raised by Mexico that the United States has breached its NAFTA obligations with respect to market access for Mexican sugar or has "refus[ed] to submit" to dispute settlement under the NAFTA.

Moreover, it would be inappropriate for the Panel substantively to address these "bilateral trade in sweeteners" issues because, with respect to Mexico's request for the Panel to decline jurisdiction, the Panel lacks the power to decline jurisdiction over the matter for which it was established (much less in favor of dispute settlement under NAFTA) and, with respect to Mexico's Article XX(d) defense, obligations under international agreements such as the NAFTA are not "laws or regulations" within the meaning of Article XX(d).

4. Can Parties indicate whether, in their opinion, is there anything in the North American Free Trade Agreement (NAFTA) that would prevent the United States from bringing the present case to the WTO dispute settlement system.

Nothing in the WTO Agreement precludes a Member from exercising its rights under the WTO Agreement – including the right to bring a claim under the DSU – based on the terms of the NAFTA. Similarly, there is nothing in the WTO Agreement which would authorize a panel to fail to make the findings, rulings and recommendations required by DSU Article 11 based on the terms of the NAFTA. Having said this, there is nothing in the NAFTA that provides that the United States may not bring the present dispute to the WTO dispute settlement system, although the United States

¹⁶ Panel Report, *US – FSC*, para. 7.17.

¹⁷ WT/DS308/5.Rev.1.

¹⁸ WT/DS308/4.

notes that a determination of rights and obligations under the NAFTA is outside this Panel's terms of reference.

5. If, as requested by Mexico, the Panel were to decline to exercise its jurisdiction in favour of NAFTA, could the Parties please comment how the NAFTA system would deal comprehensively with all the issues that Mexico considers affect the bilateral trade in sweeteners between Mexico and the United States. Could the Parties please also comment whether the NAFTA system could provide the same remedies that the United States is seeking in this case under the WTO.

For the reasons set forth above, there is no basis in the WTO Agreement for Mexico's request that the Panel decline to exercise its jurisdiction in this dispute. This is the case regardless of how the NAFTA system would deal with matters that were not identified in the US panel request and, thus, are not within the Panel's terms of reference of this dispute.

Furthermore, not even the WTO deals "comprehensively" with issues. Mexico has raised a number of issues that are distinct, some involving measures by Mexico, some involving alleged measures by the United States. The DSU, in Article 3.10, explicitly requires that complaints and counter-complaints on distinct matters not be linked. Accordingly, Mexico could not even request the WTO to make "comprehensive" findings on these various matters, even if they were all WTO matters. Mexico certainly cannot then expect a WTO panel to seek a comprehensive solution through other means.

That said, the NAFTA system could not provide the same remedies that the United States is seeking under the WTO. To take just one example, the remedies under the NAFTA are limited to NAFTA concessions. WTO remedies are broader.

6. If, as requested by Mexico, the Panel were to decline to exercise its jurisdiction in favour of NAFTA, could the Parties please comment whether the United States right to request a panel under NAFTA to examine the claims that have been brought to this Panel may be affected by the United States having previously brought this same case to the WTO.

As discussed above, there is no basis in the WTO Agreement for Mexico's request that the Panel decline to exercise its jurisdiction in this dispute. This is the case regardless of how US NAFTA rights would be affected by this dispute.

Having said this, Article 2005(6) of the NAFTA states: "Once dispute settlement procedures have been initiated under Article 2007 or dispute settlement proceedings have been initiated under the GATT, the forum selected shall be used to the exclusion of the other, unless the Party makes a request pursuant to paragraph 3 and 4." Article 2005(3) and (4) deal with matters concerning certain environmental, health or safety related issues. Article 2005(7) states: "For purposes of this Article, dispute settlement proceedings under the GATT are deemed to be initiated by a Party's request for a panel, such as under Article XXIII:2 or the *General Agreement on Tariffs and Trade 1947*, or for a committee investigation, such as under Article 20.1 of the Customs Valuation Code."

7. Could the Parties please inform the Panel what is the present state of the dispute that Mexico has brought against the United States under NAFTA concerning the bilateral trade in sweeteners.

The United States recalls again that NAFTA dispute settlement matters are outside the Panel's terms of reference. That said, the dispute Mexico has brought against the United States under NAFTA (regarding the US tariff-rate-quota on Mexican sugar) is presently in the panelist selection stage. Prior to that stage, the United States and Mexico engaged in consultations pursuant to the

NAFTA's dispute settlement provisions, and, having been unable to resolve the matter through consultations, the NAFTA Free Trade Commission established a panel. In addition, the United States and Mexico, as well as their affected industries, have held negotiations throughout this period, as recently as October 2004 (affected industries) and March 2003 (governments of United States and Mexico).

8. The Panel has noted that in paragraph 2(g) of the written version of its oral statement dated 2 December, Mexico has stated that it "triggered the dispute settlement mechanism [in NAFTA]" ("activó el mecanismo de solución de controversias") concerning its complaint against the United States related to the bilateral trade in sweeteners. Could the Parties please clarify when are dispute settlement procedures in NAFTA considered to have been triggered ("activados").

The United States recalls again that NAFTA dispute settlement matters are not within the Panel's terms of reference. That said, it is unclear what Mexico means by "triggered the [NAFTA] dispute settlement mechanism," which consists of several phases.

9. The Panel notes that, in its first submission dated 1 November, Mexico did not present any responses as to the substance of the alleged violations of Article III of the GATT 1994 claimed by the United States in its first submission (except by saying that any violations would be justified under Article XX(d) of the GATT). Could the Parties please comment what conclusions, if any, should the Panel draw from Mexico's lack of response on the claims under Article III. Should the Panel consider the evidence on the record and, drawing the appropriate legal conclusions from the fact that Mexico has not raised any substantive defence against the United States' claims under Article III, undertake an examination of whether the conditions required by the different provisions of Article III are met, before making its findings?

The Panel should construe Mexico's lack of response on US claims under Article III of the GATT 1994 to mean that Mexico does not contest that its tax measures are in breach of its Article III obligations. The panel in *US – Shrimp* took the US statement that it did not dispute that the measure at issue "amounts to a restriction on the importation of shrimp within the meaning of Article XI:1 of GATT 1994" to mean that the United States "basically admits that a given measure amounts to a restriction prohibited by GATT 1994."¹⁹ Similarly, the panel in *Turkey – Textiles* found that "given the absence of a defense by Turkey (other than its defense based on Article XXIV of GATT) to India's claims that discriminatory import restrictions have been imposed, India has made a *prima facie* case of violation of Articles XI and XIII of GATT."²⁰ Accordingly, in this dispute the Panel should undertake a brief analysis confirming that the United States has made its *prima facie* case. In this regard, all uncontested facts presented by the United States should be accepted for purposes of the Panel's factual and legal findings in this dispute.

In light of Mexico's decision not to contest the Article III breach and the extensive evidence and argumentation the United States submitted in its first submission, the Panel should similarly conclude that the United States has made a *prima facie* case of Mexico's breach of the provisions of Article III at issue in this dispute.

10. In its oral statements, the European Communities raised issues concerning the treatment accorded in Mexico to soft drinks sweetened with beet sugar. Could Parties share with the Panel any views they may have regarding the treatment accorded in Mexico to soft drinks and syrups sweetened with products different from cane sugar and High-Fructose Corn

¹⁹ Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/R, adopted 6 November 1998, para. 7.15.

²⁰ Panel Report, *Turkey – Textiles*, para. 9.66.

Syrup (HFCS), such as, for example, beet sugar and saccharine. Would these soft drinks and syrups (those sweetened with products different from cane sugar and HFCS) be covered by the scope of the United States' claims?

Mexico's tax measures also treat beet sugar and non-nutritive sweeteners such as saccharine less favorably than cane sugar. In particular, as explained in the US First Written Submission (paras. 38-39), Mexico's tax measures (as embodied in the IEPS) apply to all sweeteners other than cane sugar and all soft drinks and syrups made with any sweetener other than cane sugar. Mexico's tax measures, therefore, afford the same less favorable treatment and impose the same excess taxation on all non-cane sugar sweeteners – including beet sugar and saccharine – and soft drinks and syrups made with those sweeteners as it does on HFCS and soft drinks and syrups made with HFCS.

The United States notes that beet sugar is chemically and functionally identical to cane sugar.²¹ It is, therefore, "like" and "directly competitive or substitutable" with cane sugar. Thus, Mexico's tax measures also breach the provisions of Article III with respect to beet sugar and soft drinks sweetened with beet sugar, and the Panel should so find. Having said this, as Mexico has made clear, its measures are intended to discriminate against HFCS and soft drinks and syrups sweetened with HFCS and this is the focus of the US complaint.

11. Could the Parties please clarify whether, in their opinion, a measure, as applied to a product, may be at the same time an "internal tax measure" for such a product within the meaning of Article III:2 of the GATT, as well as a "law or regulation affecting the use" of such product within the meaning of Article III:4.

The IEPS is both an "internal tax" on HFCS for use in soft drinks and syrups within the meaning of Article III:2 and a "law ... affecting the internal ... use" of HFCS within the meaning of Article III:4. The United States refers the Panel to its response to Question 21.

12. Could the Parties please comment whether, in their opinion, the Panel could accept the contentions made by the United States of the issues regarding their claims under Article III of the GATT and at what level. Is there any difference in the manner in which the Panel should treat facts and legal arguments in the case?

In light of the evidence and arguments set forth in the US first submission and Mexico's decision not to respond, the Panel should find that the United States has established a *prima facie* breach of each of the cited provisions of GATT 1994 Article III, as set forth in the US request for findings in paragraph 163 of its first submission. Like the panels in *US – Shrimp* and *Turkey – Textiles*, this Panel should undertake a brief analysis confirming that the US has made its *prima facie* case. In this regard, all uncontested facts should be taken as given.

13. Are any soft drinks or sweetened syrups other than those sweetened with cane sugar exempted from the tax? Are soft drinks or sweetened syrups from any particular origin exempted from the tax?

The text of the IEPS before the Panel provides that with the exception of the public sales exemption,²² all soft drinks or syrups other than those sweetened solely with cane sugar are subject to the tax.²³ Article 1(I) of the IEPS taxes the "transfer in national territory, or as applicable, the final importation, of goods identified in the Law." Article 2(I)(G) and (H) apply the 20 percent tax rate to

²¹ US First Written Submission, para. 22.

²² See US First Written Submission, para. 41 (discussing the public sales exemption).

²³ See Exhibit US-4A and US-4B (Ley Del Impuesto Especial Sobre Producción y Servicios (IEPS), Dec. 31, 2003); US First Written Submission, paras. 37-47 (quoting relevant portions of the IEPS).

the "transfer or, as applicable, the importation of" soft drinks and syrups. Similarly, Article 1(II) taxes the "provision of services indicated in this Law" and Article 2(II) applies the 20 percent tax to the provision of services (*i.e.* representation, brokerage, agency, consignment and distribution) "for the purpose of transferring" soft drinks and syrups. Articles 1 and 2 make no distinction between soft drinks and syrups based on the type of sweetener used. That distinction appears in Article 8 of the IEPS which exempts from payment of the tax "transfers" of the "goods referred to in Article 2(I)(G) and (H) of this Law, provided only sugarcane is used as a sweetener." Therefore, the only soft drinks and syrups exempt from the IEPS are those sweetened only with cane sugar.

The tax does not exempt soft drinks and syrups imported from any particular country from payment of the tax. The IEPS taxes the importation of all soft drinks and syrup regardless of the type of sweetener used.²⁴ Soft drinks and syrups of Mexican origin, however, if sweetened only with cane sugar are exempt for the IEPS.

14. Does the difference in the treatment between "transfers" and "importations", if there is such a difference, also apply to the tax imposed by Mexico on the "agency, representation, brokerage, consignment and distribution" of imported soft drinks and sweetened syrups?

The text of the IEPS before the Panel appears to distinguish between "transfers" and "importations." As mentioned above, Article 1(I) of the IEPS taxes the "transfer in national territory, or as applicable, the final importation, of goods identified in the Law." Article 2(I)(G) and (H) also specify that the tax applies to the "transfer or, as applicable, the importation of" soft drinks and syrups." Article 8 of the IEPS, however, specifies that the tax "shall not be paid [o]n the following transfers" and identifies soft drinks and syrups sweetened only with cane sugar as exempt from the tax. Article 8 does not include reference to "importation" as do Articles 1 and 2 of the IEPS. Thus, only internal transfers of soft drinks and syrups are subject to the exemption provided for in Article 8.²⁵

After importation, however, a soft drink or syrup may be transferred internally. Therefore, if that soft drink or syrup were sweetened only with cane sugar, it would be subject to the exemption provided for in Article 8.

As for the tax on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups ("distribution tax"), Article 2(II) of the IEPS states that it applies to representation, brokerage, agency, consignment and distribution "for the purpose of transferring" soft drinks and syrups. The United States understands the exemption for internal transfers of soft drinks and syrups provided for in Article 8 of the IEPS to cover both an exemption from the tax on internal transfers of soft drinks and syrups (the HFCS soft drink tax as referenced in the US first submission) and the distribution tax.²⁶

15. In the view of the Parties, are sweeteners, when they are used as inputs in the preparation of soft drinks and syrups, subject to the tax measures at issue in this case, or are taxes only applied to the soft drinks and syrups?

The IEPS applies a 20 percent tax on the importation, internal transfer and distribution of soft drinks and syrups sweetened with any sweetener other than cane sugar. The IEPS is both a tax on soft drinks and syrups and a tax on non-cane sugar sweeteners such as HFCS.

²⁴ See Exhibit US-4A and US-4B (IEPS, Dec. 31, 2003), Arts 1, 2 and 8..

²⁵ See Exhibit US-4A and US-4B (IESP, Dec. 31, 2003), Arts. 1, 2 and 8.

²⁶ See Exhibit US-4A and US-4B (IEPS, Dec. 31, 2003), Arts 1, 2 and 8..

Specifically, on the one hand, the IEPS is a tax on soft drinks and syrups – in particular on soft drinks and syrups imported from the United States where HFCS is the dominant soft drink and syrup sweetener. On the other hand, the IEPS is a tax on HFCS for soft drink and syrup use. The IEPS happens to apply this tax at the time when the soft drink or syrup containing HFCS is sold or distributed. (It should be pointed out that by doing so, Mexico is able to convert the 20 percent tax on the soft drink or syrup to a 400 percent tax on the HFCS in that soft drink or syrup). The timing of tax collection, however, does not change the fact that it is the use of HFCS as a sweetener in the soft drink or syrup that determines whether any tax is owed. Thus, even though the IEPS more directly applies to soft drinks and syrups, it is also a tax on the HFCS used to make those soft drinks and syrups. In fact, Mexico essentially concedes this point when it states that the IEPS was imposed to stop the displacement of cane sugar by HFCS.

16. In paragraph 17 of the written version of its oral statement dated 3 December, the European Communities stated that "the Panel may take into account that at the time [the] Mexican measure was imposed, a certain percentage of soft drinks produced in Mexico were equally sweetened with HFCS, and thus affected by the higher taxation." Could Parties please share with the Panel any comments they may have on this assertion and what consequences, if any, should this fact have for the Panel's analysis.

At the time the IEPS was imposed on soft drinks and syrups, some Mexican soft drink bottlers, as recounted in the US submission, were beginning to use blends of HFCS and cane sugar to sweeten their soft drinks.²⁷ By 2001, the year prior to imposition of the IEPS on soft drinks and syrups, nutritive sweetener consumption by the soft drink industry was 30 percent HFCS and 70 percent cane sugar.²⁸ The use of blends of HFCS and cane sugar by the Mexican soft drink industry demonstrates that HFCS and cane sugar as sweeteners for soft drinks and syrups are interchangeable and, prior to the tax, competed head-to-head in the Mexican market. It likewise demonstrates that soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar were also competing in the Mexican market prior to imposition of the IEPS on soft drinks and syrups. Nevertheless, at the time Mexico imposed its tax, cane sugar remained the dominant sweetener for Mexican soft drinks and syrups as compared to US soft drinks and syrups which were sweetened with HFCS.

The United States does not otherwise see the relevance of the EC's statement. In this regard, we note that the fact that some domestic producers may be affected by a measure does not excuse a breach of Article III. In the *Chile – Alcoholic Beverages* report, the Appellate Body found that, although domestic products comprised the majority of sales subject to the highest tax rate, that tax rate as applied to imported products nonetheless constituted a breach of Article III:2, second sentence. "The relative proportion of domestic versus imported products within a particular fiscal category is not, in and of itself, decisive of the appropriate characterization of the total impact of the New Chilean System under Article III:2, second sentence, of the GATT 1994."²⁹

17. China expressed in its oral statement of 3 December that "when the tax law says that it is applicable to a product ... the scope of taxation will not extend to the components of the taxed product." Do Parties have any comment on this assertion?

The United States does not agree with China's assertion. As stated in response to Question 15, the IEPS is both a tax on soft drinks and syrups and a tax on non-cane sugar sweeteners such as HFCS.

²⁷ US First Written Submission, para 34.

²⁸ US First Written Submission, para. 23 and Exh. US-8.

²⁹ Appellate Body Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, para. 67.

In any event, Article III:2 of the GATT 1994 covers taxes applied, "directly or indirectly", to imported products. China's reliance on the Ad Note to GATT Article III:2 is misplaced. The Ad Note clarifies the types of products covered by the second sentence as compared to the first sentence of GATT Article III:2 (*i.e.*, that the first sentence covers "like" products while the second covers "directly competitive or substitutable" products). It does not undo the fact that Article III:2 disciplines taxes applied, directly or indirectly, to a product. Thus, as a legal matter, the United States does not agree with China's interpretation of Article III:2 as stated in its oral statement.

18. Could the Parties please inform the Panel whether they agree that imported soft drinks and sweetened syrups are "alike" to Mexican domestic soft drinks and sweetened syrups. Do the Parties consider that imported soft drinks and sweetened syrups are "directly competitive or substitutable" with Mexican domestic soft drinks and sweetened syrups.

The United States first submission, at paragraphs 63 through 83, explains that imported soft drinks and syrups sweetened with HFCS are like products relative to Mexican domestic soft drinks and syrups sweetened with cane sugar. Paragraphs 141-145 of the same submission argue in the alternative that these two groups of products are directly competitive or substitutable.

19. Could the Parties please also inform the Panel whether they agree that High-Fructose Corn Syrup (HFCS) is "alike" to cane sugar, for the purpose of Article III:4.

HFCS is "like" cane sugar for purposes of Article III:4 as discussed in paragraphs 156-58 of the US first submission. Paragraphs 103-105 of the same submission note that in a 1998 antidumping determination on HFCS imports from the United States, the Mexican government determined that cane sugar and HFCS are "like" products for the purposes of Mexico's antidumping law and Article 2.6 of the Antidumping Agreement

20. China expressed in its oral statement of 3 December its opinion that the question of "whether the conclusion that cane sugar and HFCS are 'like products' under Article III:4 [cannot] be exclusively established by referring to the analysis on 'directly competitive and substitutable product' in the meaning of Article III:2 second sentence." Do Parties have any comment on this assertion?

The analysis presented in the US First Written Submission that HFCS is "like" cane sugar for purposes of Article III:4 is supported by more than a reference to its analyses of why HFCS and cane sugar are directly competitive or substitutable for purposes of Article III:2, second sentence. The United States refers the panel to its first submission at paragraphs 156-58.

21. If the tax measures imposed by Mexico have any effect on High-Fructose Corn Syrup (HFCS), in the view of the Parties, should they be more properly examined in this regard – with respect to their effect on HFCS – under Article III:2 or under Article III:4 of the GATT 1994?

The IEPS as a tax on HFCS may properly be examined under both Article III:2 and III:4 of the GATT 1994.

Article III:2 prohibits dissimilar taxation of imported and domestic products. Article III:4 prohibits less favorable treatment of imported products as compared to domestic products with respect to laws affecting their internal sale, use, etc. Thus, to the extent the less favorable treatment of the imported product takes the form of dissimilar taxation that affects its internal sale, use, etc., the measure at issue may constitute a breach of both Articles III:2 and III:4 of the GATT 1994.

In the context of this dispute, the measure at issue is the IEPS. The IEPS imposes a tax on HFCS for use in soft drinks and syrups; cane sugar for use in soft drinks and syrups is exempt from the tax. As a result, the IEPS applies a tax on HFCS that is not similarly applied to cane sugar within the meaning of Article III:2. Through this dissimilar taxation (a 400 percent tax on HFCS and no tax on cane sugar), the IEPS also affects the internal sale and use of HFCS and affords it less favorable treatment than cane sugar within the meaning of Article III:4. With respect to the bookkeeping and reporting requirements imposed by the IEPS, these requirements are not in themselves a tax and, therefore, are appropriately viewed as requirements affecting the internal use of HFCS within the meaning of Article III:4.

Articles III:2 and III:4 also overlap in the imported and domestic products to which they apply. The first sentence of Article III:2 addresses "like" products while the second sentence of Article III:2 addresses "directly competitive or substitutable" products. Article III:4 addresses "like" products. While the analysis of whether an imported and domestic product are "like" or "directly competitive or substitutable" under Article III:2 is not identical to the analysis of whether the products are "like" under Article III:4, there is nothing in the text of either Article that prevents "like" products within the meaning of Article III:4 from also being "like" or "directly competitive or substitutable products" within the meaning of Article III:2 or vice versa.

In the context of this dispute, HFCS and cane sugar are both "like" products within the meaning of Article III:4³⁰ and "like" and "directly competitive or substitutable" products within the meaning of Article III:2.³¹

In *Indonesia – Autos*, for example, the complaining parties argued that a local content requirement required to obtain a lower tax rate constituted a breach of Indonesia's obligations under Article 2 of the Agreement on Trade-Related Investment Measures ("TRIMS") and Articles III:2 and III:4 of the GATT 1994. Article 2 of TRIMS read in conjunction with its annex prohibits local content requirements that are inconsistent with Article III:4 of the GATT. The panel first examined whether the local content requirement was a breach of Article 2 of TRIMS and, specifically, whether the local content requirement was "inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of the GATT 1994." Having found the local content requirement a breach of Article 2 of TRIMS, the panel exercised judicial economy with respect to the separate Article III:4 claim. The panel then examined whether taxing imported cars at a higher rate because they lacked a certain percentage of local content was a breach of Article III:2, first sentence. The panel found in the affirmative. Thus, in *Indonesia – Autos*, the panel found it proper to examine the same local content requirement under both Article 2 of TRIMS (which includes examination of the measure's consistency with GATT Article III:4) and under Article III:2 of the GATT.³²

22. Could the Parties please comment whether, in their opinion, the bookkeeping and reporting requirements identified by the United States inter alia in paragraph 4.(2) of its first submission should be considered as separate measures from the tax on soft drinks and the distribution tax. In the opinion of the Parties, should the Panel make a separate determination on the consistency of those bookkeeping and reporting requirements with the provisions of the GATT 1994, even if it found that the tax on soft drinks and the distribution tax were inconsistent with the GATT 1994?

The United States considers the bookkeeping and reporting requirements, the HFCS soft drink tax, and the distribution tax to be separate measures, even though they share the common context of

³⁰ US First Written Submission, paras. 156-158.

³¹ US First Written Submission, paras. 94-130.

³² See Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted on 23 July 1998, paras. 14.83-14.117.

the IEPS and its application to soft drinks and syrups. The Panel should make findings on the consistency of each of these measures with Mexico's obligations under the GATT 1994. With respect to the bookkeeping and reporting requirements, the United States notes that imposition of these requirements on soft drinks and syrups sweetened with HFCS (or other non-cane sugar sweeteners) but not on soft drinks and syrups sweetened only with cane sugar affords imported HFCS less favorable treatment than Mexican cane sugar.³³ Regardless of whether Mexico continued to tax HFCS sweetened soft drinks and syrups dissimilarly from, or in excess of, cane sugar sweetened soft drinks and syrups, imposition of bookkeeping and reporting requirements with respect to HFCS-sweetened soft drinks and syrups (for example a requirement to report a bottler's top 50 customers) that are not also applied to cane sugar-sweetened soft drinks and syrups would continue to disadvantage the use of HFCS as compared to cane sugar as a sweetener for soft drinks in Mexico. A complete resolution of this dispute therefore requires separate findings, rulings and recommendations with respect to the bookkeeping and reporting requirements.

The United States draws attention to the Appellate Body's discussion of judicial economy in *Australia – Salmon*. There the Appellate Body found the panel in error for not making findings with respect to certain kinds of salmon. The Appellate Body explained that to make findings with respect to only one kind of salmon would leave the DSB unable to make sufficiently precise recommendations and rulings so as to allow for compliance by the defending party with its WTO obligations.³⁴

23. Could the Parties please comment whether, in their opinion, the bookkeeping and reporting requirements identified by the United States, inter alia in paragraph 4.(2) of its first submission, should be considered as internal measures which affect the internal use of High-Fructose Corn Syrup (HFCS).

The bookkeeping and reporting requirements are internal measures which affect the internal sale and use of HFCS. Specifically, the bookkeeping and reporting requirements are imposed pursuant to a Mexican law, the IEPS. The IEPS taxes the internal transfer of soft drinks and syrups sweetened with HFCS or other non-cane sugar sweeteners. The IEPS requires individuals and entities subject to the IEPS (*i.e.*, those transferring soft drinks and syrups sweetened with HFCS or other non-cane sugar sweeteners) to follow certain bookkeeping and reporting requirements. Soft drinks and syrups sweetened with cane sugar are exempt from the IEPS and, therefore, also exempt from the bookkeeping and reporting requirements.

These bookkeeping and reporting requirements include the requirements, for example, to provide an annual listing of the goods "produced, transferred or imported in the previous year, as regards consumption by state and the corresponding tax, as well as the services provided by establishment in each state" and to report quarterly "information regarding [the taxpayer's] 50 main clients and suppliers."³⁵ Compliance with these requirements demand both the time and expense of doing so in addition to the risk that business sensitive information, such as a producer's top clients and suppliers, may not be adequately safeguarded. Accordingly, the bookkeeping and reporting requirements impose a burden on the use of HFCS that is not also applied to cane sugar.

As prior panels have explained, the word "affecting" in Article III:4 of the GATT has been interpreted to cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition

³³ US First Written Submission, paras. 159-161.

³⁴ Appellate Body Report, *Australia – Salmon*, paras. 223-226.

³⁵ US First Written Submission, para. 46.

between domestic and imported products.³⁶ Imposing a burden on the use of HFCS that is not also imposed on the use of cane sugar (or, said another way, granting an advantage to the use of cane sugar that is not also granted to HFCS) has an impact on the conditions of competition between cane sugar and imported HFCS and, thus, affects the use of HFCS in Mexican soft drink and syrup production.³⁷ The Appellate Body has previously found a tax exemption granted conditional on use of domestic content to be a law affecting the internal use of an imported product.³⁸

24. In paragraph 6 of the written version of its oral statement dated 3 December, Guatemala stated that "the Panel should respond to Mexico's request and consider, in its deliberations, the importance that the sugar activity has in Mexico and the implications for the country of the reforms undertaken in this sector". Could Parties share any views they may have regarding Guatemala's statement and, particularly, in what manner, if any, should the Panel consider it in its deliberations the factors highlighted by Guatemala.

The United States does not consider that the importance of the sugar industry in Mexico is relevant to whether Mexico's discriminatory tax on HFCS soft drinks and syrups sweetened with HFCS is consistent with its obligations under Articles III:2 and III:4 of the GATT nor to whether Mexico's discriminatory tax is justified under Article XX(d). The United States also considers its domestic HFCS industry and its ability to export to Mexico important. The importance of a domestic industry does not justify discriminating against like and directly competitive or substitutable imported products. Indeed, if the suggested approach is to excuse discrimination based on the importance of a domestic industry, then such an approach would have the perverse result that the larger the adverse trade impact of the discrimination, the more easily a Member could discriminate.

25. Could the Parties please confirm whether they consider that Article XX(d) of the GATT 1994 would justify measures adopted by one Member which are "necessary to secure compliance" by another Member with international obligations arising from a treaty which is not part of the WTO "covered agreements". Are there any WTO or GATT precedents which could be relevant for this question?

Article XX(d) of the GATT does not justify measures adopted by one Member to secure compliance by another Member with international obligations arising from a treaty which is not part of the WTO "covered agreements."

The United States is not aware of any prior GATT or WTO panel or Appellate Body reports addressing whether Article XX(d) of the GATT justifies measures adopted by one Member to secure compliance by another Member with international obligations arising from a treaty which is not part of the WTO "covered agreements." The United States notes that in all prior reports where a Contracting Party or WTO Member has asserted an Article XX(d) defense, the "law or regulation" with which compliance was sought has universally been an internal law or regulation of the defending party.

³⁶ See, e.g., GATT Panel Report, *Italian Discrimination Against Imported Agricultural Machinery*, L/833, adopted 23 October 1958, BISD 7S/60, para. 12; Panel Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, para. 10.80; see also US First Written Submission, para. 159.

³⁷ See US First Written Submission, para. 160.

³⁸ Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, paras. 212-213.

26. Do Parties consider that the manner in which the US - Shrimp case was resolved in the WTO, and particularly the manner in which efforts at international cooperation were taken into account in the analysis of the defence under Article XX of the GATT, is relevant for the present case?

The issue of international cooperation that arose in *US – Shrimp* is not relevant to Mexico's Article XX(d) defense.

Contrary to Mexico's contention, the Appellate Body's discussion of efforts at international cooperation in *US – Shrimp* are not supportive of Mexico's defense under Article XX(d). In *US – Shrimp*, the Appellate Body considered efforts at international cooperation in the context of the chapeau to Article XX, specifically whether the United States import ban on shrimp – which the Appellate Body had already found to be "relating to the conservation of exhaustible natural resources" under subparagraph (g) with respect to sea turtles – was, nonetheless, "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail." In answering the question, the Appellate Body in its original report concluded that the US import ban was applied in a manner resulting in arbitrary and unjustifiable discrimination *inter alia* because, prior to imposing its ban, the United States had engaged in negotiations with some exporting countries, but had not engaged in negotiations on a solution to the protection of sea turtles with each country affected by the import ban and, in particular, with the complaining parties in the dispute. The Appellate Body considered it arbitrary and unjustifiable to negotiate with only some countries but to impose the ban on all of them.³⁹

This is not the situation in the present case. First, the Appellate Body's discussion of international negotiations in *US – Shrimp* concerned the chapeau to Article XX, specifically the application of a measure and the words "arbitrary or unjustifiable discrimination." Prior to examining the chapeau, however, the Appellate Body had already found the US ban to be "relating to the conservation of" sea turtles and, therefore, to have met the requirements of subparagraph (g). In the present dispute, Mexico cannot show that its tax measures meet the requirements of any of the subparagraphs of Article XX. Therefore, the question of whether Mexico's tax measures are applied in a manner that is "arbitrary or unjustifiable" under the chapeau is simply not relevant. Mexico has not demonstrated that its tax measures are "necessary to secure compliance with laws or regulations" within the meaning of paragraph (d). Further, there is no issue here of Mexico's having attempted to negotiate with some countries but not others before imposing its tax measures. For that reason as well, *US – Shrimp* is not relevant.

FOR THE UNITED STATES:

27. Could the United States please clarify whether, in its opinion, the measures at issue are inconsistent with Article III "on their face" (de jure) or "as applied" (de facto).

The IEPS is inconsistent with GATT Article III because it discriminates against imported HFCS and soft drinks and syrups made with HFCS. The IEPS discriminates against HFCS and soft drinks and syrups made with HFCS both on its face (*de jure*) and in fact (*de facto*).⁴⁰

³⁹ Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/RW, adopted 21 November 2001, paras. 122-123 (summarizing its early findings), 128.

⁴⁰ The United States would respectfully suggest that "in fact" is a better term to use for "*de facto*" than "as applied" since to the uninformed reader, "as applied" could be confused with the challenge to a measure "as such" versus "as applied." For example, a measure could breach an obligation *de facto* without having ever been applied because its design, structure or architecture are such as to demonstrate the discrimination by origin even though the measure on its face does not specify origin as a criterion.

First as a tax on soft drinks and syrups, the IEPS discriminates *de jure* and *de facto* against soft drinks and syrups imported from the United States. The IEPS discriminates *de jure* against imported soft drinks and syrups by allowing a tax exemption for certain Mexican produced soft drinks and syrups – those sweetened only with cane sugar – but denying that same exemption to the importation of soft drinks and syrups sweetened with HFCS or any other sweetener, including cane sugar.

The IEPS discriminates *de facto* against imported soft drinks and syrups by taxing the internal sale and distribution of soft drinks and syrups sweetened with HFCS, but not the internal sale and distribution of soft drinks and syrups sweetened only with cane sugar. As detailed in the US first submission, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are "like products."⁴¹ As also detailed in the US first submission, most soft drinks and syrups produced in the United States are sweetened with HFCS, while cane sugar is the dominant sweetener in Mexican produced soft drinks and syrups.⁴² Consequently, by taxing the internal sale and distribution of soft drinks and syrups sweetened with HFCS, the IEPS taxes soft drinks and syrups imported from the United States. At the same time, the IEPS exempts from the tax the type of soft drinks and syrups produced most widely in Mexico – those sweetened with cane sugar. In this manner, the IEPS constitutes *de facto* discrimination against soft drinks and syrups imported from the United States and sweetened with HFCS.

Second, as a tax on HFCS for use in soft drinks and syrups, the IEPS discriminated *de facto* against imported HFCS. As explained in the US first submission, cane sugar is by far the dominant sweetener in Mexico comprising between 90 and 95 percent of Mexican sweetener production prior to imposition of the IEPS.⁴³ HFCS on the other hand dominates sweetener imports comprising over 99 percent of sweetener imports prior to imposition of the IEPS.⁴⁴ Accordingly, by taxing the internal transfer and distribution of soft drinks and syrups sweetened with HFCS but not those sweetened only with cane sugar, the IEPS *de facto* aims at the imported sweetener, HFCS, while excluding from taxation the domestic sweetener, Mexican cane sugar. The IEPS bookkeeping and reporting requirements similarly discriminate *de facto* against imported HFCS.

28. Could the United States please clarify the units in which the different figures contained in its Exhibit US-8, part of its first submission, are provided.

As contained in Exhibit US-8, all consumption figures are in metric tons unless otherwise indicated; the first set of GDP figures are in pesos; the second set of GDP figures are in US dollars; per capita GDP figures are in US dollars. HFCS figures are provided on a "dry basis."

For ease of reference, the United States has attached Exhibit US-57. Exhibit US-57 is the same as Exhibit US-8 except with the addition of units for each set of figures provided therein.

29. Could the United States please confirm whether, in its opinion, the challenged tax measures are applied by Mexico "so as to afford protection" to its domestic production of soft drinks and syrups? If so, how are those tax measures applied so as to afford protection to domestic production of soft drinks and syrups? Or are they instead, or additionally, applied by Mexico so as to afford protection to its domestic production of cane sugar?

The IEPS is applied by Mexico "so as to afford protection" to domestic production of soft drinks and syrups as well as "so as to afford protection" to domestic production of cane sugar.

⁴¹ US First Written Submission, paras 64-83.

⁴² US First Written Submission, paras. 30-34, 86.

⁴³ US First Written Submission, paras 24, 137.

⁴⁴ US First Written Submission, para. 25, 137.

As the Appellate Body has related on more than one occasion:

"an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective *analysis of the structure and application* of the measure in question on domestic as compared to imported products. We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products."⁴⁵

With respect to soft drinks and syrups, the IEPS is structured and applied such that imported soft drinks and syrups are subject to a 20 percent tax,⁴⁶ while soft drinks and syrups sweetened with cane sugar and produced in Mexico are exempt from that tax.⁴⁷ A 20 percent tax that applies to imported soft drinks and syrups but not to domestic soft drinks and syrups clearly disadvantages imports in favor of domestic production and, thus, affords protection to domestic production.

With respect to HFCS, the IEPS is structured and applied such that the imported sweetener HFCS is subject to a 400 percent tax on its use in soft drinks and syrups while the domestic sweetener cane sugar is exempt from that tax.⁴⁸ A 400 percent tax that applies to the imported sweetener HFCS but not to the domestic sweetener cane sugar clearly disadvantages HFCS – in fact, effectively prohibits its use – in favor of domestic production of cane sugar and, thus, affords protection to domestic production of cane sugar.⁴⁹

As concerns HFCS, the protectionist structure of the IEPS is confirmed by a series of legislative statements and judicial interpretations that the purpose of the IEPS is to protect the Mexican cane sugar industry.⁵⁰ The stated purpose of the IEPS to protect the Mexican cane sugar industry does not, however, detract from the fact that the IEPS is also structured and applied so as to discriminate against imported soft drinks and syrups and afford protection to domestic production of soft drinks and syrups.

As the first US submission has discussed, the tax on soft drinks and syrups that are not exclusively sweetened with cane sugar has as an object to afford protection to domestic production of cane sugar. However, because Mexico essentially requires its domestic soft drink and syrup producers to use high-priced Mexican sugar, the tax necessarily must also protect these downstream producers against imports of competing soft drinks and syrups sweetened with lower-cost sweeteners such as HFCS.

30. The Panel has noted that in paragraph 8 of the written version of its oral statement dated 2 December, the United States has stated that "NAFTA is not a 'law or regulation,' and Mexico's tax is not 'necessary to secure compliance.'" Could the United States please elaborate on those two assertions. In particular, why does the United States consider that Mexico's taxes may not be considered "necessary" to secure compliance?

⁴⁵ Appellate Body Report, *Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages II)*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 31; see also Appellate Body Report, *Chile – Taxes on Alcoholic Beverages (Chile – Alcoholic Beverages)*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, para. 61.

⁴⁶ See *supra* US Response to Question 27 (discussing how the IEPS *de jure* and *de facto* discriminates against imported soft drinks and syrups).

⁴⁷ US First Written Submission, paras. 149-52.

⁴⁸ US First Written Submission, paras. 45, 131.

⁴⁹ US First Written Submission, paras. 134-138.

⁵⁰ US First Written Submission, para. 139.

The US statement that "NAFTA is not a 'law or regulation'" was made in the context of rebutting Mexico's contention that a breach of its Article III obligations was necessary to secure compliance with obligations Mexico has unilaterally and erroneously determined that the United States has breached under the NAFTA, without any finding by a NAFTA panel to that effect. As the United States explained in its oral statement, however, international obligations owed Mexico by other countries under the NAFTA and other international agreements are not "laws" or "regulations" within the meaning of Article XX(d).⁵¹ As contained in Article XX(d), "laws or regulations" means the laws and regulations of a state, not an international agreement or obligations assumed thereunder.

This interpretation of "laws or regulations" is based on the ordinary meaning of those words. Black's Law Dictionary defines the word "laws":

*"Rules promulgated by government as a means to an ordered society. Strictly speaking, session laws or statutes and not decisions of court; though in common usage refers to both legislative and court made law, as well as to administrative rules, regulations and ordinances."*⁵²

It defines the word "regulations":

*"Such are issued by various governmental departments to carry out the intent of the law. Agencies issue regulations to guide the activity of those regulated by the agency and of their own employees to ensure uniform application of the law."*⁵³

In contrast, Black's Law Dictionary defines "international agreement":

*"Treaties and other agreements of a contractual character between different countries or organizations of states (foreign) creating legal rights and obligations."*⁵⁴

Thus, the ordinary meaning of "laws" and "regulations" is that these are rules (e.g. in the form of a statute) issued by a government and not obligations under an international agreement.

This interpretation is supported by the context in which "laws or regulations" appear – namely, Article XX of the GATT and more broadly the GATT and the WTO Agreement as a whole. In particular, Article XX itself distinguishes between "laws" and "regulations" on the one hand and "obligations" under an international agreement on the other. Thus, while Article XX(d) provides a defense for measures necessary to secure compliance with "laws or regulations," Article XX(h) provides a defense for measures "undertaken in pursuance of obligations under any intergovernmental commodity agreement." There would be no reason for the different phrasing had the drafters intended "law or regulations" to mean the same thing as "obligations under" an international agreement.

Other provisions of the GATT support the distinction between "laws" and "regulations" on the one hand and "agreements" and "obligations" on the other. For example, Article X:1 makes a distinction between "laws, regulations, judicial decisions and administrative rulings" and "agreements affecting international trade policy between government[s]" Article X:1 states:

"Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification

⁵¹ US First Oral Statement, para. 9.

⁵² *Black's Law Dictionary* 887 (1990) (emphasis added).

⁵³ *Black's Law Dictionary* 1286 (1990) (emphasis added).

⁵⁴ *Black's Law Dictionary* 816 (1990).

or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. *Agreements affecting international trade policy which are in force between the government or a governmental agency of any contracting party and the government or governmental agency of any other contracting party shall also be published*".⁵⁵

Article III of the GATT distinguishes an "internal tax" from a "trade agreement" and "obligation" thereunder. Article III:3 states:

"With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax."

Further, "obligations under this Agreement" appears throughout the GATT – itself an international agreement.⁵⁶ Not once does the GATT reference "laws under this Agreement." In addition, Article XXI:(c) references "obligations under the United Nations Charter"; it similarly does not reference "laws" under the Charter. This phrasing is, of course, in recognition of the fact that commitments under an international agreement are "obligations" not "laws."

With respect to the fact that Mexico's tax measures are not "necessary to secure compliance," the United States points out that the Panel need not even reach the issue. Because US obligations under the NAFTA are not "laws or regulations," Mexico's tax measures cannot be "necessary to secure compliance with laws or regulations."

In any event, Mexico's tax measures are not "necessary to secure compliance" with US NAFTA obligations. In the first instance, Mexico's contention is based on its own determination that United States is not already in compliance with those obligations. As Mexico even admits, however, there is a genuine disagreement between Mexico and the United States over the market access commitments undertaken by both side during the NAFTA negotiations. Mexico's tax measure, therefore, cannot be necessary to secure compliance with US NAFTA obligations when it even admits there are different understanding regarding what those obligations are.

Moreover, negotiations between the United States and Mexico, as well as private sector interests, concerning the bilateral sweeteners trade under the NAFTA have been on-going. In fact, during the consultation phase of this dispute, Mexico acknowledged these discussions and expressed its belief that requesting a WTO panel was premature given these ongoing discussions.⁵⁷ It is difficult to understand how Mexico's tax measures are a response to the failure of these discussions, and

⁵⁵ GATT Art. X:1 (emphasis added).

⁵⁶ See, e.g., GATT Arts. XII:4(d), XV:6, XVIII:12, XVIII:16, XVIII:18, XVIII:21, XVIII:22, XIX:1 and XXIII.

⁵⁷ See *Dispute Settlement Body: Minutes of the Meeting Held on 22 June 2004*, WT/DSB/M/171, para. 26.

therefore in Mexico's eyes "necessary", when the discussions continued well after enactment of Mexico's tax measures even through the consultation phase of this dispute.

In addition, as the Appellate Body stated in *Korea – Beef*, whether a measure is "necessary" involves the extent to which the measure contributes to the enforcement of the law or regulation at issue, the measure's impact on trade and the importance of the law or regulation to be enforced.⁵⁸ While Mexico apparently attributes a great deal of importance to a viable cane sugar industry and its ability to export, the United States has difficulty understanding how a breach of Mexico's WTO obligations contributes to these goals. As reviewed in our first written submission, this breach has had a devastating impact on US HFCS exports to Mexico. It has not, however, solved any of Mexico's or the US concerns under the NAFTA and, in fact, has only contributed to the tensions on both sides.

Moreover, Mexico's tax measures apply not just to imports from the United States, but imports from any country. Again, the United States finds it difficult to understand how, in seeking to enforce the alleged obligations of the United States under the NAFTA, it is necessary to breach the national treatment obligations Mexico has undertaken with respect to every other WTO Member.

Furthermore, no matter what Mexico's complaint might be, Mexico could have sought NAFTA compliance through any number of means – diplomatic or otherwise – short of breaching its WTO obligations.

31. Could the United States please comment on Mexico's assertion that the list of laws and regulations in paragraph (d) of Article XX is illustrative and not exhaustive. What conclusion, if any, should be drawn from this fact?

The United States agrees that the laws and regulations listed in Article XX(d) is illustrative and not exhaustive. Specifically, the laws and regulations listed in Article XX(d) are introduced by the word "including" indicating that what follows is not an exhaustive list but rather examples of what comprise "laws or regulations."

However, any additional items to those illustrated in the list would still need to be "laws and regulations." As explained above, this would exclude obligations under international agreements. The mere fact that the listing is illustrative cannot be construed to mean that "laws and regulations" as used in Article XX(d) also encompass obligations of another WTO Member under an international agreement.

32. Could the United States please comment on Mexico's assertion that its tax measures are necessary to secure compliance by the United States with international obligations arising under the North American Free Trade Agreement.

The United States refers to the Panel to its response to Question 30.

33. Assuming that the tax measures applied by Mexico were to be examined under Article XX(d) of the GATT, could the United States suggest whether in its opinion there are alternative measures which would be reasonably available to Mexico and which would achieve the same objective.

⁵⁸ Appellate Body Report in *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS 161/AB/R, WT/DS169/AB/R, adopted on 10 January 2001, paras. 163-64.

Mexico could have sought to achieve its bilateral trade objectives with the United States through any of the diplomatic means customarily employed in trade negotiations; it did not have to breach its multilateral trade obligations to the United States.

FOR MEXICO:

37. The Panel has noted that in paragraph 38 of the written version of its oral statement, Mexico has stated that the WTO case on *Argentina - Poultry* differs from the present case in several important aspects and that it may not be used as a precedent. Could Mexico please explain, in its opinion, in what ways do the two cases differ and why should the *Argentina - Poultry* case not be relevant as a precedent.

Argentina – Poultry is an example of a dispute in which the responding party asked the panel to refrain from making findings on the issues in the dispute due to dispute settlement proceedings under a non-WTO agreement. The panel rejected Argentina's request. The panel explained that proceedings under a non-WTO tribunal (MERCUSOR) did not impose obligations on a WTO panel to find in a particular way and that Argentina's request had "no basis in Article 3.2 of the DSU, or any other provision."⁵⁹

The Panel may find the panel's findings in *Argentina – Poultry* as useful guidance in this dispute because it presents a similar situation to what Mexico argues in this dispute. In both disputes the responding party argues that dispute settlement proceedings before a non-WTO tribunal (whether those that have already occurred or may occur sometime in the future) justify the panel from declining to make findings on claims within the panel's terms of reference. The panel in *Argentina – Poultry* rejected the responding party's contention, as should the Panel in this dispute.

42. Could Mexico provide figures on the Mexican market of sweeteners for the production of soft drinks and sweetened syrups for the most recent ten years of available information. In particular, could Mexico provide information on: (a) yearly Mexican production of High-Fructose Corn Syrup (HFCS), of cane sugar and of other sweeteners, in value and kilograms; (b) yearly Mexican consumption of HFCS, of cane sugar and of other sweeteners, in value and kilograms, by the Mexican producers of soft drinks and sweetened syrups; (c) yearly Mexican exports, if any, of HFCS, of cane sugar and of other sweeteners Could Mexico please provide figures on the Mexican market for soft drinks and on the Mexican market for sweetened syrups; and, (d) yearly Mexican imports (by origin), if any, of HFCS, of cane sugar and of other sweeteners for the production of soft drinks and sweetened syrups.

As an initial comment, the United States notes that the data presented in the US first submission more than adequately satisfies the US burden to establish a *prima facie* case on its Article III claims. That data comes from a variety of official sources including from the Mexican Government itself. Mexico has not contested this data, and it should therefore be taken as a given for purposes of this dispute.

The United States notes, however, that the information requested of Mexico regarding the Mexican sweeteners market appears in the US first submission as follows:

- (a) yearly Mexican production of HFCS in metric tons: US First Written Submission, para. 24 (company data) and footnote 38 (FAS data); Exhibit US-11A through 11E (FAS data);

⁵⁹ Panel Report, *Argentina - Definitive Anti-Dumping Duties on Poultry from Brazil (Argentina – Poultry)*, WT/DS241/R, adopted 19 May 2003, para. 7.41.

- (b) yearly Mexican production of cane sugar in metric tons: Exhibit US-11A through 11E (FAS data); Exhibit US-15 (FAS data);
- (c) yearly Mexican consumption of HFCS by Mexican producers of soft drinks and syrups: Exhibit US-8 and Exhibit US-57 (attached as revised Exhibit-8) (ERS data);
- (d) yearly Mexican consumption of cane sugar by Mexican producers of soft drinks and syrups: Exhibit US-8 and Exhibit US-57 (attached as revised Exhibit-8) (ERS data);
- (d) yearly Mexican exports of HFCS: Exhibit US-11A through 11E (Mexico Secretary of Economy data);
- (e) yearly Mexican exports of cane sugar: Exhibit US-11A through 11E (Mexico Secretary of Economy data);
- (f) yearly Mexican imports of HFCS: Exhibit US-10 (from the US) (Mexico Secretary of Economy data); Exhibit US-11A through US-11E (by country) (Mexico Secretary of Economy data); and
- (f) yearly Mexican imports of cane sugar: Exhibit US-15 (from US and world) (Mexico Secretary of Economy data); Exhibit US-11A through US-11E (by country) (Mexico Secretary of Economy data).

Additionally, information on Mexican soft drink and syrup imports appears in the US first submission at Exhibit US-13. Information on Mexican soft drink and syrup production and consumption can be found in the US first submission *inter alia* at paragraphs 28 and 30, Exhibit US-16, Exhibit US-18, Exhibit US-19, Exhibit US-23 and Exhibit US-48.

43. Could Mexico identify the main producers of soft drinks and sweetened syrups in the Mexican market. Could it also clarify whether, for each producer, the products are sweetened with High-Fructose Corn Syrup (HFCS), cane sugar or other sweeteners.

The main producers of soft drinks and syrups in the Mexican market are identified in the US first submission at paragraph 31. Mexican soft drink and syrup producers using HFCS/cane sugar pre- and post-imposition of the IEPS are identified in the US first submission at paragraphs 30 and 34. The use of HFCS versus cane sugar by Mexican soft drink and syrup producers is contained in Exhibit US-8 and Exhibit US-57 (attached to this response as revised Exhibit US-8).

QUESTION POSED BY MEXICO

Does the United States continue to adhere to the view expressed in the quotation cited at paragraph 126 of Mexico's First Written Submission?

The cited quotation helps explain why the United States actively supported the transition from the *General Agreement on Tariffs and Trade 1947* (to which this quotation relates) to the DSU. In this connection, it is interesting that Mexico chose to leave off the sentence immediately following the quotation it cites. That sentence reads: "The way to minimize or avoid unilateralism was to create a credible multilateral system – by strengthening the existing system."⁶⁰ This is, of course, what the Uruguay Round participants did in concluding the Uruguay Round negotiations on the DSU.

⁶⁰ GATT Document C/163 of March 16, 1989, p. 4.

The United States is now seeking recourse to that dispute settlement system, as is its right under the WTO Agreement. The United States assumes that Mexico, by citing to this quotation, supports the US position on a credible multilateral dispute settlement system and the United States welcomes Mexico's support.

ANNEX C-3*

RESPONSES BY MEXICO TO QUESTIONS POSED BY THE PANEL
AFTER THE SECOND SUBSTANTIVE MEETING

(15 March 2005)

FOR BOTH PARTIES:

52. The Panel recalls that, in its response to Panel questions Nos. 45 and 50, Mexico stated that "as of 1 January 2005, imported soft drinks, syrups and concentrates for preparing soft drinks will be exempt from payment of the IEPS, as long as they are sweetened only with cane sugar." Could parties please provide more information in this regard? The Panel further notes that, in its rebuttal submission, the United States has said that "The January 1, 2005 amendment to the HFCS soft drink tax is outside the Panel's terms of reference". Do parties have any additional comments on the matter? Could they please explain how the new amendment works and how it has changed the previous relevant provisions of the law.

The new amendment creates an additional exemption from the payment of the IEPS tax. It provides that imports of soft drinks, syrups and concentrates for preparing soft drinks are exempted from the IEPS payment provided that only cane sugar is used as a sweetener:

"Article 13.- The tax established under this Law is not payable, in the following imports:

V. Those of goods referred to in subsections (G) and (H) of section I of Article 2 of this Law, provided that they use only cane sugar as a sweetener."¹

In Mexico's view, the Panel has the power to consider the amendment to the IEPS in the context of this dispute.

In past disputes, some panels have considered whether to take into account amendments made to the measures in the course of the procedure. While some panels have declined to have them examined, at least two panels have taken into account the most recent evolutions of the measures at issue in their analysis.

In the context of the GATT 1947, the panel in *Thailand – Cigarettes* took into account, in drawing its conclusions as to the consistency of the measures submitted to it, an amendment of the measures on the basis of which it concluded that the measures at issue were no longer inconsistent with Article III:2 of the GATT. The panel found the "current" measures no longer to be in violation.²

More recently in *India – Measures Affecting the Automotive Sector*, the Panel noted that if the most recent evolutions of the measures at issue are not taken into account in a panel's assessment of

* Annex C-3 contains the responses by Mexico to questions posed by the Panel after the second substantive meeting. This text was originally submitted in Spanish by Mexico.

¹ See *Decreto por el que se reforman y adicionan diversas disposiciones de la Ley del Impuesto Especial sobre Producción y Servicios* published in the Diario Oficial de la Federación (Mexican Official Gazette) on 1 December 2004. Exhibit MEX-46.

² The panel concluded that "[t]he current regulations relating to the excise, business and municipal taxes on cigarettes are consistent with Thailand's obligations under Article III of the General Agreement". See *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, BISD 37S/200, para. 88.

the matter before it, "there may be a significant risk that the resulting ruling could remain of very uncertain value even as of the date of release of the Panel's report, as well as potentially be internally inconsistent in making a recommendation to bring into conformity measures alleged to have ceased to have an effect".³ The Panel also made the following finding:

In light of the foregoing, the Panel felt that it would not be making an "objective assessment of the matter before it", or assisting the DSB in discharging its responsibilities under the DSU in accordance with Article 11 of the DSU, had it chosen not to address the impact of events having taken place in the course of the proceedings, in assessing the appropriateness of making a recommendation under Article 19.1 of the DSU.⁴

Accordingly, Article 11 of the DSU requires panels to take into account events which occurred in the course of the proceedings, including amendments to the measures at issue.

53. In its response to Panel question No. 46, Mexico stated that the "soft drinks tax", as it had been in place before December 2004, did not discriminate based on the origin of the product. Does Mexico mean that internal transfers of imported soft drinks are exempt from the "soft drinks tax" as long as those soft drinks are sweetened with cane sugar under the measures at issue, even though no exemption is allowed for the same imported products at the time of importation? In other words, is it correct to understand that the "soft drinks tax" operates differently depending on the two specific times when the tax is imposed, i.e., upon importation and upon any internal transfer occurred within the market? Could the United States also provide its comments?

Prior to the 1 January 2005 amendment referred to in Question 52, the tax operated differently depending on whether it was imposed at the time of importation or at the time when internal transfer occurred within the national territory. As a result of the new amendment, imports of soft drinks, syrups and concentrates for preparing soft drinks that use only cane sugar as a sweetener receive the same exempt treatment that applies to internal transfers that take place in national territory.

54. Do the parties view the so-called "bookkeeping requirements" as a separate measure from the "soft drinks tax" and the "distribution tax", or rather as a measure which is ancillary to the two last. If it is an ancillary measure, would that fact have any consequence on the way the Panel should analyse those "bookkeeping requirements"?

As discussed in Mexico's response to Question 22, the bookkeeping requirements are contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* published on 15 May 1990, the *Resolución Miscelánea Fiscal Para 2003* (Title 6) published on 31 March 2003, and the *Resolución Miscelánea Fiscal Para 2004* (Title 6) published on 30 April 2004. These instruments implement and are relevant to the administration of various aspects of the IEPS tax. Thus, these are elements belonging to the same measure, and are linked inseparably to it. They are not a "separate measure".

Mexico believes that this fact should not have any consequence on the way the Panel should analyse those "bookkeeping requirements". As the complaining Party, the United States must establish that those requirements fall within the scope of Articles III:2 and III:4 of the GATT.

³ *India – Measures Affecting the Automotive Sector*, Report of the Panel, WT/DS146/R and WT/DS175/R, adopted on 5 April 2002, para. 8.26.

⁴ *Id.*, para. 8.28.

55. The Panel recalls that, in its response to Panel question No. 21, the United States asserted that "The IEPS as a tax on HFCS may properly be examined under both Article III:2 and III:4 of the GATT 1994". During the second substantive meeting (paragraph 53 of written version), Mexico expressed its doubts that, as a matter of WTO law, a same measure may violate both Article III:2 and Article III:4. Do the parties have additional views on the matter? Could they also clarify whether, if in a particular case, simultaneous claims were raised against the same measure under both Article III:2 and III:4, a panel should proceed in any particular order when dealing with such claims?

Mexico reiterates its view that WTO jurisprudence suggests that if a measure constitutes a tax measure, it should be assessed under Article III:2 of the GATT 1994 whereas non-fiscal regulation is covered by Article III:4. In the light of the above, Mexico doubts that simultaneous claims can be raised against the same measure under both Article III:2 and Article III:4 (See Second Oral submission of Mexico, paras. 53-54 and Answers of Mexico to Questions of the Panel in Relation to the First Substantive Meeting with the Parties, page 8). In Mexico's view, if the measure constitutes a tax measure, the appropriate assessment is under Article III:2.

56. Does the so-called "distribution tax" operate on its own or is it dependent on the operation of the "soft drinks tax"? Does its existence depend on the "soft drinks tax"? Is it in any other manner linked to the so-called "soft drinks tax"?

The tax on certain services – i.e. commercial intermediation, dealer, agency, representation, brokerage, consignment, and distribution services in respect of soft drinks and syrups sweetened with sweeteners other than cane sugar – is independent of that on the transfer of the goods that are subject to the tax, and the law regulates such activities in a different manner.

57. In the view of the parties, can Article III:2 of the GATT cover a measure that imposes a tax on services related to specific products?

Article III:2 of the GATT 1994 expressly refers to "internal taxes or other internal charges" applied to the "*products* of the territory of any contracting party imported into the territory of any other contracting party". In Mexico's view, thus, Article III:2 of the GATT 1994 covers tax measures that apply to products.

58. During the second substantive meeting (paragraph 33 of written version), Mexico has said that its measures may be justified under the NAFTA. Further, in its closing statements, Mexico argued that a NAFTA panel could find that the tax measures imposed by Mexico would be acceptable countermeasures. Does the United States agree with this statement? Could Mexico please elaborate on its statements and provide reference to the provisions of the NAFTA agreement under which its measures would be justified.

The Panel will appreciate that for obvious reasons, Mexico does not wish to address the arguments that it might advance before another panel or arbitral tribunal in the future. Therefore, Mexico will sketch out the basis of its legal position, taking note of the United States' position on the adoption of countermeasures.

First, in order to understand the legality of countermeasures under the NAFTA, it is necessary to refer to NAFTA Articles 2003, 2004 *et seq.* As pointed out in Mexico's previous submissions, in NAFTA Chapter Twenty, which establishes the treaty's general dispute settlement mechanism, the Parties agreed to cooperate "*at all times*" and to "*make every attempt* through cooperation and consultations to arrive at a mutually satisfactory resolution of any matter that might affect ... [the] operation" of the Agreement (Article 2003). They also agreed to apply the provisions of Chapter Twenty to "the avoidance or settlement of *all* disputes between the Parties regarding the interpretation

or application of [the] Agreement or whenever a Party considers that an actual or proposed measure of another Party is or would be inconsistent with the obligations of [the] Agreement or cause nullification or impairment ... ". [Emphasis added.]

NAFTA Chapter Twenty was described as follows by the United States in a very recent pleading (filed 4 February 2005) before an arbitral tribunal:

"... The Chapter Twenty mechanism has an unusually broad reach: it applies to all disputes concerning "the interpretation or application of this Agreement or wherever a Party considers that an actual or proposed measure of another Party is would be inconsistent with the obligations of this Agreement."⁵ [Emphasis added.]

The underlying fundamental obligation is that the NAFTA Parties shall cooperate in good faith in resolving disputes and if they cannot agree on a satisfactory resolution, they shall submit to the jurisdiction of an independent arbitral panel.

Second, Chapter Twenty does not permit a Party to refuse to resolve a dispute either through consultations or an arbitral panel proceeding. Nothing in the NAFTA authorizes a Party to decline to participate in dispute settlement proceedings, and so avoid having its measures scrutinized. The fact that Chapter Twenty does not allow a Party to "self-judge" the merits of another Party's complaint or the legality of its measures makes eminent sense: if it were left to potential respondents to determine whether or not to submit to an arbitral panel, they would be tempted to refuse to submit to the dispute settlement mechanisms except in cases in which they considered they faced no significant exposure (this was apparently the United States' concern about the GATT system when it made the statement to the GATT Council quoted at paragraph 126 of Mexico's First Written Submission).

Third, the question that arises when a Party wrongly refuses to submit to dispute settlement is what avenues of redress are available to the complainant at international law and to induce the obstructionist State to participate in the dispute settlement mechanisms. This leads Mexico to the next relevant provision of the NAFTA: The treaty is to be interpreted, according to Article 102(2), "in the light of its objectives ... and in accordance with *applicable rules of international law*". [Emphasis added.] Article 1131(1) contains the same requirement (tribunals constituted under the NAFTA have given a broad meaning to the phrase "applicable rules of international law".⁶)

It is well established at international law and in the NAFTA jurisprudence that the rules of customary international law continue to apply between States unless amended or rescinded by agreement between the latter. This is a point that both Mexico and the United States have made on a number of occasions. In the *Loewen* case, for example, the United States discussed a submission by Mexico in which Mexico had pointed out the care that should be taken to ensure the existence of a rule of customary international law said to constitute an applicable rule of international law. The United States commented:

"1. The Governing Law

The Government of Mexico submits that, as provided in NAFTA Article 1131(1), the Tribunal must decide this matter in accordance with the terms of the Agreement and

⁵ Objection to Jurisdiction of Respondent United States of America in *Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc., v. United States of America*. Exhibit MEX-47.

⁶ For example, in *S.D. Myers, Inc. v. Canada*, the tribunal held that when applying NAFTA Article 1105, a determination of breach "must [in addition to taking into account certain factors] also take into account any specific rules of international law that are applicable to the case". Award, para. 263. Exhibit MEX-48.

applicable rules of international law. The United States agrees with Mexico and submits, respectfully, that this point is an important one.

Unlike common-law courts, an international tribunal is not authorized to make law or otherwise to rely on considerations that are not recognized rules of international law. Rather, as Mexico correctly observes, a tribunal constituted under NAFTA Chapter Eleven may apply as the rule of decision only the terms of the Agreement and applicable rules of international law. A rule may be considered to form part of customary international law only where the existence of the rule is established by general and consistent practice of States followed by them from a sense of legal obligation. If there is no widespread or substantial uniformity of State practice with regard to the rule in question, then that rule cannot be regarded as one of customary international law and, therefore, cannot govern the resolution of the dispute.

...

B. Other Sources of Governing Law

The Government of Mexico observes correctly that customary international law is determined by international custom as evidence of the general practice accepted as law, and offers comment on several sources of international law and their varying degrees of authoritativeness. The United States agrees with Mexico that customary international law is defined by State practice and that only those rules that have gained widespread acceptance as law may be considered as part of customary international law."⁷

[Emphasis added; footnotes omitted.]

Later in the same proceeding, the United States and the claimants disagreed as to whether the customary international law rule of continuous nationality of claims continued to exist under the NAFTA. The United States asserted in this regard (and the Tribunal ultimately agreed with it⁸) that:

"Loewen does not contest (nor could it) that the NAFTA, by its express terms, incorporates rules of international law to supply the rules of decision in Chapter Eleven disputes. See NAFTA Article 1131 ("A Tribunal ... shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.") At the same time, Loewen argues that *this particular* rule of international law (i.e., that of continuous nationality) was selectively and conveniently excluded from NAFTA Chapter Eleven by the Agreement's other express terms. As the United States has already shown, however, and as we reconfirm below, Chapter Eleven contains no such express terms that can fairly be construed to derogate from the customary international law requirement of continuous nationality through the date of the award.

...

⁷ Response of the United States of America to the November 9, 2001 Submissions of the Governments of Canada and Mexico Pursuant to NAFTA Article 1128 in *The Loewen Group International, Inc. and Raymond L. Loewen v. United States of America*, page 1. Exhibit MEX-49.

⁸ See the Final Award, paras. 228 *et seq.* "Respondent correctly contends that Article 1131 requires the Tribunal to decide the issues in accordance with 'applicable rules of international law'." The tribunal then proceeded to find that the continuous nationality rule continued to apply to the NAFTA although not expressly provided therein. Exhibit MEX-50.

As the United States has demonstrated, customary international law requires that a claimant maintain a nationality other than that of the respondent State from the date of injury (the *dies a quo*) through the date of the award (the *dies ad quem*). NAFTA Chapter Eleven was drafted against this legal background and explicitly incorporates "applicable rules of international law" as part of the Agreement. (NAFTA Article 1131(1); Decision on Jurisdiction para. 50). This Tribunal has already recognized that "an important principle of international law should not be held to have been tacitly dispensed with by an international agreement, in the absence of words making clear an intent to do so." (Decision on Jurisdiction para. 76.) Therefore, in the absence of an express derogation, the rule of continuous nationality, like other rules of international law, applies to NAFTA Chapter Eleven claims.

...

... A customary international law rule, which supplies the rule of decision by virtue of NAFTA Article 1131(1) unless overridden by an explicit, contrary provision of the Agreement, need not be further codified in the NAFTA in order to apply to a Chapter Eleven claim."⁹

[Emphasis added; italics in original; footnotes excluded.]

Under both Article 102(2) and Article 1131, not only Chapter Eleven but the NAFTA as a whole is to be interpreted in accordance with its own terms and the applicable rules of international law, including the Vienna Convention on the Law of Treaties. The customary international law rules concerning countermeasures are applicable when, by reason of one Party's obstructionism, a treaty's dispute settlement mechanism breaks down and the complainant State is unable to secure independent third party consideration of its grievance.

If this were not the case, it would be open to a potential respondent to refuse to submit to the agreed dispute settlement mechanisms and then to argue that the complainant had no right to take countermeasures to protect its own interests (which in itself disproves the proposition), thereby undermining the body of agreed rights and obligations. Any State would be able to violate the Treaty with impunity. However, customary international law establishes relevant rules under which an injured State clearly has the right to take action to redress the situation, and to encourage use of these existing institutional mechanisms.

Mexico has persuasive arguments that could be put to a NAFTA panel or arbitral tribunal.

For example, Mexico would direct the Panel's attention to the *Air Services Agreement Arbitration* award (see Exhibit MEX-37). In that case, the United States successfully justified the adoption of measures intended to induce France to submit to dispute settlement under their bilateral air services treaty after France had imposed certain restrictions that the United States considered were inconsistent with France's treaty obligations. The United States in fact took more severe action against French carriers than France did against the US carrier. The US action was nevertheless upheld by the international tribunal.

Mexico finds that award to be particularly apposite because the facts of the case were far less egregious than the facts of the instant case and the rationale of the US countermeasures was similar to Mexico's rationale. The parallels and relevant findings include the following:

⁹ Reply of the United States of America on Matters of Jurisdiction and Competence, pp. 9-11. Exhibit MEX-51.

- First, it was the United States that successfully defended its countermeasures. The award thus provides evidence of what the US view is when it is a complainant facing an obstructing respondent.
- Second, as in the instant case, the measures were taken to induce France to submit to dispute settlement under the applicable treaty. They were upheld in the face of an obligation which required the parties to make a good faith effort to negotiate on issues of potential controversy. The US measures were upheld although France quickly agreed to submit the matter to an international tribunal. Unlike the US in this case, France did not drag on the dispute for over 6 years.
- Third, although the tribunal held that it must be satisfied with a "very approximative appreciation" of the proportionality of the measures, it declined to find that the US measures were "clearly disproportionate" in comparison to France's measures which gave rise to the dispute.¹⁰
- Fourth, the tribunal considered that in addition to the commercial issues at stake, the systemic issues arising under the treaty were also relevant to its consideration of the countermeasures.¹¹ Mexico has a systemic interest in having the United States submit to NAFTA dispute settlement.
- Fifth, the tribunal considered that the aim of countermeasures "is to restore equality between the Parties and to encourage them to continue negotiations with mutual desire to reach an acceptable solution. It found that "the United States countermeasures restore in a negative way the symmetry of the initial positions."¹² This is precisely what Mexico sought to do, to return the bilateral trade in sweeteners to the *status quo ante*, and to induce the United States to submit to the NAFTA dispute settlement mechanism in compliance with its obligations thereunder.
- Finally, the tribunal emphasized the need to accompany countermeasures with "a genuine effort at resolving the dispute" but found it impossible "to lay down a rule prohibiting the use of countermeasures during negotiations, especially where such countermeasures are accompanied by an offer for a procedure affording the possibility of accelerating the solution of the dispute".¹³ Over a period of more than six years, Mexico has repeatedly sought in good faith to resolve the dispute in many ways, but to no avail, given the position maintained by the United States.

The essential finding of the tribunal was that:

81. ... If a situation arises which, in one State's view, results in a violation of an international obligation by another State, the first State is entitled, within the limits set by the general rules of international law pertaining to the use of armed force, to affirm its rights through "counter-measures".

This remains an accurate statement of the law.

Mexico has also reviewed the United States' pleadings in the *Air Services Agreement* case. Interestingly, in support of its argument that a State may temporarily suspend treaty rights pending

¹⁰ *Air Services Agreement Arbitration* award, para.83.

¹¹ *Id.*

¹² *Id.*, para. 90.

¹³ *Id.*, para. 91.

arbitration, the United States invoked Article 27 of the 1935 Harvard Draft Convention on the Law of Treaties, which provided that:

- (a) If a State fails to carry out in good faith its obligations under a treaty, any other party to the treaty, acting within a reasonable time after the failure, may seek from a competent international tribunal or authority a declaration to the effect that the treaty has ceased to be binding upon it in the sense of calling for further performance with respect to such State.
- (b) Pending agreement by the parties upon and decision by a competent international tribunal or authority, the party which seeks such a declaration may provisionally suspend performance of its obligations under the treaty *vis-à-vis* the State charged with failure.
- (c) A provisional suspension of performance by the party seeking such a declaration will not be justified definitively until a decision to this effect has been rendered by the competent international tribunal or authority. [Emphasis added.]

The United States cited with approval the drafters' commentary on Article 27 of the Harvard Draft, which reads as follows:

It is apparent, therefore, that it might frequently be within the power of the state alleged to have committed the breach to prevent or delay submission of the matter to an international tribunal or authority simply by neglecting or refusing to agree upon any such tribunal or authority, or by denying that tribunals or authorities which it already had agreed upon for certain purposes possess jurisdiction to make the sort of declaration referred to in this article. Furthermore, even after the states concerned have agreed upon a competent international tribunal or authority, a considerable time will necessarily elapse before it can render its decision. In consideration of these facts, and in view of the further fact that continued performance of its obligations under a treaty *vis-à-vis* a state charged with breach thereof might prove costly or even involve irreparable damage to the state seeking the declaration, if the decision is ultimately in its favor, it seems only reasonable to permit the latter state to suspend the performance of its own obligations under the treaty *vis-à-vis* the state charged with failure pending agreement upon a competent international tribunal or authority, and pending final decision by such authority.¹⁴

This view is both logical and consistent with the rules of customary international law on countermeasures. At international law, a State may, under certain circumstances, take action to redress a particular situation.

In its Second Oral Statement, the United States alleged that Mexico had relied on "out-of-context citations made by the United States in connection with the Air Services Agreement of 1946 (as well as the GATT 1947, the NAFTA and the WTO *Section 301* panel proceeding)".¹⁵ Mexico rejects any suggestion that any of the passages it quoted from US statements were taken out of context. The hedging on what was actually said by the United States (i.e., "Whatever statements the United States may or may not have made in these contexts ... "¹⁶) should be seen for what it is: an

¹⁴ Department of State, Office of the Legal Adviser, *Digest of United States Practice in International Law*, 1978, p. 775. Exhibit MEX-52.

¹⁵ Second Oral Statement of the United States, para. 25.

¹⁶ *Id.*

attempt to resile from the effect of its official statements for the purposes of this proceeding, while preserving the United States' ability to rely on them when it suits its own interests.

The United States Department of State considered the *Air Services Agreement* award to be an excellent statement of the law in 1997 when it provided the United States' comments on the then draft Articles on State Responsibility for internationally wrongful acts, under consideration by the International Law Commission:

The United States agrees that under customary international law an injured State takes countermeasures "in order to induce [the wrongdoing State] to comply with its obligations". See Draft Article 47(1). See also Case Concerning the Air Services Agreement of March 27, 1946 Between the United States of America and France, 18 R.I.A.A. 417, 443 (1978) [hereinafter Air Services Case] stating that an injured State "is entitled ... to affirm its rights through 'counter-measures'".¹⁷

In a six-page discussion of countermeasures, the United States cited the *Air Services Agreement Arbitration* award with approval no less than nine times, six times more than the next most frequently cited case (*Case Concerning the Gabčíkovo-Nagymaros Project*). The Panel will see from reviewing the State Department document that the award is cited for the right to impose countermeasures during negotiations and in support of the principle that they should be compared to the act motivating them and that there should be some degree of equivalence with the alleged breach. Indeed, the award is relied upon to criticize the ILC's attempt to introduce a more restrictive proportionality test (the award in this case had applied a not "clearly disproportionate" standard), saying that the ILC's proposed interpretation "does not accord with customary practice".¹⁸

In contrast with the United States' position, in the instant case, it must be appreciated, among other things, that:

- a. Mexico adopted the measure at issue only after having exhausted unsuccessfully, during several years, all other efforts;
- b. during that period of time the Mexican sugar segment suffered a real damage as a result of the United States' denial of giving the negotiated access to its market, while HFCS continued to gain market share in Mexico;
- c. Mexico confined the adopted measure to the sweeteners sector (years before, the United States itself had established the sugar-HFCS link);
- d. Mexico's measure was entirely proportionate (not "clearly disproportionate"); and
- e. as the United States Department of Agriculture repeatedly reported, the United States was at all material times fully aware of the adverse impact of its continued failure to submit the Mexican market access grievance to dispute settlement.

With respect to Mexico's having chosen to use taxation measures, Mexico would point out that customary international law gives a State wide discretion in formulating countermeasures. Subject to very basic requirements (such as not violating human rights obligations or contravening the laws of armed conflict) it is free to choose the form and type of such measures. In this case, the

¹⁷ Draft Articles on State Responsibility for internationally wrongful acts: Comments of the Government of the United States of America, 22 October 1997. Exhibit MEX-53.

¹⁸ *Id.*

measures were intended to deal with the displacement of sugar by HFCS, pending a resolution of the dispute.

Finally, Mexico also wishes to re-emphasize that the United States has claimed the same right, both in the GATT and under the NAFTA, and in fact has taken such action *vis-à-vis* Canada. This is evidence of relevant State practice under the NAFTA (see Article 31 of the Vienna Convention).

59. Do the parties consider that the NAFTA Agreement is part of the United States' domestic "laws or regulations"? What implication would that fact have for the expression "laws or regulations" as used in paragraph (d) of Article XX of the GATT in this dispute?

This question follows the United States' practice of qualifying the terms "laws or regulations" by including a word that is not contained in Article XX(d), namely, "domestic". Mexico has argued that it is not correct to read into Article XX(d) a word that is not actually in the text.

The more salient point is that although NAFTA is an international treaty, it plainly has effects in the domestic legal orders of all three NAFTA Parties that go beyond implementing action taken by any particular signatory. Mexico pointed out at the Second Substantive Meeting that the three Parties expressly agreed not to establish a cause of action which would permit a private party to sue another NAFTA Party in its domestic courts for breach of the treaty. The implication of this is that had they not so agreed, it would have been permissible for a Party to create such cause of action.

The United States in fact reserved standing for itself to have a cause of action under the NAFTA and Canada retained a discretionary power vested in its Attorney General to decide whether to consent to a cause of action to enforce any right or obligation that arises under the NAFTA.¹⁹ NAFTA also contains a provision (Article 2020) permitting the Free Trade Commission to submit agreed interpretations of the NAFTA to domestic courts or administrative tribunals (or for each Party to do so in the absence of such agreement) "[i]f an issue of interpretation or application of [the] Agreement arises in any" such domestic judicial or administrative proceeding. It would be unnecessary to so provide if the treaty had no effect in the domestic legal order of a Party.

The strict separation between international obligations and domestic law advocated by the United States is not borne out by the treaty itself. The implication of this point is simply that if, as here, an international treaty breaks down by reason of a Party's obstruction, it would be open to another State adversely affected thereby to seek to secure compliance with its terms and action taken by that State would be justified under Article XX(d) of the GATT 1994 (in circumstances which Mexico has already explained in detail and will not repeat here).

60. As parties are aware, the Appellate Body has stated that, in order to evaluate the "necessity" of a measure under Article XX(d), a panel would need to examine, among other factors, "the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect" (Appellate Body Report, Korea – Various Measures on Beef). Could parties please explain, in their view, what would be "the common interests or values" that the NAFTA Agreement is intended to protect.

The best evidence of the important common interests and values that the NAFTA is intended to protect is contained in the Preamble and Objectives provisions of the Treaty. The three Parties took care to express their common interests or values. In the Preamble these include:

¹⁹ See Footnote 59 of Mexico's Second Written Submission.

- Strengthening "the special bonds of friendship and cooperation among" the three nations;
- contributing to "the harmonious development and expansion of world trade and provid[ing] a catalyst to broader international cooperation";
- creating "an expanded and secure market for the goods and services produced in ...[the signatories'] territories";
- establishing "clear and mutually advantageous rules governing their trade";
- building "on their respective rights and obligations under the *General Agreement on Tariffs and Trade* and other multilateral and bilateral instruments of cooperation";
- creating "new employment opportunities and improve[ing] working conditions and living standards in their respective territories"; and
- preserving the Parties' "flexibility to safeguard the public welfare".

[Emphasis added.]

The Agreement's objectives, set forth in Article 102, are to *inter alia*:

- "Eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties";
- "promote conditions of fair competition in the free trade area";
- "create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes"; and
- "establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement".

[Emphasis added.]

On 4 February 2005, the United States affirmed, in a pleading filed in the defence of a NAFTA Chapter Eleven claim, that the NAFTA Parties attach great importance to the effective resolution of disputes under the NAFTA. It stated:

The final element of the Vienna Convention's cardinal rule of treaty interpretation focuses on the treaty's object and purpose. NAFTA Article 102 states in pertinent part as follows:

The objectives of this Agreement, as elaborated more specifically through its principles and rules, ... are to:

- (e) create *effective* procedures ... for the resolution of disputes ...

As demonstrated below, a review of the NAFTA's various rules for dispute resolution reveals an overriding concern with promoting effective dispute resolution procedures and avoiding the inefficacies that result from redundant proceedings between the same parties before different dispute resolution panels ...

Much scholarly attention has been focused on the proliferation of international tribunals in recent decades. One consequence of this phenomenon is that claimants have expanded opportunities to submit the same dispute simultaneously or consecutively to multiple fora, giving rise to redundant proceedings. Redundant proceedings present the risk of conflicting judgments, undermine the principle of finality, present the possibility of double recovery for claimants, are burdensome and unfair to the respondent, represent a poor use of judicial and arbitral resources and have potentially negative systemic implications for international law and international dispute resolution generally.²⁰

[Italics in original; underlining added; footnotes omitted.]

Mexico shares this view. In the light of the importance that the United States confers to effective NAFTA dispute settlement proceedings, and to the consequences and risks that it notes would arise from redundant proceedings, Mexico seriously questions the position of the United States in instituting WTO proceedings in respect of a portion of the broader bilateral dispute, whereas it has repeatedly refused to submit to the NAFTA mechanism; Mexico seriously questions the total omission of the United States in its First Written Submission to make any reference to this broader dispute, and the position it has advanced on the relevance of the dispute and of the corresponding facts; Mexico questions as well the position the United States has advanced on the recommendations that the Panel can make; and particularly questions the false statements that the United States has made to the Panel with regard to the status of the NAFTA proceeding requested by Mexico. The United States' conduct is especially open to criticism, considering the position that the United States has taken in the case referred to above, a position that reinforces Mexico's arguments in the present case.

Mexico does not see how the United States' conduct in contributes to any of the NAFTA's values and objectives, and questions how a WTO panel could contribute to finding a favourable solution to disputes by rewarding the United States for its conduct.

61. Could parties share their views on whether a successful invocation of an Article XX(d) defence would require that the contested measure be necessary to prevent or correct a breach of the underlying "law or regulation"?

As discussed in paragraphs 82-83 of Mexico's Second Written Submission, a successful invocation of an Article XX(d) defence does not require that the contested measure perfectly secure compliance with the law or regulation at issue. In *Korea – Beef*, the Appellate Body stated that "[t]he greater the contribution [to the realization of the end pursued], the more easily a measure might be considered to be 'necessary'".²¹ This statement implies that measures that make a less than perfect contribution to the securing of compliance with the law or regulation at issue may still be considered to be necessary (according to the Appellate Body's reasoning in a similar, hypothetical case in which an import tax measure is adopted in order to secure compliance with a given law or regulation, the fact of opting for tax payment rather than securing strict compliance with the law or regulation in question does not imply that the measure is not necessary and is not justifiable under Article XX(d)). Accordingly, measures that contribute to securing compliance with the law or regulation at issue, which, in Mexico's view, includes measures that are instruments to prevent or correct a breach of the underlying law or regulation, can be justified under Article XX(d) of the GATT 1994.

²⁰ Objection to Jurisdiction of Respondent United States of America in *Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc., v. United States of America*, Exhibit MEX-47.

²¹ *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161, Report of the Appellate Body, adopted on 10 January 2001, para. 163.

62. Is there any provision in the NAFTA Agreement that can be considered equivalent to Article 23(2) of the DSU in the sense that a unilateral determination by a party that a violation has occurred, or that its benefits have been nullified or impaired or that the attainment of any objective of the covered agreement has been impeded, is prohibited and such decisions can only be made through recourse to dispute settlement in accordance with the rules and procedures under that Agreement?

There is no analogous provision in the NAFTA.

Under Article 2019, entitled "Non-Implementation – Suspension of Benefits", a Party may suspend the application, to the Party violating the treaty or causing benefits to be nullified or impaired, of benefits of equivalent effect only if no agreement has been reached on a resolution of the dispute after the arbitral panel has issued its final report. However, as discussed in the answer to Question 58, the dispute settlement mechanism established under NAFTA Chapter Twenty (which includes Article 2019) is predicated upon a panel being established and composed and being able to carry out its task, which includes issuing a final report. Obviously, if a panel cannot be created in the first place, the whole dispute settlement mechanism is frustrated, including the operation of Article 2019, and it then falls to the aggrieved Party to exercise its other rights at international law.

63. In its second written submission and also during the second substantive meeting (paragraphs 43-52 of written version), Mexico has stated that a WTO panel does not have a legal obligation to issue findings on the claims raised by a complaining Member, but rather has the flexibility to decide whether to issue rulings or to make recommendations, as appropriate. Is it the parties' view that that discretion, if it in fact exists, is vested by the WTO agreements on panels or rather on the Dispute Settlement Body (or the Contracting Parties acting jointly, in the case of the GATT)?

In Mexico's view, the exercise of the discretion rests in the first instance with the Panel. As the GATT 1947 system evolved, the CONTRACTING PARTIES delegated to panels the power of reviewing complaints and making recommendations. Indeed, they were empowered to draft recommendations which could then be acted upon by the CONTRACTING PARTIES.

An example of this process is the *Jamaica – Margins of Preference* case, where the panel concluded that Jamaica's tariffs were not consistent with commitments previously made on its behalf by Great Britain but that in the circumstances it was appropriate that a waiver (the proposed terms of which were drawn up by the panel) should be given by the CONTRACTING PARTIES (which waiver was duly given).²² This is sensible because the panel is closest to the complexities of the case and therefore in the best position to determine the appropriateness of its recommendations.

The drafters of the DSU did not amend the GATT 1947 when they created the WTO and this became the GATT 1994. They in fact affirmed, in Article 3 of the DSU, their adherence to the principles set forth in Articles XXII and XXIII of the GATT 1947. Consequently, Mexico sees no justification for reviewing the approach under which panels are empowered to make recommendations.

64. Mexico has said throughout the case that the Panel would not need to interpret NAFTA rules. However, in an Article XX(d) defence, a panel may need to interpret the underlying "law or regulation" to assess whether a measure is actually justified. Would that mean, in the parties' opinion, that this Panel may in fact have to interpret NAFTA rules?

²² *Jamaica – Margins of Preference*, Report of the Panel, adopted on 2 February 1971, BISD 18S/183.

The position of Mexico has been and remains that this Panel has no jurisdiction to determine disputes arising under the NAFTA. The broader NAFTA dispute to which Mexico has alluded comprises two central matters (among others): whether the United States has breached its obligations established under NAFTA Annex 703.2 and whether Mexico's countermeasures were justifiable under the NAFTA in light of the United States' refusal to submit to dispute settlement under Chapter XX. Mexico has not asked the Panel to resolve those matters.

Nevertheless, this does not mean that the Panel cannot consider the facts relevant to this dispute, for example: that the NAFTA exists; that it provides for a specific regime applicable to the bilateral sugar trade; that a dispute between Mexico and the United States exists about this trade regime (as part of the relevant facts, Mexico referred to the letters exchanged between the parties in 1993 and expressed its opinion about their content and validity); that the NAFTA establishes a mechanism to resolve disputes regarding the interpretation or application of the treaty; that Mexico activated that dispute settlement mechanism (Mexico requested consultations pursuant to the relevant provisions of the treaty, and those consultations were held but did not resolve the dispute, and Mexico then requested a meeting of the Free Trade Commission, which was held but also failed to resolve the dispute); that Mexico requested the establishment of an arbitral panel and made all efforts to have the panel constituted, but the United States has refused to designate panelists (and even instructed its Secretariat Section not to do so); and that until now Mexico's request remains pending, but the arbitral panel has not been established and Mexico's attempts to find a solution through the institutional mechanisms have been frustrated by the United States' acts and omissions.

These are all matters of fact that the Panel can consider, determine by the record evidence and decide on as such (i.e. as matters of fact). In some cases the evidence comprises communications exchanged between Mexico and the United States (for example the letters regarding the establishment of an arbitral panel); in others, for example, the text of certain NAFTA provisions (e.g., the relevant provisions of Annex 703.2 or of Chapter XX). Mexico has submitted this evidence for the Panel to see and consider. The fact that the Panel cannot resolve the dispute that has arisen under the NAFTA does not mean that it cannot review the relevant provisions of the treaty and that it should reject or ignore the other evidence submitted by Mexico.

It is conceivable that the United States could have contested, for example, that the NAFTA contains a Chapter XX that includes a mechanism as described by Mexico. Nothing would prevent the Panel from considering the text of the treaty to determine that, indeed, it contains a Chapter XX. The same situation could arise with a specific provision of Annex 702.3. In this case, however, there is no disagreement between Mexico and the United States with regard to the fundamental facts of that dispute.

It is quite different for the Panel to examine the evidence and make a finding, as an issue of fact, that Mexico has alleged that the United States has breached the NAFTA, which the United States disputes (even though it has refused to submit the matter to independent review) than for the Panel to make a legal determination as to whether Mexico is right in asserting that the United States has breached the NAFTA or whether the US contentions are correct.

It is incorrect to suggest that a panel can never state an opinion on an international treaty other than the WTO. Hypothetically, an issue in dispute could be whether the law or regulation at issue, for example, the IEPS Law or the NAFTA, is not inconsistent with the provisions of the GATT 1994. In that case the panel would have to formulate an opinion regarding the content of the law or the international treaty, as the case may be. That does not mean that by doing so the panel would be deciding a matter of internal law as if it were a national court, or resolving the correct interpretation of the treaty as if it were a Chapter XX arbitral panel. Moreover, in a dispute with regard to the consistency of a free trade agreement with Article XXIV of GATT 1994, a panel would have to reach

an opinion on whether the terms of the treaty complied with the requirements for the establishment of a free trade zone.

In the present case, as an element of the exercise of its jurisdiction over the covered agreements generally and Article XX(d) in particular, the Panel is invested with the power to review and consider the general dispute settlement chapter of the NAFTA and to determine whether, as contended by Mexico and fully substantiated by the record evidence (which has not been contested by the United States), the United States failed to submit to NAFTA dispute settlement in order to resolve Mexico's grievance. This does not involve fine points of law peculiar to the free trade agreement and the essential facts have not been disputed after two rounds of written and oral submissions and the filing of evidence. The issue is essentially one of fact to be determined by reference to the plain text of Chapter Twenty and does not involve the kind of evidence that would be put before a NAFTA panel or the kind of interpretation that would be required of the latter.

The Panel must take cognizance of these matters because they are a central underpinning to the Panel's determination of whether GATT Article XX(d) can be invoked to justify Mexico's measures.

65. In the view of the parties, does the provision contained in Article 3.10 of the DSU, whereby it is "understood that complaints and counter-complaints in regard to distinct matters should not be linked" have any relevance for the present case?

No.

First, as a matter of fact, the Panel's consideration of Mexico's measures taken in response to the United States' measures cannot be considered to be the linking of distinct matters. They are all a part of a larger dispute over NAFTA sweeteners trade.

Second, in Mexico's view the reference to "complaints and counter-complaints" in Article 3.10 of the DSU refers to claims and counter-complaints that both arise under the WTO. In the instant case, Mexico has not submitted a counter-complaint, which does not mean that the Panel cannot consider the issues regarding the broader NAFTA dispute. Mexico has been clear with regard to the jurisdiction of this Panel for considering, on the one hand, and resolving, on the other, the NAFTA dispute (See answer to Question 64).

Mexico has pointed out that an arbitral panel under NAFTA Chapter XX is the appropriate body to resolve the dispute entirely and it is in this context that it has requested a particular recommendation from this Panel. For the reasons set out in the first paragraph to this question (question 65), as long as complaints and counter-complaints exist under the NAFTA, a single panel could address them (similarly as Article 3.10 establishes that similar issues can be linked under the WTO). In fact, NAFTA Article 2007 (Commission – Good Offices, Conciliation and Mediation) grants a specific power to the Free Trade Commission (FTC) to join different matters together. Article 2007(6) permits the Commission to consolidate two or more proceedings before it regarding the same measure. This would deal with the situation where Mexico and Canada, for example, sought to challenge the same US measure. Paragraph 6 then states:

... The Commission may consolidate two or more proceedings regarding other matters before it pursuant to this Article that it determines are appropriate to be considered jointly.

66. Could the parties please expand upon the views they hold regarding the relevance of Article 23 of the DSU to the present dispute?

Mexico does not believe that Article 23 is relevant in this case. As explained before, Mexico's measure at issue is intended to secure the United States' compliance with its obligations established in a treaty authorized by Article XXIV of the GATT 1994 and, to that extent, it is justified under Article XX(d) of the GATT 1994. Article 23 of the DSU does not deal with this issue. It is a provision that refers to entirely different questions: (a) a violation of provisions of the covered agreements has occurred, benefits deriving from those agreements have been nullified or impaired, or the attainment of any objective of the covered agreements has been impeded; (b) the determination of the reasonable period of time for implementing panel and Appellate Body recommendations and rulings; and (c) the suspension of concessions or other obligations.

67. In the view of the parties, does the list of subjects contained in paragraph (d) of Article XX (customs enforcement; enforcement of monopolies; protection of patents, trade marks and copyrights; and prevention of deceptive practices) suggest that there are certain types of laws or regulations which would be covered by the exception contained in that provision? Can parties suggest any GATT or WTO precedents that may throw light on this issue?

Clearly, the list of subjects contained in paragraph (d) of Article XX is illustrative. The clause is preceded of the words "such as", which means "for example". In other words, it provides examples of certain types of laws or regulations which might be covered by the Article XX(d) exception. As the United States noted in paragraph 81 of its Answers to the Panel's Questions after the First Substantive Meeting, the list in Article XX(d) is illustrative and not exhaustive.

Mexico notes that the disputes listed at footnote 64 of the United States' Second Written Submission include instances in which the underlying law or regulation concerned subjects other than those contained in the list of Article XX(d).

68. In the opinion of the parties, does Article 60 of the Vienna Convention on the Law of Treaties codify a principle of international law by which a material breach of a bilateral treaty by one of the parties may allow the other to invoke that breach as a ground for, inter alia, suspending the operation of that treaty in whole or in part, but not for suspending the operation of a different multilateral treaty?

Although the conditions for the taking of countermeasures at customary international law and for the suspension of treaties under Article 60 of the Vienna Convention are similar, they are not identical. As the International Law Commission commented on countermeasures:

- (4) Countermeasures are to be clearly distinguished from the termination or suspension of treaty relations on account of the material breach of the treaty by another State, as provided for in Article 60 of the Vienna Convention on the Law of Treaties. Where a treaty is terminated or suspended in accordance with Article 60, the substantive legal obligations of the States parties will be affected, but this is quite different from the question of responsibility that may already have arisen from the breach. Countermeasures involve conduct taken in derogation from a subsisting treaty obligation but justified as a necessary and proportionate response to an internationally wrongful act of the State against which they are taken. They are

essentially temporary measures, taken to achieve a specified end, whose justification terminates once the end is achieved.²³

Thus, it is not necessary for the Panel to answer this question, which raises many issues that fall outside of the relevant matters in this dispute.

That being said, there are parallels between treaty suspension and countermeasures. Both are based on the old rule of law expressed in the maxim *inadimplenti non est adimplendum* and have their roots in the notion of contractual balance, that is, the necessity of maintaining the balance between the action required of one party and the action required of another party under an international treaty. If one party materially breaches the treaty the other can suspend its operation in whole or in part or take countermeasures as the case may be.

Mexico observes that in drawing the distinction between bilateral and multilateral treaties, the Vienna Convention does not contemplate the unusual legal question presented to the Panel in this case: that the WTO obligation alleged to have been violated is *identical* to the obligation contained in the NAFTA, the agreement under which the dispute arose. We are not dealing with different obligations expressed in two different treaties but rather the same obligation set forth in identical terms in both treaties. Thus, if Mexico is said to be altering the operation of the NAFTA, that can legitimately and reasonably be considered to be a matter governed purely by the NAFTA insofar as the other NAFTA Party, the object of the suspension or countermeasures, is concerned. In Mexico's view, it would be one thing if a measure allegedly violated WTO obligations that do not carry a correlative obligation in the NAFTA; it is another when it allegedly violates NAFTA obligations that also exist in the GATT 1994.

The Panel's question replicates the assumption contained in Article 60 of the Vienna Convention but requires further examination because it is critically important to understand the legal relationship between the NAFTA and the WTO Agreement. The question as posed assumes that material breach of a bilateral treaty may be invoked by one of the parties as a ground for, *inter alia*, suspending the operation of that treaty in whole or in part, "but *not* for suspending the operation of a different multilateral treaty". [Emphasis in original.]

In the light of the undisputed facts, Mexico does not accept that the United States has WTO rights that are separable from those at issue in the larger NAFTA dispute, as it stated in its Second Written Submission. That is, while other WTO Members may have rights enforceable in the WTO, Mexico does not accept that the United States has rights that are additional to its NAFTA rights. This is a NAFTA dispute. Therefore, the assumption contained in the question is not valid in this case.

69. Could parties expand on their views of whether the challenged measures may be considered to be a "disguised restriction on international trade" or an "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", under the chapeau of Article XX?

The challenged measures cannot be considered to be a "disguised restriction on international trade" or an "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", under the chapeau of Article XX of GATT 1994. As discussed in paragraphs 136 to 138 of Mexico's First Written Submission, the measures at issue constitute a proportionate, legitimate and legally justified response to actions and omissions of the United States. It is directly related to the

²³ United Nations Organization. International Law Commission, Report on the work of its fifty-third session (23 April – 1 June and 2 July – 10 August 2001), p. 358, available on line at: <http://www.un.org/law/ilc/reports/2001/2001report.htm>.

long-standing bilateral dispute that has arisen under the NAFTA regarding trade in sweeteners and the United States' persistent refusal to resolve it.

For the same reasons, the measures do not constitute "arbitrary or unjustifiable discrimination between countries where the same conditions prevail". Any discrimination that may result from the application of the measures is perfectly justifiable. The measures relate virtually exclusively to Mexico's trade with the United States. By any objective standards, Mexico's measures have been applied reasonably with due regard to the international legal rights and obligations of both countries.

FOR THE UNITED STATES:

Mexico will not respond to the questions for the United States in this document, but it reserves its right to comment on the answers that the United States will provide in due course.

FOR MEXICO:

81. Regarding the tax that Mexico applies on the provision of certain services (commercial intermediation, dealership, mediation, agency, representation, brokerage, consignment, and distribution, the so-called "distribution tax") for the purpose of transferring goods specified in Section I(A), (B), (C), (G) and (H) of Article 2:I, could Mexico please explain what is the nature of services such as "commercial intermediation, dealership, mediation, agency, representation, brokerage, consignment, and distribution" (comisión, mediación, agencia, representación, correduría, consignación y distribución) and for each of those services, how are they related to certain products, including the soft drinks at issue (but also to other products, such as alcoholic beverages, cigarettes and other tobacco products)?

Commercial intermediation, dealership, mediation, agency, representation, brokerage, consignment, and distribution are legal terms of a commercial nature, that refer to the use by producers or importers of goods of intermediation services in activities such as the sale of soft drinks, alcoholic beverages, cigarettes and other tobacco products. An example would be the commercial intermediation concept, defined by Article 273 of the Mexican Commercial Code as the mandate applied to commercial acts.²⁴ The tax base used for its calculation corresponds to the value of the agreed remuneration for the services.

82. Could Mexico please provide the following information regarding the operation of the "distribution tax":

- (a) **The Panel notes that, according to the legislation that has been provided, the "distribution tax" seems to be imposed at an ad valorem rate of 20 per cent, not of the price of the soft drinks or syrups, but rather on the value of the services provided. Could Mexico please explain if, in practice, the value of the services provided would in any manner be linked to the value of the goods related to those services or to the volume of the products to be transferred?**
- (b) **Does the value of the services differ in cases where taxes are exempted for the transfer of products sweetened with cane sugar?**
- (c) **Could Mexico please explain if, according to the legislation, the person legally liable for the payment of the tax is the supplier of the service. If so, could Mexico please clarify what effect, if any, does the fact that the producers seem to retain the tax and pay it directly to the tax authorities have in practice.**

²⁴ Available at <http://www.diputados.gob.mx/leyinfo>.

- A. The distribution of goods that are subject to the IEPS tax is exempt from the tax payment unless services of commercial intermediation, which involve the participation of third parties through which the transfer of the goods takes place, are used. If the manufacturers, producers, bottlers or importers do not separately contract with third parties for the transfer or distribution of the goods, they are not required to pay the IEPS tax on commercial intermediation services.

The IEPS tax is calculated on the value of the service provided (i.e., on the agreed consideration) that the parties freely determine.

- B. In accordance with Article 2, Section II (A), of the IEPS Law, services of commercial intermediation, mediation, agency, representation, brokerage, consignment, and distribution, are not subject to the IEPS tax when they are related to transfers of goods that are not subject to the IEPS tax.

In the present case, since the transfer of goods sweetened with cane sugar is not subject to the IEPS tax, neither are the commercial intermediation services linked to such goods.

The value of the services is determined by contract between the parties.

- C. In accordance with Articles 1, Section II and 2, Section II, Subsection (a) of the IEPS Law, individuals and legal persons that supply services of commercial intermediation, mediation, agency, representation, brokerage, consignment, and distribution are subject to the IEPS tax with regard to transfers of beverages with an alcoholic content and beer, alcohol, denaturalized alcohol, non-crystallized honey, processed tobacco, soft drinks and its concentrates.

Notwithstanding that the above-mentioned persons are subject to the IEPS tax, they are not the ones that make the actual tax payment. In accordance with Article 5-A of the IEPS Law, manufacturers, producers, bottlers or importers that through commercial intermediaries, mediators, agents, representatives, brokers, consigners, and distributors, transfer the aforementioned goods must retain the tax applicable to these services and pay it to the tax authorities.

The tax retaining feature is a measure of tax control to improve efficiency in the exercise of tax administration powers, since the obligation of paying the tax is concentrated in a more limited and better identified number of taxpayers, as is the case with the manufacturers, producers, bottlers or importers.

- 83. In its first written submission and also during the second substantive meeting (paragraph 18 of written version), Mexico said that the tax measures were "not intended to afford protection to domestic production within the meaning of Article III of the GATT 1994". Could Mexico please elaborate on this assertion. In Mexico's opinion, does the intent of a measure relate to the expression contained in Article III:1 that measures should not be applied "so as to afford protection to domestic production"?**

Mexico recognizes that in the ordinary course of WTO dispute settlement, intent is not considered when applying Article III. However, the *Air Services Agreement* award makes clear that where States find it necessary to take action to protect their interests when international disputes arise, they do act with intent. In the unusual circumstances of this case, Mexico has taken action to protect its legitimate legal interests under another international treaty, under which an unusual dispute has arisen. Accordingly, in Mexico's view, the Panel should take such intent into consideration.

The United States presented this dispute as one in which Mexico had taken action out of purely protectionist motives in order to give undue advantage to its industry in the face of competition from HFCS. This is incorrect.

Due to the relationship between sugar and HFCS in the market, the United States' restrictions on US market access for Mexican sugar caused a serious imbalance in the Mexican market. While the US HFCS and that produced in Mexico from US corn displaced sugar in the Mexican market, the generated sugar surpluses did not find a way out into the US market because of the restrictions adopted by the United States. Any of the alternatives - exporting to the international market where the prices are much lower or selling the excess supply in the domestic market, which would have resulted in the collapse of the domestic price - would have been extremely costly. The measures adopted by the Mexican Government to alleviate the industry's situation were not enough. Many sugar mills faced a severe liquidity crisis, which put the whole sector at risk; it is a politically, socially and economically sensitive sector, because a very large number of people with limited resources depend on it for their subsistence.

Mexico attempted to resolve the situation through all possible ways. It exhausted all efforts, without success. Due to the persistent refusal of the United States to submit to the institutional mechanism for resolving the dispute, Mexico took measures to rebalance the situation. In clear contrast with the restrictions adopted by the United States on Mexican sugar imports, Mexico did not seek to disrupt a negotiated balance for the benefit of its producers, but it was forced to restore the balance that the United States had altered. Had the United States not broken the balance established in the NAFTA, it would not have been necessary for Mexico to adopt the tax measures at issue.

84. During the second substantive meeting, Mexico made reference to specific provisions in the WTO covered agreements that use expressions such as "laws", "regulations", "international law" in different forms. Could Mexico identify more precisely those specific provisions.

In the Second Substantive Meeting, Mexico pointed out that Article XX(d) of the GATT is not the only provision where reference is made to laws, regulations and others types of measures without qualifying them as domestic. In the agreements, there are numerous references to different types of measures. In some cases, it is specified that the provision relates to domestic measures, through expressions such as "its laws and regulations" (to refer to a Member's measure), "national legislation", "a Member's legislation" or of a "non Member", etc. When reference to international law was intended to exclude domestic law, a qualifying term was used as well. In other cases, there was no express distinction. Exhibit Mex- 55 contains an illustrative list of the use of such terms for both situations.

In Mexico's view, when the drafters intended to limit such terms to internal measures, they did so expressly. The Panel must avoid unduly restricting the terms of Article XX(d) considering the implications that this could have for other provisions of the covered agreements in which the drafters did not make the distinction expressly.

85. In paragraph 70 of its second written submission, Mexico observed that "international law is no less law than domestic law" and added that "[t]he NAFTA has effect in the internal legal order of its signatories." Could Mexico please elaborate on that statement. Does Mexico mean that the NAFTA agreement is part of Mexican domestic law and how would Mexico sustain that assertion by reference to its law?

Please see the answer to Question 59.

Due to the constitutional system of incorporation of international law under Mexican law, in Mexico international treaties, including the NAFTA, are internal laws that do not require further implementation action. In this way, they have direct and immediate effects in the internal legal system.

86. Could Mexico please explain why it considers that its measures "actually greatly contribute to the end pursued by Mexico, that is, the securing of US compliance with the NAFTA" (paragraph 83 of its second written submission).

No amount of formal requests for panels, international cooperation or other steps that Mexico has taken over more than six years has induced the United States to resolve the dispute. Mexico noted a substantial increase in US expressions of concern after it finally adopted measures to rebalance the Mexican market. Obviously, the US HFCS industry and various other sectors are concerned about measures, and they have communicated that to the US authorities. This dispute is evidence of the seriousness with which the Mexican measures were viewed by the United States. The United States is relying upon this Panel to find the measures inconsistent with the GATT 1994, in the hopes that Mexico will then lose the leverage that it has obtained.

Mexico strongly believes that if the Panel does not reward the United States for its conduct, including forum shopping, and finds that Mexico's measures are justified under Article XX of the GATT 1994, the circumstances will finally be ripe for a mutually satisfactory resolution of the dispute.

87. In its second written submission (paragraph 14) and also during the second substantive meeting (paragraph 37 of written version), Mexico has referred to "a general principle of international law" by which "one party cannot avail himself of the fact that the other has not fulfilled some obligation, or has not had recourse to some means of redress, if the former party has, by some illegal act, prevented the latter from fulfilling the obligation in question, or from having recourse to the tribunal which would have been open to him". Could Mexico clarify what is the "illegal act" that it is alleging the United States is committing in this regard?

Please see the response to Question 58.

There are two breaches of the NAFTA at issue here: the denial of market access for Mexican sugar, agreed under the NAFTA and more critically, the persistent refusal to submit to dispute settlement, thus preventing Mexico from resolving its first grievance. It lies ill in the mouth of the United States to complain that in the absence of a panel ruling, Mexico made a unilateral determination that the United States had breached the NAFTA when the United States prevented Mexico from using the recourse available to it under Chapter Twenty of the NAFTA.

88. During the second substantive meeting (paragraph 20 of its closing statement), Mexico recalled Article 19.1 of the DSU, under which "[w]here a panel... concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement". Mexico argued, however, that that provision does not prevent a panel from issuing other resolutions or recommendations. Could Mexico clarify whether it is arguing that a panel may make these other resolutions or recommendations in addition to recommending that a Member bring its measures into conformity or instead of recommending that a Member bring its measures into conformity.

Please see the answer to Question 63.

If the Panel finds that the measure at issue is inconsistent with the GATT 1994, it should recommend that Mexico bring its measure into conformity with this agreement, but nothing impedes it from making other recommendations pursuant to Article XXIII of the GATT 1994.

89. In its first submission, Mexico expressed its belief "that the only fair and appropriate course of action [in this case] would be for both parties to agree to submit their respective grievances to a NAFTA Chapter Twenty Arbitral Panel, as the only body in which the dispute – both parties' complaints – [could] be considered fully in light of all of their respective rights and obligations" (paragraph 12). Mexico will recall that in its question No. 5, the Panel asked if parties could comment on "how the NAFTA system would deal comprehensively with all the issues that Mexico considers affect the bilateral trade in sweeteners between Mexico and the United States". In its response to that question, Mexico stated that it would agree "to submit the dispute as a whole, including the United States claims under Article III of the GATT 1994 (and NAFTA Article 301), to a NAFTA Chapter Twenty arbitral panel". Could Mexico please clarify whether, according to NAFTA rules, a NAFTA Chapter Twenty Arbitral Panel could deal comprehensively with both a United States claim against the tax measures imposed by Mexico and the Mexican complaint on the United States' market access commitments for sugar under the NAFTA. Would that mean that NAFTA panels may accumulate in a single case complaints and counter-complaints in regard to different matters?

Please see the answer to Question 65.

90. Could Mexico please provide information on any measures it may have had in place during the last five years (such as tariffs, quantitative restrictions, trade preferences, subsidies, anti-dumping measures, countervailing measures, sanitary or phytosanitary measures) that have affected the importation or domestic sales of the products that are relevant for the present case (soft drinks; hydrating or rehydrating drinks; concentrates, powders, syrups, essences or flavour extracts that can be diluted to produce soft drinks and hydrating or rehydrating drinks; and, syrups or concentrates for preparing soft drinks sold in open containers which use automatic, electric or mechanical equipment, cane sugar, beet sugar, and High-Fructose Corn Syrup, HFCS).

In the last five years, Mexico has adopted the following measures:

- the *Decreto por el que se modifican diversos aranceles de la tarifa de la ley del Impuesto General de Importación* published on 11 October de 2001, which established an MFN tariff for HFCS;
- the *Decreto por el que se establece la Tasa Aplicable para el 2002 del Impuesto general de Importación para las Mercancías Originarias de América del Norte, la Comunidad Europea, los Estados de la Asociación Europea de Libre Comercio, el Estado de Israel, El Salvador, Guatemala, Honduras, Nicaragua, Costa Rica, Colombia, Venezuela, Bolivia, Chile y la República Oriental del Uruguay*, published on 31 December 2001, which established an import quota for HFCS imported under the NAFTA;
- the *Acuerdo por el que se establece un cupo de importación para la fructosa de los Estados Unidos de América*, published on 22 April 2002 in the Mexican Official Gazette, which established the import quota for the 2001-2002 harvest;
- the *Ley del Impuesto Especial sobre Producción y Servicios* (the measure at issue in this dispute); and

- the *Resolución por al que se da cumplimiento a la decisión del panel binacional del 15 de abril de 2002, encargado de la impugnación al informe de devolución de la autoridad investigadora del 23 de noviembre de 2001, del caso MEX-USA-98-1904-01, revisión de la resolución final de la investigación antidumping sobre las importaciones de jarabe de maíz de alta fructosa, mercancía clasificada en las fracciones arancelarias 1702.40.99 y 1702.60.01 de la Tarifa de la Ley del Impuesto General de Importación, originarias de los Estados Unidos de América, independientemente del país de procedencia, emitida por la ahora Secretaría de Economía, y publicada el 23 de enero de 1998*, published on 13 May 2002, which revoked the previous resolution adopted in January 1998 through which countervailing duties were imposed on US HFCS imports into Mexico.

Although Mexico has adopted in the last five years measures that have affected imports and sales in the domestic market of the products that are relevant for the present case, only two of those measures were adopted in response to the United States' refusal to comply with the conditions for access of Mexican sugar under the terms established in NAFTA Annex 703.2.

91. In response to Panel questions Nos. 42 and 43 addressed to parties after the first substantive meeting, Mexico informed the Panel that it would be attempting to provide further information. Has Mexico been able to obtain this additional information?

The Government does not have the information requested by the Panel.

ANNEX C-4

RESPONSES BY THE UNITED STATES TO QUESTIONS
POSED BY THE PANEL AFTER THE SECOND SUBSTANTIVE MEETING

(15 March 2005)

BOTH PARTIES

52. The Panel recalls that, in its response to Panel questions Nos. 45 and 50, Mexico stated that "as of 1 January 2005, imported soft drinks, syrups and concentrates for preparing soft drinks will be exempt from payment of the IEPS, as long as they are sweetened only with cane sugar." Could parties please provide more information in this regard? The Panel further notes that, in its rebuttal submission, the United States has said that "The January 1, 2005 amendment to the HFCS soft drink tax is outside the Panel's terms of reference." Do parties have any additional comments on the matter? Could they please explain how the new amendment works and how it has changed the previous relevant provisions of the law.

The measures within a panel's terms of reference are those identified in the panel request.¹ The US panel request in this dispute does not identify the January 1, 2005 amendment, principally because the amendment was published on December 3, 2004, nearly six months after June 10, 2004, the date of the panel request.² The January 1, 2005 amendment is, therefore, outside this Panel's terms of reference. As a result, the Panel should not make findings on the January 1, 2005 amendment.

The Panel also should not consider the January 1, 2005 amendment in making findings on the IEPS as it existed at the time of the US panel request. First, the United States has established a *prima facie* case that Mexico's tax measures (as they existed at the time of the US panel request) are inconsistent with Mexico's obligations under Article III of the GATT 1994. Mexico has not rebutted that case and, in fact, Mexico has stated that it does not contest that its tax measures breach Article III.

Second, although the January 1, 2005 amendment is outside the Panel's terms of reference, the United States would note that the amendment in actuality does not appear to eliminate the discrimination Mexico's tax measures impose on soft drinks and syrups imported from the United States. As mentioned below, the January 1, 2005 amendment appears simply to amend the IEPS to substitute one form of discrimination against imports for another.³

Third, there is the concern expressed by the Appellate Body in *Chile – Price Bands* of a "moving target." In that report,⁴ the Appellate Body stated that "a practice of amending measures during dispute settlement proceedings if such changes are made with a view to shielding a measure

¹ Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, para. 284; Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R, adopted 19 December 2002, para. 124.

² WT/DS308/4.

³ In this regard, the Panel should find the IEPS inconsistent with Article III of the GATT even if it were to assesses the IEPS inclusive of the January 1, 2005 amendment.

⁴ In *Chile – Price Bands*, although the Appellate Body upheld the panel's decision to make findings on the measure inclusive of amendments made to the measure after the panel's establishment, the Appellate Body did so after first concluding that the amended measure "[did] not change the price band system into a measure *different* from the price band system that was in force before the Amendment." Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002, para. 137. As stated above, the Panel's terms of reference in this dispute do not include the January 1, 2005 amendment to the IEPS.

from scrutiny by a panel or by us" was not to be condoned and that "generally speaking, the demands of due process are such that a complaining party should not have to adjust its pleadings throughout dispute settlement proceedings in order to deal with a disputed measure as a 'moving target.'"⁵ The United States shares the concern of the Appellate Body in that it should not have to – indeed the DSU does not ask it to – adjust its arguments in this dispute to take into account an amendment to Mexico's tax measures that was published nearly six months after its panel request and that was notified to the Panel only after its first meeting with the parties.⁶

With respect to the operation of the January 1, 2005 amendment, it amends Article 13 of the IEPS to add soft drinks and syrups (products identified in Article 2(g) and (h) of the IEPS) sweetened exclusively with cane sugar to the list of imports exempt from the IEPS. In the limited time the United States has had to understand the amendment, the amendment appears to be limited to the application of the IEPS to importations of soft drinks and syrups and not to affect the IEPS as it applies to the internal transfer or distribution of imported soft drinks and syrups sweetened with non-cane sugar sweeteners. It also does not appear to have any effect on the way in which the IEPS discriminates against imported non-cane sugar sweeteners used to produce soft drinks and syrups in Mexico.

As to importations, it appears that the January 1, 2005 amendment amends the IEPS to exempt importations of soft drinks and syrups sweetened exclusively with cane sugar from the IEPS, whereas prior to the amendment the IEPS subjected all soft drinks and syrups regardless of the type of sweeteners used to the IEPS. The January 1, 2005 amendment thus appears to extend the same exemption afforded to the internal transfer of soft drinks and syrups sweetened exclusively with cane sugar to the importation of soft drinks and syrups sweetened exclusively with cane sugar. In this regard, the amendment appears to continue to discriminate against like or directly competitive or substitutable imports from the United States.⁷

53. In its response to Panel question No. 46, Mexico stated that the "soft drinks tax", as it had been in place before December 2004, did not discriminate based on the origin of the product. Does Mexico mean that internal transfers of imported soft drinks are exempt from the "soft drinks tax" as long as those soft drinks are sweetened with cane sugar under the measures at issue, even though no exemption is allowed for the same imported products at the time of

⁵ Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002, para. 144.

⁶ Faced with similar situations, prior panels have made findings with respect to measures within their terms of reference that were (or allegedly were) amended or terminated after the date of the panel request. See Panel Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/R, adopted 30 August 2004, as amended by the Appellate Body Report, WT/DS276/AB/R, para. 6.259 (noting that the substantive terms of the amended and unamended measures were essentially the same and that a ruling on the unamended measure would be meaningful for resolution of the dispute); Panel Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products* ("*Chile – Price Band System*"), WT/DS207/R, adopted as modified by the Appellate Body on 23 October 2002, paras. 7.124-7.125 (making findings on an expired preliminary safeguard measure and noting the complaining party's argument that it had suffered nullification or impairment as a result of the expired measure); Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998, para. 14.9 (making findings with respect to a measure Indonesia alleged had been terminated). The *Canada – Wheat* and *Indonesia – Autos* panels note several disputes in which findings were made on allegedly terminated or amended measures. Panel Report, *Canada – Wheat*, para. 6.259 n.334; Panel Report, *Indonesia – Autos*, para. 149 n.642.

⁷ The exemption for internal transfers is specified in Article 8 of the IEPS, whereas the January 1, 2005 amendment adds the exemption for imports of soft drinks and syrups sweetened exclusively with cane sugar to the list of imports already exempted in Article 13 of the IEPS. See *Se Reforman Y Adicionan Diversas Disposiciones De La Ley Del Impuesto Especial Sobre Producción Y Servicios*, Diario Oficial (Dec. 1, 2004).

importation? In other words, is it correct to understand that the "soft drinks tax" operates differently depending on the two specific times when the tax is imposed, i.e., upon importation and upon any internal transfer occurred within the market? Could the United States also provide its comments?

Although on its face the IEPS exempts internal transfers of soft drinks and syrups sweetened exclusively with cane sugar and does not distinguish in this regard between imported and domestically produced soft drinks and syrups, as the United States has explained, in providing an exemption for the internal transfer of soft drinks and syrups sweetened exclusively with cane sugar, the IEPS discriminates *de facto* against imports from the United States which are sweetened with non-cane sugar sweeteners. Mexico's response to Question 46 simply ignores this *de facto* discrimination.

The Panel is correct that IEPS operates differently depending on the two specific times when the tax is imposed. With respect to application at the time of importation, the IEPS applies to all soft drinks and syrups, even those sweetened exclusively with cane sugar. When the IEPS applies on internal transfers, however, it differentiates between the type of sweetener used: internal transfers of soft drinks and syrups sweetened exclusively with cane sugar are exempt from the tax.

54. Do the parties view the so-called "bookkeeping requirements" as a separate measure from the "soft drinks tax" and the "distribution tax", or rather as a measure which is ancillary to the two last. If it is an ancillary measure, would that fact have any consequence on the way the Panel should analyse those "bookkeeping requirements"?

While the bookkeeping and reporting requirements clearly relate to the HFCS soft drink and distribution taxes, they impose separate requirements, and should be treated as separate measures. Compliance with Mexico's obligations under Article III requires elimination not only of its dissimilar taxation of non-cane sugar sweeteners such as HFCS, but also the elimination of requirements that disadvantage the use of imported non-cane sugar sweeteners. As explained in prior US submissions, the bookkeeping and reporting requirements imposed by the IEPS disadvantage the use of import non-cane sugar sweeteners by requiring soft drink and syrup producers who use non-cane sugar sweeteners to comply with certain bookkeeping and reporting requirements including a requirement to report their main 50 clients and suppliers to the Mexican Government. These same requirements are not imposed on soft drink and syrup producers who use the like domestic sweetener cane sugar. If Mexico were to amend its tax measures to eliminate the dissimilar taxation, but continued to impose the bookkeeping and reporting requirements, Mexico would not have eliminated the disadvantage imposed on the use of imported non-cane sugar sweeteners. The IEPS would, therefore, continue to treat imported sweeteners less favorably than like domestic sweeteners in breach of Mexico's obligations under Article III:4 of the GATT 1994.

As the United State recalled in its responses to the Panel's questions after the first meeting, the Appellate Body emphasized in *Australia – Salmon* that panels are "to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings in order to ensure effective resolution of disputes to the benefit of all Members."⁸ Findings in this dispute that would enable the DSB to make sufficiently precise recommendations and rulings would be those that addressed each of the ways in which Mexico discriminates against imports of non-cane sugar sweeteners (including HFCS and beet sugar) and imports of soft drinks and syrups.

55. The Panel recalls that, in its response to Panel question No. 21, the United States asserted that "The IEPS as a tax on HFCS may properly be examined under both Article III:2

⁸ US Responses to the Questions of the Panel, para. 2; Appellate Body Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/AB/R, adopted 6 November 1998, para. 223.

and III:4 of the GATT 1994". During the second substantive meeting (paragraph 53 of written version), Mexico expressed its doubts that, as a matter of WTO law, a same measure may violate both Article III:2 and Article III:4. Do the parties have additional views on the matter? Could they also clarify whether, if in a particular case, simultaneous claims were raised against the same measure under both Article III:2 and III:4, a panel should proceed in any particular order when dealing with such claims?

As to whether the IEPS as a tax on HFCS (HFCS soft drink and distribution taxes) may properly be examined under Articles III:2 and III:4 of the GATT 1994, the United States disagrees with Mexico's analysis in paragraph 53 of its opening statement at the second panel meeting. The HFCS soft drink and distribution taxes may properly be analyzed under both Article III:2 and III:4 of the GATT.

By its terms, Article III:2 applies to any "internal taxes or other internal charges of any kind" which are "applied, directly or indirectly, to ... products." As the GATT panel on *Superfund Taxes* pointed out, excise taxes are subject to Article III:2.⁹

A tax subject to Article III:2, however, may also be a law affecting imported products within the scope of Article III:4. Article III:4 refers to "all laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use" of imported products. Article III:4's use of the word "all" indicates that any law, including laws imposing taxes on products, may fall within the scope of Article III:4, provided the law affects the internal sale, offering for sale, purchase, transportation, distribution or use of imported products. The terms "laws, regulations or requirements affecting" in Article III:4 are also "general terms that have been interpreted as having a broad scope."¹⁰ A tax provision that influences a taxpayer's choice whether to purchase like imported or domestic inputs is a measure "affecting" the internal use of imported products, within the meaning of Article III:4.¹¹

The HFCS soft drink and distribution taxes are both taxes "applied directly or indirectly to ... products" as well as "laws ... affecting [the] internal ... use" of imported products. On the one hand, the HFCS soft drink and distribution taxes are taxes levied "directly or indirectly" on non-cane sugar sweeteners. The fact that these taxes are collected on the transfer and distribution of the downstream product (soft drinks and syrups) does not change the fact that the taxes are applied to HFCS. The

⁹ *United States – Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, 154, para. 5.1.1. Other examples of excise taxes evaluated under Article III:2 include various federal and state taxes on beer and wine in the United States, in *United States – Measures Affecting Alcoholic and Malt Beverages* (BISD 39S/206); excise taxes on cigarettes in *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes* (BISD 37S/200) and in *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/R, paras. 7.317ff; an excise tax on automobiles in *Indonesia – Autos*, WT/DS54/R, paras. 14.104-14.114; excise taxes on certain periodicals in *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, pp. 20-23; and excise taxes on distilled spirits in *Japan – Taxes on Alcoholic Beverages* (WT/DS8/AB/R), *Korea – Taxes on Alcoholic Beverages* (WT/DS75/AB/R) and *Chile – Taxes on Alcoholic Beverages* (WT/DS87/AB/R).

¹⁰ Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW, para. 8.144 (citing *EC – Bananas*, WT/DS27/AB/R, para. 220; *Canada – Autos*, WT/DS139/R, para. 10.80; and *Italian Agricultural Machinery*, BISD 7S/60, para. 12); Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, para. 210.

¹¹ Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, paras. 212-213.

United States has already demonstrated how Mexico's tax measures on soft drinks and syrups translate to a prohibitive tax on HFCS¹² and Mexico has stated that its tax measures target HFCS imported from the United States.¹³ The structure of Mexico's tax measures is not unlike the "internal charges" considered by a GATT panel in *EEC – Parts and Components*. These internal charges were imposed on certain products assembled within the EC, if the products in question included excessive amounts of imported parts and components. The panel analyzed the charges under Article III:2 of the GATT and found that the internal charge on finished products subjected imported parts and components to an internal charge in excess of that applied to like domestic products in breach of Article III:2.¹⁴

On the other hand, the HFCS soft drink and distribution taxes are measures "affecting" the use of imported HFCS. Through their application to soft drinks and syrups sweetened with HFCS, but not soft drinks and syrups sweetened with Mexican cane sugar, the HFCS soft drink and distribution taxes provide an effective incentive for bottlers to cease using HFCS and to switch to using domestic cane sugar. The HFCS soft drink and distribution taxes, therefore, fall under Article III:4.

If there is overlap with respect to Articles III:2 and III:4 in this dispute, it is because of the particular tax measures Mexico has chosen to employ to discriminate against HFCS. Indeed, a discriminatory excise tax on a product, which also punishes users of that product for using imported inputs, would fit under both provisions.

As to the order in which to analyze the US claims, the United States found it helpful in its first and second written submissions to analyze the consistency of the HFCS soft drink and distribution taxes with respect to sweeteners first under Article III:2 and second under Article III:4. The Panel could employ the same order of analysis.

With respect to the bookkeeping and reporting requirements of the IEPS, the US challenge is limited to Article III:4.

56. Does the so-called "distribution tax" operate on its own or is it dependent on the operation of the "soft drinks tax"? Does its existence depend on the "soft drinks tax"? Is it in any other manner linked to the so-called "soft drinks tax"?

The distribution tax (i.e., the 20 percent tax imposed on the distribution, representation, brokerage, agency, and consignment of soft drinks and syrups sweetened with non-cane sugar sweeteners) operates on its own and discriminates against imported sweeteners and soft drinks and syrups made with imported sweeteners independently of the HFCS soft drink tax (i.e., the 20 percent tax imposed on the importation of soft drinks and syrups and on the internal transfer of soft drinks and syrups made with non-cane sugar sweeteners). As recounted in the US first submission,¹⁵ the IEPS taxes three types of activities: the importation, the internal transfer and the distribution (along with the representation, brokerage, agency, and consignment) of soft drinks and syrups made with non-cane sugar sweeteners.¹⁶ Taxation of any one of these activities results in discriminatory treatment for non-cane sugar sweeteners and soft drinks and syrups made with such sweeteners and does not depend on whether non-cane sugar sweeteners and soft drinks and syrups made with such sweeteners

¹² US First Written Submission, para. 45.

¹³ Mexico Second Written Submission, paras. 3, 81.

¹⁴ GATT Panel Report, *EEC – Regulations on Imports of Parts and Components*, BISD 37S/193, adopted on May 16, 1990, paras. 5.9. The internal charge in the dispute constituted so-called "anti-circumvention duties" which the panel found constituted an "internal charge" within the meaning of Article III:2 rather than a "customs duty" within the meaning of Article II:1(b). *Id.* paras. 5.8-5.9.

¹⁵ US First Written Submission, paras. 37-39.

¹⁶ With respect to importations, the IEPS taxes all soft drinks and syrups regardless of the type of sweetener used. *See supra* response to Question 52.

are also taxed on their importation, internal transfer or distribution, respectively. Thus, for example, if Mexico were to amend the IEPS to eliminate the 20 percent tax on the internal transfer of soft drinks and syrups made with non-cane sugar, the IEPS would nonetheless continue to discriminate against imported sweeteners and soft drinks and syrups by taxing the distribution, representation, brokerage, agency, and consignment of soft drinks and syrups made with non-cane sugar sweeteners.

57. In the view of the parties, can Article III:2 of the GATT cover a measure that imposes a tax on services related to specific products?

Article III:2 covers measures that subject imports directly or indirectly to taxes in excess of those applied to like or directly competitive or substitutable domestic products. The IEPS subjects imported sweeteners and soft drinks and syrups made with such sweeteners to taxation that is in excess of, and dissimilar from, that imposed on like and directly competitive or substitutable products produced in Mexico, namely cane sugar and soft drinks and syrups made with cane sugar. The IEPS accomplishes this by way of a 20 percent tax imposed on the importation, internal transfer and distribution (along with the representation, brokerage, agency, and consignment) of soft drinks and syrups made with non-cane sugar sweeteners. The fact that the distribution tax subjects imported sweeteners and soft drinks and syrups made with such sweeteners to excess or dissimilar taxation at the time they are distributed and calculates the amount of tax owed on the value of the distribution service does not remove it from the purview of Article III:2. The distribution tax is simply another means by which to subject imported sweeteners and soft drinks and syrups to excess and dissimilar taxation in breach of Article III:2.

In this regard, the United States views the distribution tax as a tax applied on a product (whether soft drinks and syrups or the sweeteners they contain) that applies at the time the product is distributed and that is calculated on the value of the service rendered. The fact that the distribution tax involves services supplied in conjunction with particular goods (soft drinks and syrups sweetened with non-cane sugar sweeteners) does not change the fact that the distribution tax discriminates against those goods. Measures can be subject to both the GATT and the GATS. In *EC – Bananas*, for example, the Appellate Body explained that measures "that involve a service relating to a particular good or a service supplied in conjunction with a particular good" may properly be examined under both the GATT and the GATS.¹⁷

58. During the second substantive meeting (paragraph 33 of written version), Mexico has said that its measures may be justified under the NAFTA. Further, in its closing statements, Mexico argued that a NAFTA panel could find that the tax measures imposed by Mexico would be acceptable countermeasures. Does the United States agree with this statement? Could Mexico please elaborate on its statements and provide reference to the provisions of the NAFTA agreement under which its measures would be justified.

Whether Mexico's tax measures might be justified under the NAFTA is not relevant to resolution of this dispute, which concerns the consistency of Mexico's tax measures with its obligations under the WTO Agreement.

There is nothing in the text of the NAFTA providing parties the right to take countermeasures in the manner Mexico contends in this dispute. Like the DSU, the NAFTA dispute settlement provisions proscribe rules for the suspension of benefits including that any suspension be *preceded* by a finding of breach by a NAFTA panel.¹⁸ In addition, the suspension of benefits authorized under NAFTA dispute settlement provisions would be benefits accruing under the NAFTA, not those under

¹⁷ Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted on 25 Sept. 1997, para. 221.

¹⁸ NAFTA Arts. 2018 and 2019.

another international trade agreement such as the WTO Agreement – which Mexico has breached vis-a-vis the United States and every other WTO Member by imposing its discriminatory tax measures.

Mexico's contention that it has "directed the Panel to examples of counter-measures being taken or being reserved in the NAFTA context as well as to other instances where the United States has reserved the right to take action of the type that Mexico took"¹⁹ is incorrect. Neither "example" Mexico cites with respect to the NAFTA²⁰ constitute an instance where a party maintained, as Mexico does in this dispute, that the NAFTA or any principle of international law justified the party's breach of NAFTA rules.

59. Do the parties consider that the NAFTA Agreement is part of the United States' domestic "laws or regulations"? What implication would that fact have for the expression "laws or regulations" as used in paragraph (d) of Article XX of the GATT in this dispute?

The NAFTA is an international agreement and does not have direct effect in the United States. It is not self-executing. It is also not a domestic law or regulation of the United States. The NAFTA has not been passed by the US Congress pursuant to its legislative powers under the US Constitution, nor was the NAFTA submitted as a treaty to the US Senate for its advice and consent.

It was precisely because the NAFTA itself is not US law that it was necessary for Congress to pass implementing legislation so that US laws would be changed to accord with the international obligations of the United States under the NAFTA. Mexico's assertions about the NAFTA to the contrary are simply incorrect.²¹

Even if the NAFTA were part of US domestic laws or regulations, however, Mexico could not claim an Article XX(d) exception for a measure necessary to secure compliance with *another* Member's laws or regulations. Article XX(d) provides an exception for measures necessary to secure compliance with the laws or regulations of the Member claiming the Article XX(d) exception. In *Korea – Beef*, for example, the Appellate Body stated that "[i]t is not open to doubt that Members of the WTO have the right to determine for themselves the level of enforcement of *their* WTO-consistent laws and regulations."²² Article XX(d) is not a provision by which Members might seek to enforce the domestic laws and regulations of *other* Members. If it were, Article XX(d) would in effect become a tool for one sovereign to enforce the domestic laws and regulations of another.

60. As parties are aware, the Appellate Body has stated that, in order to evaluate the "necessity" of a measure under Article XX(d), a panel would need to examine, among other factors, "the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect" (Appellate Body Report, *Korea - Various Measures on Beef*). Could parties please explain, in their view, what would be "the common interests or values" that the NAFTA Agreement is intended to protect.

¹⁹ Mexico Second Submission, para. 8.

²⁰ Mexico Second Submission, paras. 27-31, 33-35 (discussing a NAFTA panel report on Agricultural Products and a US – Canada Memorandum of Understanding on wheat).

²¹ With respect to paragraph 13, it is Mexico's reading of *Corus Staal* that is too narrow. In that case, Corus Staal had argued: "[the US Department of] Commerce's zeroing methodology violates the United States' obligation to interpret section 1677(35) to conform to World Trade Organization ("WTO") decisions prohibiting zeroing." The court found: "Because zeroing is in fact permissible in administrative investigations and because Commerce is not obligated to incorporate WTO procedures into its interpretation of US law, Corus' arguments fail." The court explained: "Neither the GATT nor any enabling international agreement outlining compliance therewith (e.g., the ADA) trumps domestic legislation; if US statutory provisions are inconsistent with the GATT or an enabling agreement, it is strictly a matter for Congress."

²² Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, para. 176 (emphasis supplied).

Because the United States does not consider that Article XX(d) can apply to international obligations, the United States is not in a position to identify what "common interests or values" (as the Appellate Body used the phrase in *Korea – Beef*) could be served by the NAFTA. In any case, Mexico has certainly not identified any such "common interests or values."

61. Could parties share their views on whether a successful invocation of an Article XX(d) defence would require that the contested measure be necessary to prevent or correct a breach of the underlying "law or regulation"?

It is difficult to comment on the issues raised in this question in the abstract, and, for the reasons already described, the United States does not consider that the Article XX(d) defense is available to a Member asserting the need to secure compliance with an international agreement.

Having said this, the United States notes that the panel in *Korea – Beef*, for example, found that a measure that served to "prevent acts inconsistent with" a Korean law (the Unfair Competition Act) prohibiting misrepresentation as to the origin of beef "was put in place at least in part, in order to secure compliance with" that law.²³ The panel then turned to analyze whether the measure was "necessary to prevent misrepresentation as to the origin of beef."²⁴ On appeal, however, the Appellate Body did not address whether "secure compliance" might include "preventing" a breach of the Unfair Competition Act, but simply examined whether the measure was "'necessary' to secure compliance with the Unfair Competition Act."²⁵

62. Is there any provision in the NAFTA Agreement that can be considered equivalent to Article 23(2) of the DSU in the sense that a unilateral determination by a party that a violation has occurred, or that its benefits have been nullified or impaired or that the attainment of any objective of the covered agreement has been impeded, is prohibited and such decisions can only be made through recourse to dispute settlement in accordance with the rules and procedures under that Agreement?

There is no provision in the NAFTA containing language identical or similar to Article 23.2 of the DSU. There is also no provision in the NAFTA that justifies a breach of the NAFTA on the fact or assertion that another party has breached its obligations under the NAFTA. The only provision that would authorize a NAFTA party to take countermeasures is Article 2019, which by its terms only applies "[i]f in its final report a panel has determined that a measure is inconsistent with the obligations of the [NAFTA]" and the parties have not agreed on a solution to the dispute within 30 days.

NAFTA Article 2004 provides that except for antidumping and countervailing duty matters and as otherwise provided in the NAFTA Agreement, "the dispute settlement provisions of this Chapter [20] shall apply with respect to the avoidance or settlement of all disputes between the Parties regarding the interpretation or application of this Agreement or wherever a Party considers that an actual or proposed measure of another Party is or would be inconsistent with the provisions of this Agreement" Article 2019 provides a right to temporarily suspend benefits, but only after a panel determination under Chapter 20. Article 2019 articulates the procedures to be followed in suspending benefits.

²³ Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, adopted on 10 January 2001, para. 658.

²⁴ *Id.*, paras. 659 *et seq.*

²⁵ Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, paras. 159 *et seq.*

63. In its second written submission and also during the second substantive meeting (paragraphs 43-52 of written version), Mexico has stated that a WTO panel does not have a legal obligation to issue findings on the claims raised by a complaining Member, but rather has the flexibility to decide whether to issue rulings or to make recommendations, as appropriate. Is it the parties view that that discretion, if it in fact exists, is vested by the WTO agreements on panels or rather on the Dispute Settlement Body (or the Contracting Parties acting jointly, in the case of the GATT)?

For the reasons stated in prior US submissions,²⁶ a WTO panel does have a legal obligation to issue findings on the claims raised by a complaining party and, therefore, does not have the flexibility to "decide whether to issue rulings or make recommendations, as appropriate." The Panel has already stated in its denial of Mexico's request for a "preliminary ruling": "Under the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), [the Panel] does not have the discretion, as argued by Mexico, to decide not to exercise its jurisdiction in a case that has been properly brought before it."²⁷ In stating that it did not have the discretion to decline to exercise jurisdiction over this dispute, the United States understands the Panel to have concluded that it must issue findings on the US claims, as the US claims are what comprise this dispute.

A WTO panel likewise does not have the flexibility to decide what an "appropriate" recommendation might be. Mexico's reliance on Article XXIII:2 of the GATT in this regard is misplaced. Although Article XXIII:2 of the GATT instructs the CONTRACTING PARTIES to make "appropriate" recommendations, what is an "appropriate" recommendation from a WTO panel has been definitively answered by Article 19.1 of the DSU. Article 19.1 of the DSU provides:

Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. In addition to its recommendations, the panel or the Appellate Body may suggest ways in which the Member concerned could implement the recommendations.²⁸

Therefore, pursuant to Article 19.1 of the DSU, whenever a panel finds a violation of the GATT or any other covered agreement, the panel must recommend that the violation be brought into conformity the agreement; the panel has no discretion to do otherwise. Article 19.1 also does not provide any discretion for a panel to make any additional recommendations, to any party, that would go beyond the correction of a violation. Mexico's argument that Article XXIII of the GATT allows WTO panels greater flexibility than this simply ignores the terms of DSU Article 19.²⁹

In any event, to the extent that Article XXIII:2 continues to afford authority to make further recommendations (an issue which the Panel need not reach), it affords that authority to the WTO Members, not a panel or the Appellate Body.

64. Mexico has said throughout the case that the Panel would not need to interpret NAFTA rules. However, in an Article XX(d) defence, a panel may need to interpret the underlying "law

²⁶ US Responses to Questions of the Panel after the First Meeting, paras. 1-11; US Opening Statement to the Panel at the First Meeting of the Panel, paras. 13-15.

²⁷ Letter from the Chairman of the Panel to the Parties (Nov. 3, 2005).

²⁸ DSU Art. 19.1 (footnote omitted).

²⁹ Another panel has recently reached the conclusion that the DSU does not authorize panels to make recommendations beyond the specific recommendation authorized (and mandated) by DSU Article 19.1. Panel Report, *European Communities – Export Subsidies on Sugar*, WT/DS265/R, circulated on October 15, 2004 (appeal on other issues pending), para 7.353.

or regulation" to assess whether a measure is actually justified. Would that mean, in the parties' opinion, that this Panel may in fact have to interpret NAFTA rules?

The Panel's question highlights another reason why Mexico's Article XX(d) defense is untenable and why Article XX(d) does not cover measures to secure compliance with obligations under an international agreement. There is no way for a panel to find a measure "necessary to secure compliance" with obligations under an international agreement, unless it were first to determine what the agreement's obligations were and whether the Member against whom the measure was taken was not in compliance with those obligations.³⁰ However, as the United States articulated at the second panel meeting, this would effectively convert WTO dispute settlement into a forum of general dispute resolution for all international agreements. The United States has previously explained some of the difficulties and some of the implications of this proposal.³¹

Mexico apparently shares the US concern in this regard as it has clearly stated: "This Panel has no jurisdiction to decide whether the United States has complied with its market access commitments [under the NAFTA]."³² Yet, Mexico cannot avoid the fact that, in order for the Panel to determine that its tax measures are necessary to secure US compliance with the NAFTA, the Panel would first need to examine what the obligations of the NAFTA are and whether the United States has complied with those obligations. Mexico's attempts to argue otherwise are simply a request for this Panel to find its tax measures justified under Article XX(d) without an examination of what the "laws or regulations" are with which compliance is sought or whether the measures for which the Article XX(d) exception is sought are necessary to "secure compliance" with such laws or regulations. Mexico cannot avoid these examinations, however, if it is to meet its burden of proof on its Article XX(d) defense.

Mexico has also taken pains to explain why its interpretation of Article XX(d) would not lead to the results suggested by the United States. Mexico is incorrect. If the Panel were to accept Mexico's invitation to use Article XX(d) as a means to justify its WTO breach, there is no reason why another Member could also not claim that a WTO-inconsistent measure was necessary to secure compliance with an international agreement to which it was a party. To meet its burden of proof on any such defense, the Member would have to convince a panel, and the panel would have to determine, what the obligations of the international agreement were and whether the Member against which the WTO-inconsistent measure was taken was in compliance with those obligations. While Mexico claims that the circumstances surrounding imposition of its tax measures are "extraordinary," there is nothing about Mexico's interpretation of Article XX(d) that would limit its invocation to those "extraordinary" circumstances.³³

65. In the view of the parties, does the provision contained in Article 3.10 of the DSU, whereby it is "understood that complaints and counter-complaints in regard to distinct matters should not be linked" have any relevance for the present case?

Mexico's complaint with respect to US obligations under the NAFTA and the present US complaint under the WTO Agreement are two distinct matters. One matter arises solely under NAFTA and concerns access to the US market for Mexican cane sugar; the other matter arises under the WTO Agreement and the GATT, and concerns protectionist tax discrimination by Mexico against imported HFCS and other sweeteners that compete with Mexican cane sugar.

³⁰ US Opening Statement at the Second Meeting of the Panel, para. 7; US Closing Statement at the Second Meeting of the Panel, para. 7.

³¹ US Opening Statement at the Second Meeting of the Panel, para. 7.

³² Mexico Opening Statement at the Second Meeting of the Panel, para. 33.

³³ See Mexico Closing Statement at the Second Meeting of the Panel, paras. 2-7.

Article 3.10 of the DSU concerns alleged breaches of the WTO Agreement and states that it is "understood that complaints and counter-complaints in this regard to distinct matters should not be linked." The Panel might view Article 3.10 as supporting that, even if Mexico had claimed that the United States were in breach of its WTO obligations, dispute settlement proceedings over Mexico's tax measures would not be the forum in which to address Mexico's separate claim against the United States.³⁴

66. Could the parties please expand upon the views they hold regarding the relevance of Article 23 of the DSU to the present dispute?

Article 23 is relevant context for the fact that the phrase "laws or regulations" in Article XX(d) does not mean or include obligations under an international agreement. Specifically, if the phrase "laws or regulations" in Article XX(d) did mean obligations under an international agreement, then it would also include obligations under the WTO Agreement. Article 23 of the DSU, however, provides that when Members seek the redress of a violation of WTO obligations they will abide by DSU rules. Mexico's reading of "laws or regulations" to mean obligations under an international agreement renders Article 23 of the DSU inutile.³⁵

67. In the view of the parties, does the list of subjects contained in paragraph (d) of Article XX (customs enforcement; enforcement of monopolies; protection of patents, trade marks and copyrights; and prevention of deceptive practices) suggest that there are certain types of laws or regulations which would be covered by the exception contained in that provision? Can parties suggest any GATT or WTO precedents that may throw light on this issue?

While not an exhaustive list as demonstrated by the word "including" in Article XX(d), "[c]ustoms enforcement; the enforcement of monopolies ..., the protection of patents, trade marks and copyrights, and the prevention of deceptive practices" all suggest laws or regulations that are the domestic laws or regulations of the Member claiming the XX(d) exception. As for prior GATT 1947 or WTO reports, every other time an Article XX(d) defense has been considered in the context of GATT 1947 or WTO dispute settlement, the laws or regulations at issue have been the domestic laws or regulations of the Member asserting the XX(d) defense. None have involved obligations owed another Member under an international agreement.³⁶

³⁴ See also US Answers to Questions of the Panel after the First Meeting, para. 15 (referencing Article 3.10 of the DSU in the context of Mexico's request for a "preliminary ruling" and whether a NAFTA panel might deal "comprehensively" with the issues Mexico asserts are relevant in this dispute).

³⁵ US Second Written Submission, para. 47; US Opening Statement at the Second Meeting of the Panel, para. 6.

³⁶ See GATT Panel Report, *United States – Imports of Certain Automotive Spring Assemblies*, L/5333, adopted 26 May 1983, BISD 30S/170 (exclusion order to enforce domestic patent law); GATT Panel Report, *United States – Section 337 of the Tariff Act of 1930*, L/6439, adopted 7 November 1989, BISD 36S/345 (exclusion order to enforce domestic patent law); GATT Panel Report, *Canada – Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, BISD 30S/140 (purchase undertakings to implement domestic investment screening law); GATT Panel Report, *Japan – Restrictions on Imports of Certain Agricultural Products*, L/6253, adopted 2 February 1988, BISD 35S/163 (import restrictions to support domestic price stabilization schemes and an import monopoly); GATT Panel Report, *EEC – Regulation on Imports of Parts and Components*, L/6657, adopted 16 May 1990, BISD 37S/132 (measures to secure compliance with antidumping duties); GATT Panel Report, *United States – Restrictions on Imports of Tuna*, DS21/R, 3 September 1991, BISD 39S/155 (intermediary nations embargo to secure compliance with direct US embargo on certain tuna imports); GATT Panel Report, *United States – Restrictions on Imports of Tuna*, DS29/R, 16 June 1994 (intermediary nations embargo to secure compliance with direct US embargo on certain tuna imports); GATT Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206 (in-state wholesaler distributor requirement argued to be necessary to secure enforcement of state excise tax laws); GATT Panel Report, *United States – Taxes on Automobiles*,

The negotiating history of Article XX(d) confirms that obligations under an international agreement were intentionally not included in the scope of Article XX(d). In particular, during the second session of the Preparatory Committee in Geneva (1947), India tabled a proposal that "a Member should be allowed temporarily to discriminate against the trade of another Member when this is the only effective measure open to it to retaliate against discrimination practised by that Member outside the purview of the Organization, pending a settlement of the issue through the United Nations."³⁷ This proposal was forwarded to the Havana Conference but was ultimately rejected, and was not included in Article 45, the commercial policy exceptions provision of the Havana Charter. Article XX(d) of the GATT has been unaltered since October 1947.³⁸

68. In the opinion of the parties, does Article 60 of the Vienna Convention on the Law of Treaties codify a principle of international law by which a material breach of a bilateral treaty by one of the parties may allow the other to invoke that breach as a ground for, inter alia, suspending the operation of that treaty in whole or in part, but not for suspending the operation of a different multilateral treaty?

Interpretation and application of Article 60 of the Vienna Convention is not relevant to the Panel's task in this dispute, which concerns determining whether Mexico's tax measures are inconsistent with Mexico's obligations under the WTO Agreement. As the United States noted at the second panel meeting, the WTO dispute settlement system exists to resolve WTO disputes, that is, disputes over Members' rights and obligations under the covered agreements.³⁹ A WTO panel's mandate does not extend to determining the rights and obligations of countries under general principles of international law or under Article 60 of the Vienna Convention in particular.⁴⁰ Moreover, Article 60 does not reflect a customary rule of interpretation of public international law, the only principles of international law identified in the DSU.⁴¹

For these reasons, the Panel is not in a position to decide whether a principle such as the one posited in its question would be grounds for deciding in favor of the United States in this dispute.⁴²

DS31/R, 11 October 1994 (assessment of penalties to secure compliance with Corporate Average Fuel Economy law); Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996 (baseline establishment methods claimed necessary to secure compliance with US environmental laws); Panel Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/R and Corr.1, adopted 30 July 1997 (Tariff Code 9958 import restriction claimed necessary to secure compliance with Canadian income tax laws); Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001 (dual retail system claimed necessary to secure compliance with domestic unfair competition laws); Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather*, WT/DS155/R and Corr.1, adopted 16 February 2001 (special treatment of imports found necessary to secure compliance with value-added tax and income tax laws); Panel Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/R, adopted 27 September 2004 (laws on treatment of foreign grain claimed to be necessary to secure compliance with domestic laws on competition, grain, and the Canadian Wheat Board); Panel Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/R, 26 November 2004 (stamp and bond requirements claimed to be necessary to secure compliance with domestic tax laws and regulations).

³⁷ Working Party on Technical Articles, Report, E/PC/T/103 dated 16 June 1947, p. 43.

³⁸ *GATT Analytical Index*, p. 596.

³⁹ DSU Arts. 1.1, 3.2 and 3.4.

⁴⁰ See DSU Art. 7.1, DSU Art. 11.

⁴¹ DSU Art. 3.2.

⁴² As a subsidiary matter, we also note that by its own terms Article 60 of the Vienna Convention does not appear to cover situations where in response to a breach of one treaty by one party another party proposes to suspend benefits under a different treaty.

69. Could parties expand on their views of whether the challenged measures may be considered to be a "disguised restriction on international trade" or an "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", under the chapeau of Article XX?

The United States explained in its second submission that Mexico's tax measures do not meet the requirements of the chapeau to Article XX because: (1) Mexico's tax measures are not provisionally justified under any of the paragraphs of Article XX, specifically under paragraph (d)⁴³; and (2) Mexico's tax measures constitute a "disguised restriction on international trade."

With respect to the latter, the United States has explained that Mexico's tax measures constitute a "disguised restriction on international trade" because, while Mexico for purposes of its Article XX(d) defense argues that its tax measures are to secure compliance with the NAFTA, Mexico has been quite open in other contexts, including in this dispute, that its tax measures are applied to protect its domestic cane sugar industry – in particular, to protect its domestic cane sugar from being displaced by imports of HFCS from the United States.⁴⁴ The protectionist application of Mexico's tax measures is highlighted by the fact that to date Mexico has been unable to explain how measures designed to protect its cane sugar industry and discriminate against imports results or contributes to compliance with the NAFTA.⁴⁵

Rather than demonstrate that its tax measures "are not *applied* in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade," Mexico has instead focused on whether it has made a "good faith effort" to resolve the NAFTA sugar dispute. Most recently in its opening statement at the second panel meeting, Mexico stated: "Mexico's good faith efforts to resolve this long-standing dispute clearly meet the requirements set out by the Appellate Body in *United States – Shrimp*."⁴⁶ Contrary to Mexico's belief, the chapeau to Article XX does not contain a requirement that Members make a good faith effort to negotiate before taking a measure falling within the scope of one of Article XX's paragraphs. Nor does the chapeau to Article XX provide that good faith efforts to negotiate before taking a measure immunize the measure from constituting a means of arbitrary discrimination or a disguised restriction on trade. Mexico misreads the Appellate Body report in *US – Shrimp* in this regard.⁴⁷

To date, Mexico has not even addressed how its tax measures are applied. This is significant, because the chapeau to Article XX requires that the measure not be "*applied* in a manner that which would constitute a means of arbitrary or unjustifiable discrimination ... or a disguised restriction on international trade." Mexico's discussions of events that preceded imposition of its tax measures are not discussions of how Mexico applies those measures and thus Mexico has not met the requirements of the chapeau.

⁴³ US Second Written Submission, para. 69.

⁴⁴ US Second Written Submission, para. 70; *see also* Mexico First Written Submission, para. 111 (conceding that its tax measures were imposed to stop the displacement of Mexican cane sugar by imported HFCS); US First Written Submission, paras. 48-55 (recounting the numerous Mexican legislative and judicial statement as to the purpose of Mexico's tax measures being to protect its domestic cane sugar industry).

⁴⁵ US Opening Statement at the Second Panel Meeting, para. 16.

⁴⁶ Mexico Second Written Submission, para. 85.

⁴⁷ *See* US Second Written Submission, para. 71; US Responses to Questions from the Panel, paras. 56-58.

FOR THE UNITED STATES:

70. For clarification, could the United States please confirm that the scope of the products which it refers to under the expression "soft drinks and syrups", coincides with the definitions used in the Mexican legislation for "soft drinks" ("refrescos") and "hydrating or rehydrating drinks" ("bebidas hidratantes o rehidratantes"), currently contained in Article 3 of the Law on the Special Tax on Production and Services (Ley del Impuesto Especial sobre Producción y Servicios).

As explained in the US response to Question 71, the term "soft drinks and syrups" as used in the US submissions and statements refers to the products identified in Article 2(G) and (H) of the IEPS. The "soft drinks" and "hydrating and rehydrating drinks" are two of the products identified in Article 2(G). The terms "soft drinks" and "hydrating and rehydrating drinks" are defined in Article 3 of the IEPS.

71. Could the United States please confirm that it is asking the Panel to assume that the information that it has provided with respect to the "likeness" and the "substituibility" of "soft drinks and syrups" is also applicable to the following other categories of products also falling within its complaint, such as "hydrating or rehydrating drinks", "concentrates, powders, syrups, essences or flavour extracts that can be diluted to produce soft drinks and hydrating or rehydrating drinks" and "syrups or concentrates for preparing soft drinks sold in open containers which use automatic, electric or mechanical equipment".

The United States is not asking the Panel to *assume* that the information that it has provided with respect to the likeness and the substitutability of "soft drinks and syrups" is also applicable to "hydrating or rehydrating drinks," "concentrates, powders, syrups, essences or flavour extracts that can be diluted to produce soft drinks and hydrating or rehydrating drinks" and "syrups or concentrates for preparing soft drinks sold in open containers which use automatic, electric or mechanical equipment." Rather, the term "soft drinks and syrups" as used in the US submissions and statements includes all products identified in Article 2(G) and 2(H) of the IEPS.⁴⁸

Therefore, the information the United States provided with respect to "soft drinks and syrups" pertains to "soft drinks, hydrating and rehydrating beverages, as well as concentrates, powders, syrups, flavor extracts or essences, which may be diluted to produce soft drinks, hydrating and rehydrating beverages" as identified in Article 2(G) and "syrups or concentrates for preparing soft drinks sold in open containers, using mechanical or automatic equipment" identified in Article 2(H). The United States used the terms "soft drinks and syrups" to avoid having to repeat the foregoing list each time it mentioned the products identified in Articles 2(G) and 2(H).

It should also be emphasized that the "like" or "directly competitive or substitutable" analyses in this dispute would not be any different if conducted individually for each product identified in Article 2(G) and 2(H). This is because the dividing line between whether a product identified in Article 2(G) and 2(H) is subject to the IEPS is whether (a) it is sweetened with cane sugar (in which case it is not subject to the IEPS) or (b) it is sweetened with non-cane sugar sweeteners such as HFCS or beet sugar (in which case it is subject to the IEPS).⁴⁹

To explain this in more concrete terms, take the example of a soft drink, such as a bottle of Coke, and a hydrating drink, such as a bottle of Gatorade. A bottle of Coke sweetened with HFCS or beet sugar is "like" or "directly competitive or substitutable" with a bottle of Coke sweetened with cane sugar *for the reasons* a bottle of Gatorade sweetened with HFCS or beet sugar is "like" or

⁴⁸ US First Written Submission, paras. 1 and 37 et seq.

⁴⁹ See also US First Written Submission, para. 67.

"directly competitive or substitutable" with a bottle of Gatorade sweetened with cane sugar. The use of HFCS or beet sugar, on the one hand, versus cane sugar, on the other, does not change the color, smell, chemical composition, calories, digestion, ingredient label, end-use, distribution, tariff classification or consumer preference for a bottle of Coke or a bottle of Gatorade. The same can be said for the use of HFCS versus cane sugar in a concentrate, powder, syrups, flavor extracts or essences that may be diluted to produce a finished soft drink as well as for a syrup or concentrate for preparing soft drinks sold in open containers, using mechanical or automatic equipment (i.e., syrups and concentrates mixed with water, typically at a restaurant or bar, to produce a fountain drink).

Although the individual products identified in Article 2(G) and 2(H) may well be "like" or "directly competitive or substitutable" with each other (e.g., because they share the same end-use and have identical or at least very similar physical characteristics) this is not something that needs to be decided in this dispute. Rather, the relevant question is whether the products identified in Articles 2(G) and 2(H) sweetened with non-cane sugar sweeteners, such as HFCS and beet sugar, are "like" and/or "directly competitive or substitutable" with the products identified in Articles 2(G) and 2(H) sweetened with cane sugar. The evidence provided in the US first and second written submission more than amply demonstrates that the answer to this question is yes.

72. In its first submission, the United States has stated that there are three different grades of High-Fructose Corn Syrup (HFCS), which have different industrial applications. For clarification, could the United States please confirm if each of the three grades of HFCS (namely, HFCS-42, HFCS-55 and HFCS-90) can be considered to be "directly competitive or substitutable products" with each other, as well as with cane sugar, and on what basis.

Because Mexico has chosen to apply its tax measures on HFCS by taxing soft drinks and syrups that use HFCS, the only relevant industrial application for purposes of determining whether HFCS and cane sugar are "like" or "directly competitive or substitutable" products is their use as sweeteners for soft drinks and syrups.⁵⁰ As demonstrated in the US first submission, HFCS is "like" or "directly competitive or substitutable" with cane sugar as a sweetener for soft drinks and syrups.

In addition, as was similarly mentioned in response to Question 71 with respect to soft drinks and syrups, the relevant inquiry in this dispute is whether HFCS is "like" or "directly competitive or substitutable" with cane sugar as a sweetener for soft drinks and syrups. This inquiry does not depend on additionally finding that HFCS-42, HFCS-55 and HFCS-90 are "like" or "directly competitive or substitutable" with each other.

The US first submissions more than amply demonstrate that HFCS is "like" and "directly competitive or substitutable" with cane sugar as a sweetener for soft drinks and syrups and the "like" and "directly competitive or substitutable" analyses contained therein apply to the three grades of HFCS: HFCS-42, HFCS-55 and HFCS-90.⁵¹ As explained in the US first submission, although HFCS-55 was developed primarily as a sweetener for soft drinks and syrups, HFCS-42 is also used as sweeteners for soft drinks and syrups.⁵² HFCS-90 may also be used as a sweetener for soft drinks and syrups if first blended with HFCS-42 to produce HFCS-55. The fact that imported HFCS-90 could be blended to produce HFCS-55 is what led Mexico to extend application of its antidumping duty order on HFCS-55 to also cover HFCS-90.⁵³ Mexico explained: "[G]rade 90 HFCS belongs to the same

⁵⁰ See also US First Written Submission, para. 96.

⁵¹ The US first submission demonstrates that HFCS and cane sugar are "directly competitive or substitutable" in paragraphs 94-130 and that HFCS and cane sugar are "like" in paragraphs 156-158.

⁵² US First Written Submission, paras. 12-13. The attached Exhibit US-58 provides a listing of popular US soft drinks and their corresponding sweetener, HFCS-42 or HFCS-55.

⁵³ See "Secretaría de Comercio y Fomento Industrial, Resolución final de la investigación sobre elusión del pago de cuotas compensatorias impuestas a las importaciones de jarabe de maíz de alta fructosa

family as grade 55 HFCS, despite their difference in fructose concentration. In fact, grade 90 HFCS is one of the inputs in the manufacturing of grade HFCS 55, which is the main use, and explains why, once mixed, it is sold to the same final consumers as the products subject to compensatory duties."⁵⁴

Further, as Exhibit US-10 demonstrates imports of HFCS-42 plummeted just as imports of HFCS-55 and HFCS-90 did from 2001 to 2002, the years prior to, and immediately following, imposition of Mexico's tax measures.⁵⁵ After imposition of Mexico's tax measures, use of HFCS in any grade in soft drinks and syrups became cost prohibitive and Mexican soft drink and syrup producers switched back to cane sugar. The essential point is that HFCS – of any grade – competes and is directly competitive with cane sugar as a sweetener for soft drinks and syrups.

In terms of physical appearance, HFCS-42, -55 and -90 are virtually identical. They are all odorless, colorless solutions of glucose and fructose molecules and small amounts of other saccharides. What distinguishes the three grades is their glucose-fructose ratio. However, for purposes of this dispute, the different fructose-glucose ratios of HFCS-42, -55 and -90 do not affect whether they are "like" or "directly competitive or substitutable" with cane sugar as a sweetener for soft drinks and syrups.

73. During the second substantive meeting (paragraph 36 of written version), Mexico has asked the Panel to make several factual determinations. Does the United States concur with the facts listed by Mexico? Does it dispute any specific one of them? If possible, could the United States refer in its response, as appropriate, to the evidence that has been brought to the record by the parties.

Paragraph 36 of Mexico's second oral statement requests the Panel to make six "determinations of fact," most of which would also involve determinations of contested legal issues. The United States disputes almost all of these proposed determinations as addressed in turn below. These proposed determinations, however, do not concern "facts" that this Panel needs to determine to fulfill its mandate in this dispute – which concerns the consistency of Mexico's tax measures with Mexico's WTO obligations and not alleged US actions under the NAFTA. The "determinations of fact" Mexico identifies are, therefore, not ones this Panel should agree to make.

With respect to the first bullet in paragraph 36, Mexico refers to the negotiation of a "preferential trade regime which includes HFCS and sugar, products that compete in certain market segments." The United States agrees that there have been trade negotiations with respect to HFCS and cane sugar although, as noted, the United States does not agree with Mexico's understanding of the outcome of those negotiations. The United States does agree that HFCS and cane sugar compete in certain market segments, specifically the soft drink and syrup industry.

With respect to the second bullet in paragraph 36, the United States agrees there is a dispute between the United States and Mexico over the exact terms of the NAFTA with respect to market

grado 55, mercancía clasificada en la fracción arancelaria 1702.60.01 de la Tarifa de la Ley del Impuesto General de Importación, originarias de los Estados Unidos de América, independientemente del país de procedencia," *Diario Oficial* (September 8, 1998) (final decision of the investigation of circumvention of the payment of duties on HFCS-55).

⁵⁴ "Resolucion Por La Que Se Declara De Oficio El Inicio De La Investigacion Sobre Elusion Del Pago De Cuotas Compensatorias Impuestas A Las Importaciones De Jarabe De Maiz De Alta Fructosa Grado 55, Mercancia Clasificada En La Fraccion Arancelaria 1702.60.01 De La Tarifa De La Ley Del Impuesto General De Importacion, Originarias De Los Estados Unidos De America, Independientemente Del Pais De Procedencia," *Diario Oficial* 71, 72 (January 23, 1998) (decision to initiate an investigation of circumvention of the payment of duties on HFCS-55).

⁵⁵ Prior to 2002, Mexico's tariff schedule did not contain separate categories for HFCS-55 and HFCS-90 but included both grades under the tariff subheading 1702.60.

access for Mexican cane sugar. The United States disagrees, however, with Mexico's suggestion that this NAFTA sugar dispute and the dispute for which this Panel was established are part of the same "dispute" for purposes of WTO dispute settlement. They are not.

With respect to the third bullet in paragraph 36, although it is correct that Mexico and the United States have engaged in bilateral discussions on the trade in sweeteners and dispute settlement under the NAFTA, the United States is not of the view that these avenues for resolving our differences have been exhausted or that Mexico has tried every means – short of breaching its WTO obligations – to resolve its grievances with respect to sugar under the NAFTA. In fact, negotiations between the United States and Mexico as well as the private interests continue on the issue. Mexico even noted before the DSB that it thought the US panel request was premature because of these ongoing negotiations.⁵⁶

With respect to the fourth bullet in paragraph 36, the United States notes that Mexico's contention is not an assertion of fact, but rather a conclusion drawn based on Mexico's view of how dispute settlement (or other means to address party grievances) should proceed under the NAFTA. As the United States noted in earlier submissions, the United States believes it is in full compliance with the dispute settlement provisions of the NAFTA.

With respect to the fifth bullet in paragraph 36, Mexico essentially raises two points, which, as in the fourth bullet, are not actually limited to a recitation of facts. First, the United States has not refused to submit to NAFTA dispute settlement. As stated in our response to questions after the first meeting, the United States has engaged in consultations with Mexico under NAFTA's dispute settlement provisions and a NAFTA panel has been established. Second, the United States does not agree that Mexico's tax measures are a response to a US "refusal to submit to NAFTA dispute settlement." In fact, Mexico's statement is wholly inconsistent with the numerous and repeated statements of its legislators and Supreme Court that Mexico's tax measures were imposed to "protect[] the national sugar industry" in Mexico. Mexico has not contested the accuracy of these statements.

With respect to the sixth bullet, it is likewise not a recitation of "fact". Rather it depends on Mexico's selective and out-of-context reading of statements made by the United States, including statements made outside of and prior to the existence of the WTO dispute settlement mechanism. For the record, the United States does not take the position that under the terms of the WTO Agreement it or any other Member may validly take countermeasures in the form of a WTO breach when another Member has refused to submit to an international agreement's dispute settlement mechanisms. Furthermore, the text of the WTO Agreement does not provide for the defense Mexico raises in this dispute.

74. Could the United States please explain with more detail in what manner does the internal application of the "soft drinks tax" and the "distribution tax" subject imported products to internal taxes in excess of those applied to like domestic products, in respect to beet sugar.

As the US second submission reviews, beet sugar and cane sugar are chemically and functionally identical. They have identical end-uses. They are sold through the same channels of distribution and to the same customers. They are classified under the same four-digit tariff heading. Beet sugar and cane sugar are "like" products.

Because beet sugar and cane sugar are virtually identical, it follows that soft drinks and syrups sweetened with them are also virtually identical. The US second submission demonstrates that soft drinks sweetened with beet sugar have the same physical appearance, end-uses, channels of

⁵⁶ See US Responses to Questions of the Panel, para. 77.

distribution, consumer preferences and tariff classifications as soft drinks and syrups sweetened with cane sugar.⁵⁷ Soft drinks and syrups sweetened with beet sugar are, therefore, "like" soft drinks and syrups sweetened with cane sugar.

Mexico does not produce beet sugar or soft drinks and syrups sweetened with beet sugar. Under the IEPS, soft drinks and syrups that contain any sweetener other than cane sugar are subject to a 20 percent tax on their importation and internal transfer (HFCS soft drink tax) as well as a 20 percent tax on their distribution, representation, brokerage, agency and consignment (distribution tax).⁵⁸ In addition, soft drinks and syrups sweetened with non-cane sugar sweeteners are subject to certain bookkeeping and reporting requirements, including a requirement for the soft drink or syrup producer to report its top 50 suppliers and customers to the Mexican Government.⁵⁹

Because the IEPS is structured so as to apply to all soft drinks and syrups and then to exempt only those soft drinks and syrups sweetened with cane sugar, the IEPS discriminates against *all* non-cane sugar sweeteners and soft drinks and syrups made with non-cane sugar sweeteners. HFCS and beet sugar are examples of non-cane sugar sweeteners and the United States has presented evidence that HFCS is "like" and "directly competitive or substitutable with" cane sugar and that beet sugar is "like" cane sugar. The United States has also presented evidence that soft drinks and syrups sweetened with HFCS are "like" and "directly competitive or substitutable" with soft drinks and syrups sweetened with cane sugar and that soft drinks and syrups sweetened with beet sugar are "like" and soft drinks and syrups sweetened with cane sugar.

The IEPS discriminates against imported non-cane sugar sweeteners and imported soft drinks and syrups sweetened with non-cane sugar sweeteners because it applies (1) a 20 percent tax on the internal transfer and (2) a 20 percent tax on the distribution of soft drinks and syrups sweetened with non-cane sugar sweeteners that it does not apply to soft drinks and syrups sweetened with cane sugar. The IEPS also discriminates against imported soft drinks and syrups because it applies a 20 percent tax on their importation, regardless of the type of sweetener they contain, but does not tax the internal transfer of soft drinks and syrups sweetened exclusively with cane sugar.

As explained in the US submissions, the vast majority of soft drinks and syrups produced in the United States are sweetened with HFCS. US producers may also use beet sugar to sweeten soft drinks in syrups, as do their European counterparts. By contrast, in Mexico most soft drinks and syrups are sweetened with cane sugar. (This is true even before application of the IEPS to soft drinks and syrups when cane sugar comprise over 70 percent of the sweeteners used in Mexican soft drinks and syrups.)⁶⁰ The IEPS, thus, subjects imported soft drinks and syrups to a 20 percent tax on their importation, internal transfer and distribution. These taxes (HFCS soft drink and distribution taxes) do not apply to most soft drinks and syrups produced in Mexico. The HFCS soft drink and distribution taxes are, therefore, taxes applied to imports "in excess of" and dissimilar than those applied to "like" and "directly competitive or substitutable" domestic products. This is the case regardless of whether the imported products are soft drinks and syrups sweetened with HFCS, beet

⁵⁷ US Second Written Submission, paras. 27-29.

⁵⁸ The IEPS accomplishes this as follows: Article 1 subjects the importation and internal transfer of, and the provision of certain services in connection with, goods identified in Article 2 to the provisions of the IEPS. Article 2 identifies the goods subject to the IEPS as well as the tax rate for those goods. Article 2.I(G) and 2.I(H) provide that soft drinks and syrups (see US response to Question 71) are subject to a 20 percent tax rate. Article 2.II identifies distribution, representation, brokerage, agency and consignment which if provided in connection with goods identified in Article 2.1(G) and (H) are subject to the IEPS. Article 8 then provides that transfers of products identified in Article 2(G) and (H) are not subject to the IEPS if they are sweetened exclusively with cane sugar. Article 2.II exempts the provision of services in connection with goods identified in Article 8.

⁵⁹ IEPS as amended, Art. 19. See US First Written Submission, paras. 37, 46.

⁶⁰ US First Written Submission, para. 23 and Exhibits US-15 and 57.

sugar or any other non-cane sugar sweetener. Said another way, the IEPS subjects imports to taxes in "excess of" and dissimilar than those applied to "like" and "directly competitive or substitutable" domestic products because the IEPS specifically excludes those domestic products from the scope of the IEPS.

The same is true with respect to non-cane sugar sweeteners used in soft drinks and syrups. Prior to application of the IEPS to soft drinks and syrups, HFCS comprised over 99 percent of Mexican sweetener imports, but only between five and ten percent of Mexican sweetener production.⁶¹ As for beet sugar, it is not produced in Mexico and, therefore, to the extent it exists in Mexico, is an imported sweetener.⁶² By subjecting soft drinks and syrups sweetened with non-cane sugar sweeteners to a 20 percent tax but not subjecting soft drinks and syrups sweetened with cane sugar to that same tax, the IEPS subjects imported sweeteners – whether those sweeteners are HFCS or beet sugar – to taxation that is dissimilar and "in excess of" that applied to the like domestic product, cane sugar.

The bookkeeping and reporting requirements also discriminate against beet sugar in the same manner they discriminate against HFCS. Only soft drinks and syrups made with non-cane sugar sweeteners (including HFCS and beet sugar) are subject to the requirements. Exclusive use of the "like" and "directly competitive or substitutable" domestic product, cane sugar, results in exemption from the bookkeeping and reporting requirements.

75. The Panel notes that, in its rebuttal submission (paragraph 53), the United States has said that obligations owed to a Member by another Member under the terms of an international agreement would not be part of the former Member's "laws or regulations" under Article XX(d) of the GATT. Does the United States mean that, in its opinion, this would always be the case or whether, under the facts of this particular case it considers that the United States' obligations under the NAFTA would not be part of a Mexico's "laws or regulations"?

In the US view, the international obligations owed to one Member by another Member under the terms of an international agreement are not "laws or regulations" within the meaning of Article XX(d). This is true regardless of whether the international obligations asserted to be "laws or regulations" are US obligations under the NAFTA or any country's international obligations under any international agreement. In addition, the phrase "laws or regulations" pertains to the laws or regulations of the Member claiming its breach of GATT rules is justified by Article XX(d). It does not pertain to the laws or regulations of the Member whose GATT rights have been impaired by the other Member's GATT-inconsistent measure.

76. The United States has argued that it "is currently engaged in the third stage" of dispute settlement under the NAFTA procedures, regarding its dispute with Mexico on market access commitments for Mexican exports of sugar to the United States' market. Could the United States please expand on that statement. How long would that third stage generally take? What would happen, under NAFTA rules, if the panel is not established?

⁶¹ US First Written Submission, paras. 24-25.

⁶² Mexico does not import beet sugar. This fact, however, does not change the fact that the IEPS discriminates against beet sugar as a sweetener for soft drinks and syrups. For example, in *EC – Bananas*, the fact that the US "never exported a single banana" did not change the fact the EC regime for the importation and sale of bananas constituted a breach of Article III of the GATT or the presumption that the EC regime, therefore, nullified and impaired benefits accruing to the United States. The Appellate Body noted that the US had a "potential export interest" in bananas. See Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, adopted on 25 September 1997, paras. 208-216, 249-254.

With respect to the first part of the question, under ten years of experience with WTO dispute settlement, dozens of panels have been formed and it is possible to discern patterns and develop expectations about this process. Since the NAFTA was implemented eleven years ago, only three panels have been formed (Canada Agriculture Products, US Brooms, and US Trucks). With such a small number of disputes, it is impossible to suggest norms or set expectations. It is correct, as a matter of fact, that the time taken to constitute each of these three panels was longer than provided for under the NAFTA.

With respect to the second part of the question, under the NAFTA, panel establishment is automatic. That is, if parties to the dispute are unable to resolve the dispute after proscribed time periods and one of the parties delivers a request for the establishment of a panel, the NAFTA Free Trade "Commission shall establish an arbitral panel."⁶³ An arbitral panel has been "established" in the NAFTA sugar dispute. Unlike the DSU, which permits a party to request that the Director-General appoint panelists 20 days after the panel's establishment if the parties are unable to agree,⁶⁴ there is no parallel provision in the NAFTA. As Mexico concedes: "NAFTA's Chapter Twenty lacks the automaticity of the DSU."⁶⁵ In this regard, the NAFTA Secretariat did not appoint panelists in the NAFTA sugar dispute pursuant to Mexico's request,⁶⁶ because under NAFTA dispute settlement rules the NAFTA Secretariat does not have the authority to appoint panelists.

77. In its response to Panel question No. 30, the United States has said that there are alternative means "diplomatic or otherwise - short of breaching its WTO obligations" that Mexico could have pursued to address its concerns regarding the bilateral trade in sweeteners under the NAFTA, such as bilateral negotiations between governments and between the private sectors of both countries. Could the United States please elaborate on this assertion and explain what are some of the alternative means that Mexico could have reasonably pursued in order to address its concerns regarding the bilateral trade in sweeteners under the NAFTA. Would this include suspension of benefits under the NAFTA Agreement that are not part of Mexico's obligations under the WTO agreements?

As an initial matter, the existence of "alternative measures" is an analytical tool the panels and the Appellate Body have employed to assess the extent to which a GATT-inconsistent measure, for which a defense under Article XX(d) is raised, is in fact "necessary." Thus, in other disputes complaining parties have suggested that the existence of an alternative measure that secures compliance with the relevant laws or regulations and that is GATT-consistent means that the disputed measure is not "necessary." Whether a GATT-consistent alternative measure exists, however, does not answer the question of whether the Member invoking Article XX(d) has established that the dispute measure is "necessary" to secure compliance with laws or regulations. Therefore, regardless of whether the United States identifies a GATT-consistent alternative measure, it is Mexico's burden in the first instance to establish that its tax measures are "necessary" to secure compliance with laws or regulations.

⁶³ NAFTA Art. 2008(2).

⁶⁴ The Secretariat's most recent overview of dispute settlement cases in WT/DS/OV22 reflects the fact that even panel composition in the WTO can take a long time. *See, e.g., Australia – Certain Measures Affecting the Importation of Fresh Fruit and Vegetables* (Philippines) (DS270) (panel established on Aug. 29, 2003, not yet composed); *Australia – Quarantine Regime for Imports* (EC) (DS287) (panel established on Nov. 7, 2003, not yet composed); (3) *United States – Countervailing Duties on Imports of Steel Plate from Mexico* (Mexico) (DS280) (panel established on Aug. 29, 2003, not yet composed).

⁶⁵ Mexico Second Written Submission, para. 3.

⁶⁶ *See* Mexico First Written Submission, para. 75 n.41; Mexico Second Written Submission, para. 3; Mexico Opening Statement at the Second Meeting of the Panel, para. 78; Mexico Responses to the Questions of the Panel, p. 6 (WTO translation).

With that in mind, diplomatic means exist under the NAFTA for Mexico to pursue its concerns regarding bilateral sweeteners trade, including periodic meetings at official and ministerial level and Mexico has, in fact, pursued and is currently pursuing these means. In addition, the sweeteners industries of both countries have pursued unofficial discussions in aid of a mutually acceptable solution for bilateral sweeteners trade, and these discussions continue. Industry officials involved in the talks brief the governments periodically.

It is also useful to keep in mind that the tax measures at issue violate the GATT rights not just of the United States, but those of Canada, the EC and other Members. The United States rejects the proposition that Article XX(d) can be used to resolve disputes under other international agreements, as Mexico has argued in this case. However, even if such use of Article XX(d) were acceptable, it would not justify impairing the rights of all WTO Members because of a bilateral dispute.

With respect to the suspension of benefits under the NAFTA, the United States points out that Mexico has already suspended benefits under the NAFTA with respect to HFCS by applying NAFTA-inconsistent antidumping duties against HFCS imported from the United States from 1997 through April 2002. And with respect to sugar, as noted in the US second submission,⁶⁷ the United States finds it difficult to reconcile that Mexico committed under the NAFTA to allow duty-free market access for a minimum of 7,258 MT of US sugar per year, with the fact that it has not provided this level of market access in the 11 years since NAFTA's entry into force.

78. During the second substantive meeting (paragraph 23 of written version), the United States used the expression "whether recognized or not" referring to principles of international law. What would the expression " recognized or not" mean in that context?

The reference in paragraph 23 referred to paragraphs 120-125 of the *Hormones* decision, in which the Appellate Body rejected arguments by the EC that the "precautionary principle" is a "general customary rule of international law" that would override the provisions of Articles 5.1 and 5.2 of the SPS Agreement. The Appellate Body found that it was "less than clear" that Members of the WTO had accepted the precautionary principle as a principle of general or customary international law and it declined to take any position on this question. The Appellate Body then provided guidance that is quite germane to the present dispute. It found that "the precautionary principle does not, by itself, and without a clear textual directive to that effect, relieve a panel from the duty of applying the normal (i.e. customary international law) principles of treaty interpretation in reading the SPS Agreement."⁶⁸

Thus, general principles of international law could only be relevant if there were a clear textual directive in the WTO Agreement that makes them relevant. General principles of international law cannot be used to override the text of the WTO Agreement, to create new exceptions to WTO obligations, or otherwise to abridge the rights and obligations of WTO Members. This would be the case even for a "recognized" principle of international law, let alone something (like the "precautionary principle" in *Hormones*) which has not been recognized as a principle of international law.

79. In a preliminary response to the previous question when it was posed orally by the Panel during the second substantive meeting, Mexico stated that it is not asking the Panel to rule on the dispute under NAFTA. Could the United States' comment on that response, particularly in light of the statement by the United States during the second substantive meeting (paragraphs 6 and 7 of written version) that acceptance of Mexico's interpretation of "law or regulations" to

⁶⁷ US Second Written Submission, para. 58 n.79.

⁶⁸ Appellate Body Report, *EC – Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 124.

include obligations owed to Mexico under the NAFTA would require WTO panels and the Appellate Body to determine if there was, in fact, "a breach of the underlying agreement".

The United States refers the Panel to its response to Question 64 above.

80. Could the United States please clarify the specific scope, for the purpose of this dispute, of each imported product group at issue that is allegedly being discriminated against when compared to domestic products. In particular, as for imported soft drinks and syrups, is the product scope: (a) imported soft drinks and syrups; (b) imported soft drinks and syrups sweetened with nutritive sweeteners; (c) imported soft drinks and syrups sweetened with non-cane sugar sweeteners; (d) imported soft drinks and syrups sweetened with HFCS and beet sugar; or (e) imported soft drinks and syrups sweetened with HFCS? As for imported sweeteners, is the product scope: (a) imported sweeteners; (b) imported nutritive sweeteners; (c) imported non-cane sugar sweeteners; (d) imported HFCS and beet sugar; or (e) imported HFCS?

With respect to soft drinks and syrups, the answer to the question depends on the point at which the IEPS is being applied. With respect to the IEPS as applied on the importation of soft drinks and syrups, the answer is (a): the IEPS discriminates against imported soft drinks and syrups regardless of the type of sweetener they contain. With respect to the IEPS as applied on the internal transfers and the distribution, representation, brokerage, agency and consignment of soft drinks and syrups, the answer is (c): the IESP discriminates against imported soft drinks and syrups sweetened with non-cane sugar sweeteners including HFCS and beet sugar.

With respect to sweeteners, the answer is (c): The IEPS discriminates against imported non-cane sugar sweeteners including HFCS and beet sugar.

ANNEX C-5*

**COMMENTS BY MEXICO TO THE UNITED STATES' RESPONSES TO QUESTIONS
POSED BY THE PANEL AFTER THE SECOND SUBSTANTIVE MEETING**

Mexico hereby submits its comments on the United States' answers of 15 March 2005 to the Panel's questions regarding the Second Substantive Meeting with the Parties. The United States has restated its earlier arguments, and Mexico has already addressed them in previous submissions. To avoid repetition, Mexico will confine its comments to certain key issues and respond to certain points raised by the United States that it has not addressed previously.

Question 58

Mexico notes that the United States did not answer the question. It did not state whether or not it agrees with Mexico's argument that a NAFTA panel could find the tax measures imposed by Mexico to be acceptable counter-measures. Throughout this proceeding the United States has sought to avoid the matter of its position as to a State's right to take counter-measures when another State refuses to submit a matter to dispute settlement under an international agreement or otherwise impedes the operation of the dispute settlement mechanism.

The fact that the United States has simply avoided stating its position – in marked contrast to its lengthy and detailed submissions on Articles III and XX(d) of the GATT 1994 – is a further indication that it does not really believe that counter-measures cannot be justified under NAFTA. In Mexico's view, the United States wants to remain free to impose counter-measures when it is the complainant, and not the obstructing respondent, in other NAFTA disputes or in other contexts. Otherwise, why did it not simply state that it *disagrees* with Mexico's statement? Why did it not reject the view expressed in the quotation at paragraph 126 of Mexico's First Written Submission? Why did it not attempt to explain why, when its Cabinet secretaries signed an agreement undertaking not to adopt counter-measures inconsistent with the GATT or NAFTA for a period of twelve months, the term "counter-measures" as used there did not mean counter-measures as discussed by Mexico in this case? Why does it not provide specific details to support its contention that Mexico took its statements and actions "out of context"? Why did it not rule out taking action of the kind taken by Mexico?

Rather than confirming that it upholds its view that a State may take unilateral action when international cooperation to resolve a problem fails because another State has blocked the dispute settlement mechanism of a treaty other than the WTO Agreement, the United States persistently tries to change the subject. For example, its assertion that "[t]here is nothing in the text of the NAFTA providing parties the right to take countermeasures in the manner Mexico contends in this dispute"¹ is misleading because it ignores the fact that:

- Under Article 102(2), NAFTA as a whole is to be interpreted in accordance with its terms and the "applicable rules of international law";
- the applicable rules of international law include rules on counter-measures that exist and apply under NAFTA unless expressly modified by some treaty;

* Annex C-5 contains comments by Mexico to the United States' responses to questions posed by the Panel after the second substantive meeting. This text was originally submitted in Spanish by Mexico.

¹ See para. 23.

- no NAFTA provision takes precedence over such rules, and even if Chapter Twenty did provide for derogation (which it does not) the rules would still apply if, as here, a party obstructed consideration of a legitimate grievance by an independent third party.

The rules of customary international law that concern counter-measures need not be further codified in NAFTA in order to apply under NAFTA.

The United States' reference to NAFTA Articles 2018 and 2019 is also misplaced. First, these provisions govern the implementation of a NAFTA panel's *final* report and the suspension of benefits in case the parties fail to agree on the implementation of the panel's recommendations. They presuppose that a respondent has submitted in good faith to dispute settlement. They do not address a NAFTA party's right to take counter-measures when the respondent causes a breakdown of the dispute settlement mechanism. The United States is confusing two distinct legal concepts: the right under customary international law to take counter-measures and the suspension of benefits under the agreement as a result of the latter's operation.

Second, as the United States pointed out, the suspension of benefits under Article 2019 must be "*preceded* by a finding of breach by a NAFTA panel".² However, Article 2019 does not apply if an arbitral panel is prevented from forming and hence from issuing a final report. It is precisely because the United States prevented a panel from forming and resolving Mexico's claim that Mexico exercised its rights under customary international law. Article 2019 has nothing to do with the use of counter-measures.

The Panel will further note that the United States has attempted through mere bald assertion to question Mexico's evidence that the United States has in the past taken, and reserved the right to take, action of the kind Mexico took.³ Mexico would simply urge the Panel to review the relevant paragraphs of Mexico's Second Written Submission identified by the United States and the corresponding evidence, since they plainly establish that the United States not only claimed a right to take counter-measures, but took such measures even before submitting to dispute settlement.

In short, the United States does not rule out the possibility of a NAFTA panel finding that the measure under challenge here is a legitimate exercise of a counter-measure.

Finally, the United States' comments at paragraph 23 of its Answers show that it is still evading the fact that Mexico's action modified the treatment of HFCS under NAFTA Article 301. The present dispute both arises under NAFTA and is subject to NAFTA.

Question 62

In its answer, the United States first agrees with Mexico that there is no provision in NAFTA that can be considered equivalent to Article 23(2) of the DSU. But here again, the United States is confusing the suspension of benefits under Article 2019 of NAFTA with the imposition of counter-measures. It also conveniently ignores that the rules of international law, as the United States has itself held in other disputes, apply under NAFTA (in the absence of an express derogation).⁴ The United States' assertion that "[t]here is ... no provision in the NAFTA that justifies a breach of the NAFTA on the fact or assertion that another party has breached its obligations under the NAFTA"⁵ misses the point.

² *Ibid.*

³ See para. 24.

⁴ See Mexico's answer of 15 March 2005 to Question 58 of the Panel.

⁵ See para. 31.

The United States' repeated submissions concerning NAFTA Article 2019 only highlight the great irony in this case: the United States is attempting to use against Mexico the fact that Mexico has been unable to obtain a finding from a NAFTA panel, when it is the United States that has blocked all Mexico's efforts to have a panel appointed! It is unfortunate – though entirely predictable – that the United States should complain that Mexico applied measures in the absence of a NAFTA panel finding of breach, yet refuse to acknowledge that it is responsible for this state of affairs (see the United States' response to Question 76 where it attempts to obfuscate what happens when panelists are not appointed under NAFTA Chapter Twenty). Mexico reiterates that it would not have imposed the measure at issue had the United States submitted to the procedure initiated by Mexico.

In any event, the United States' argument that before taking counter-measures Mexico ought to have obtained a finding by a NAFTA panel that the United States breached its obligations under NAFTA is untenable. To accept it would lead to an absurd result: as the United States pointed out in the Air Services Agreement Arbitration, a respondent State would be able to refuse to submit to dispute settlement without any fear of adverse consequences. In circumstances such as these, where for more than six years a NAFTA party's efforts to resolve a dispute have been frustrated by another NAFTA party, the former party is clearly entitled to take action to set matters straight. Mexico again directs the Panel to the United States' submissions in the Air Services Agreement Arbitration and the commentary to the 1935 Draft Harvard Convention which it relies on.

Question 67

The United States argues in its answer to Question 67 that the subjects in the indicative list of paragraph (d) of Article XX of the GATT 1994 all suggest "laws or regulations that are the domestic laws or regulations of the Member claiming the Article XX(d) exception".⁶ That is not so. Matters such as customs enforcement, the enforcement of monopolies, the protection of patents, trade-marks and copyright are not confined to domestic law, but are also the subject of international cooperation and are addressed in different international agreements.

Question 73

In spite of the United States' assertion that it "disputes almost all of [Mexico's] proposed determinations [of fact]", careful review of its answer to Question 73 reveals that it in fact concurs with the key facts put forward by Mexico. These include:

- The existence of a preferential trade regime in sweeteners between Mexico and the United States which includes HFCS and sugar, two products that compete in certain market segments;
- the existence of a dispute between the United States and Mexico over the terms of NAFTA regarding the access of Mexican sugar to the United States market;
- Mexico properly invoked the NAFTA Chapter Twenty dispute settlement mechanism to resolve that dispute;
- in spite of Mexico's efforts, six years later the dispute between the Parties under NAFTA remains unresolved.

⁶ See para. 42.

The United States denies thwarting Mexico's attempts to resolve its grievance under NAFTA, denies that Mexico has exhausted all efforts to resolve the dispute and denies the reasons underlying Mexico's measures. But contrary to what the United States asserts, these are issues of fact substantiated by the evidence on file and do not involve contested legal issues.

Moreover, the United States has completely overlooked the evidence which Mexico has filed in this proceeding and which fully supports its position. For example, the United States has not denied that it not only failed to appoint panelists but instructed its Section of the NAFTA Secretariat not to do so. Nor has it directed the Panel to any evidence contradicting Mexico's assertion to that effect.

After two rounds of written submissions, two hearings and two rounds of responses to Panel questions, the United States has offered no evidence to support the implausible contention that it did try to allow a NAFTA panel to discharge its duty of assisting the parties to find a mutually satisfactory solution to their dispute. The fact that, after so many opportunities, the United States has produced not a jot of evidence to counter Mexico's evidence can lead to only one conclusion: the United States blocked the formation and, hence, the operation of the NAFTA panel.

The United States has provided neither an alternative explanation nor any evidence to demonstrate that it is not entirely responsible for this "lamentable state of affairs". It has offered only the absurd assertion that the NAFTA parties are in the "third stage" of panelist selection. The Panel can easily make the finding of fact requested by Mexico.

As to the bald statement that Mexico has not exhausted all avenues for resolving the dispute, the United States has once again been unable to specify what avenues Mexico should or could have followed other than those it has taken.

As to what prompted the measure impugned in this dispute, as Mexico has said before, it took the measure in response to the United States' acts and omissions in the NAFTA dispute in an attempt to secure compliance by the United States with its NAFTA obligations. Mexico fails to see how the United States can contest this fact considering that Mexico has repeatedly stated that it would not have imposed the measure but for the United States' refusal to allow the NAFTA dispute settlement system to operate, particularly as for more than three years, the United States Department of Agriculture time and again drew attention to Mexico's serious plight in its reports on the sugar sector.

Finally, with respect to the United States' attempt to dismiss as "irrelevant" its statement that under international law it can validly adopt counter-measures when another State refuses to submit a matter to the dispute settlement mechanisms, Mexico notes that the United States has been careful not to deny its prior statements on that subject. Mexico has provided ample proof that the United States has consistently held this view. Mexico further notes that the United States' "for the record" comment is vague and ambiguous.⁷ The United States has certainly not stated that it will not take valid counter-measures when another WTO Member refuses to submit to dispute settlement under an international agreement.

Question 76

In its answer to Question 76, the United States asserts that "... the NAFTA Secretariat did not appoint panelists in the NAFTA sugar dispute pursuant to Mexico's request, because under NAFTA dispute settlement rules the NAFTA Secretariat does not have the authority to appoint panelists."⁸ That assertion as to why a NAFTA Panel has not been appointed is quite simply wrong.

⁷ See para. 67.

⁸ See para. 79.

Mexico fails to see how the United States can make such a statement bearing in mind that:

- On 17 October 2000, Mexico sent a letter to the United States proposing a chairman for the NAFTA panel;
- on 17 November 2000, the United States rejected the proposal and indicated that it would make its own proposal in the week of 26 November 2000;
- during November 2000 there was e-mail correspondence in the course of which the United States said it needed more time to finalize its proposal; however, the United States never proposed a chairman;
- in view of the Secretariat's duties under NAFTA Article 2002 and the fact that the respondent party's Secretariat Section administers the dispute settlement proceedings, Mexico thereafter sought to have the United States Section of the NAFTA Secretariat appoint panelists on behalf of the United States. However, the United States blocked this effort by instructing the United States' Section not to appoint panelists.

To plead systemic reasons for the lack of a NAFTA panel to hear Mexico's grievance is disingenuous to say the least. It is thus quite inappropriate to attempt, as the United States does, to draw a parallel between the NAFTA sugar dispute and other disputes, including in the WTO, in which it may take longer than contemplated to form a panel. There is no indication that any party to such a dispute has avoided submitting a grievance to dispute settlement by prolonging the panelist appointment process indefinitely.

Finally, the United States' assertion that a NAFTA panel has been "established" is ludicrous. There is no such panel; not a single member has been appointed. There is no need for the Panel to undertake any legal interpretation of NAFTA in order to ascertain that the United States' assertion is wrong.

Question 77

Mexico notes that the United States has avoided responding to the substance of the Panel's question. While attempting to minimize the importance for the complaining party of identifying alternative measures that would secure compliance with the relevant laws or regulations⁹, the United States is unable to explain what alternative means Mexico could reasonably have pursued in order to resolve its concerns about the bilateral trade in sweeteners under NAFTA.¹⁰

Finally, the United States is wrong in its assertion that Mexico "has already suspended benefits under the NAFTA with respect to HFCS by applying NAFTA-inconsistent anti-dumping duties against HFCS imported from the United States from 1997 through April 2002".¹¹ First, application of anti-dumping duties is provided for in NAFTA and so cannot amount to suspension of benefits under NAFTA. Second, when Mexico applied anti-dumping duties against HFCS imported from the United States, it was asserting a right even though the latter was successfully challenged subsequently. Third, Mexico revoked the resolution imposing the anti-dumping duties, cancelled the

⁹ See para. 80.

¹⁰ The United States recites a list of other complaints it has about Mexican measures. The sugar dispute is certainly not the only one. Mexico could list more complaints about United States measures. None are material, however.

¹¹ See para. 83.

surety and refunded the anti-dumping duties. In short, Mexico did not upset the balance of rights and obligations under NAFTA.

ANNEX C-6

COMMENTS BY THE UNITED STATES ON MEXICO'S RESPONSES
TO QUESTIONS POSED BY THE PANEL AFTER THE
SECOND SUBSTANTIVE MEETING

FOR BOTH PARTIES:

Question 52

Mexico's response misinterprets Article 11 of the DSU. Contrary to Mexico's assertion and its incorrect reading of the panel report in *India – Autos*,¹ Article 11 of the DSU does not require panels to take into account amendments to measures that occur after the date of the panel request.

Rather, Article 11 of the DSU requires panels to make an "objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements...." The "matter before" a panel is the matter (which consists of the measures at issue and the claims made with respect to those measure) identified in the panel request. Accordingly, the matter before this Panel is the consistency of the tax measures identified in the US panel request with Mexico's obligations under Article III of the GATT 1994. The tax measures identified in the US panel request are:

"Law on the Special Tax on Production and Services (*Ley del Impuesto Especial sobre Producción y Servicios* or "IEPS") published on January 1, 2002 and its subsequent amendments published on December 30, 2002 and December 31, 2003; and any related or implementing measures, including the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* published on May 15, 1990, the *Resolucion Miscelanea Fiscal Para 2004* (Title 6) published on April 30, 2004, and the *Resolucion Miscelanea Fiscal Para 2003* (Title 6) published on March 31, 2003 which identify, *inter alia*, details on the scope, calculation, payment and bookkeeping and recording requirements of the IEPS."²

Because the US panel request does not include the January 1, 2005 amendment, it is not within the Panel's terms of reference and, accordingly, is not part of the "matter" of which Article 11 of the DSU requires the Panel to make an objective assessment. In fact, because the January 1, 2005 amendment is not within the Panel's terms of reference, it is not a measure for which this Panel is authorized to issue findings, either alone or in connection with the IEPS as it existed on the date of the US panel request.

While Mexico refers to *India – Autos* in support of its assertion that panels are required to take into account amendments to a measure after a panel request, the panel in that report did not find this.³ To the contrary, it made findings on the measures as they existed on the date of panel

¹ It is evident from the quotation included in Mexico's response that the *India – Autos* panel's citation to Article 11 of the DSU was made in connection with "the appropriateness of making a recommendation under Article 19.1 of the DSU." It was not made in connection with whether the panel should make findings on the measures at issue inclusive of subsequent amendments. Panel Report, *India – Measures Affecting the Automotive Sector*, WT/DS146/R, WT/DS175/R, adopted on April 5, 2002, para. 8.26; *see also infra*.

² WT/DS308/4.

³ In fact, the panel specifically rejected the proposition that events occurring subsequent to the panel's establishment prevented it from examining the measures as they existed at the time of the panel's establishment. Panel Report, *India – Autos*, para. 7.29-7.30.

establishment.⁴ The context in which the panel examined India's amended measure was to determine whether to make the recommendation called for under DSU Article 19.1.⁵ In this regard, it is worth noting that none of the parties, including India and the United States, considered that the panel had the authority to undertake this examination.⁶

Furthermore, the United States did not consider that the *India – Autos* panel's concerns regarding its obligations under DSU Article 11 supported the panel's approach. The United States noted that the panel had expressed a concern that it would not be carrying out its function of assisting the Dispute Settlement Body ("DSB") unless it revisited the Indian measures as amended during the course of the proceedings. The United States disagreed with the panel on this point and noted that the panel's report – even without the additional analysis of the amended measure – would provide the DSB with assistance by establishing the rulings and recommendations with which India would have to comply. As the *Indonesia Autos* panel had noted, a revocation (or other elimination or amendment) of a challenged measure would be particularly relevant at the implementation stage of dispute settlement.⁷

Finally, we note that even under its own terms, the analysis of the *India – Autos* panel would not apply here. That Panel noted that its approach was not required by the DSU but instead responded to a very particular set of circumstances:

"[T]he decision taken by this Panel to proceed in this way in the particular circumstances of this case is in no way intended to imply that panels have a general duty to systematically re-evaluate the existence of any violations identified before proceeding with making their recommendations under Article 19.1. This Panel is simply responding to the particular arguments placed before it, where the parties disagree as to the implications of subsequent events on the Panel's power to make recommendations and rulings. The principal aim of the Panel in proceeding in this manner is to discharge its duty in the most efficient way towards resolving the matter at issue in this dispute."⁸

The panel also noted that the impact of the subsequent events had been "discussed before this Panel from the very first stages of the proceedings" and that the parties to the dispute had raised "a number of arguments ... to suggest that certain events having occurred in the course of the proceedings fundamentally affect the existence or persistence of the alleged violations."⁹ In contrast, Mexico has not argued that the January 1, 2005 amendment eliminates the discriminatory treatment of imports imposed by the IEPS.¹⁰

⁴ *Id.* paras. 7.29-7.30, 8.2-8.3.

⁵ *Id.*, para. 8.20 ("The issue is limited solely to the question of whether, as argued by the respondent, certain events subsequent to the Panel's establishment are such as to affect the continued relevance of the Panel's initial findings with regard to measures clearly within its terms of reference. This raises the issue of whether they should be considered, in this light, before the Panel can make appropriate recommendations as to the need for India to bring its measures into conformity with the GATT 1994"); *see also id.*, paras. 8.00-8.30, 8.32, 8.58.

⁶ *Dispute Settlement Body: Minutes of the Meeting Held on 5 April 2002*, WT/DSB/M/171, paras. 12, 15-18.

⁷ This paragraph summarizes a portion of the US submission to the Appellate Body in the appeal that India filed from the panel report in the *India – Autos* dispute. India ultimately withdrew that appeal, as is evident from the minutes of the DSB referred to in the previous footnote.

⁸ Panel Report, *India – Autos*, para. 8.30.

⁹ *Id.*, para. 8.16.

¹⁰ *See* US Second Written Submission, para. 33; *see also* US Answers to the Questions of the Panel After the Second Meeting, paras. 5-6.

Therefore, for a number of reasons, the approach of the panel in *India – Autos* should not be adopted in this dispute. As the United States noted in its second submission and responses to questions after the second meeting, a number of panels have confronted the issue of how to handle post-panel request changes to measures within their terms of reference and each decided to issue findings on the measure as it existed at the time of the panel request.¹¹

Question 54

Mexico states that "the bookkeeping and reporting requirement are contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* published on May 15, 1990, the *Resolución Miscelanea Fiscal Para 2003* (Title 6) published on March 31, 2003, and the *Resolución Miscelanea Fiscal Para 2004* (Title 6) published on April 30, 2004."¹²

To avoid confusion, the measure at issue with respect to the US claim against the "bookkeeping and reporting requirements" is the IEPS.¹³ Article 19 of the IEPS requires producers of soft drinks and syrups who use sweeteners other than cane sugar to maintain and submit the following to the Mexican Government:¹⁴

- annual listing of the goods "produced, transferred or imported in the previous year, as regards consumption by state and the corresponding tax, as well as the services provided by establishment in each state";¹⁵
- quarterly reporting of "information regarding [taxpayers'] 50 main clients and suppliers";¹⁶
- quarterly reporting of the "monthly reading registered by devices used to carry out [physical] inspection" of the volume of goods manufactured, produced, or bottled;¹⁷
- quarterly reporting of the price, value and volume of goods transferred in the previous quarter;¹⁸ and
- registry by importers and exporters of soft drinks and syrups with the Ministry of Finance and Public Credit.¹⁹

¹¹ US Second Written Submission, para. 32 n.47; US Answers to the Questions of the Panel After the Second Meeting, para. 4 n.6; *see also* Panel Report, *India – Autos*, para. 7.26 n. 313. The GATT panel in *Thailand – Cigarettes* also does not support Mexico's position. GATT Panel Report, *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, BISD 37S/200, adopted on November 7, 1990. In making findings on the measures inclusive of amendments made subsequent to the panel request, the *Cigarettes* panel would appear to have exceeded its terms of reference, although the panel's report does not reflect that either the parties or the panel considered this issue.

¹² Mexico Responses to Questions of the Panel After the Second Meeting, p. 3 (revised courtesy translation).

¹³ *See* US First Written Submission, paras. 46, 155, 161-162; US Answers to the Questions of the Panel After the First Panel Meeting, paras. 50-52.

¹⁴ The following list of bookkeeping and reporting requirements contained in IEPS is cited in the US First Written Submission. US First Written Submission, para. 46.

¹⁵ IEPS as amend, Art. 19.VI, Exh. US-4.

¹⁶ *Id.*, Art. 19.VIII.

¹⁷ *Id.* Art. 19.X.

¹⁸ *Id.* Art. 19.XIII.

¹⁹ IEPS as amended, Art. 19.XI, Exh. US-4.

The "transitional provisions" of the IEPS require soft drink and syrup producers who use sweeteners other than cane sugar to maintain and report their complete inventory of taxable products as of December 31, 2001.²⁰

The regulations Mexico cites in response to the Panel's questions²¹ guide implementation of the IEPS, including implementation of the IEPS's bookkeeping and reporting requirements.²² The United States understands Mexico's statement that these regulations "are linked inseparably" to the IEPS to mean that Mexico understands that conformity with its obligations under Article III:4 of the GATT with respect to the bookkeeping and reporting requirements (if a breach is found) requires elimination of the discriminatory treatment of imports imposed by the IEPS as well as by these implementing regulations.

Also, to avoid confusion, the US claim against the IEPS's bookkeeping and reporting requirements is under Article III:4 of the GATT not Articles III:4 and III:2 as Mexico's response to the Panel's question suggests.

Question 58

As the United States has stated, whether Mexico's tax measures are inconsistent with the NAFTA is not relevant to resolution of this dispute, which concerns the consistency of Mexico's tax measures with its obligations under the WTO Agreement.

Mexico's response to the Panel's question does, however, highlight the complexity of any "defense" Mexico might raise under the NAFTA and why this Panel should not take into account Mexico's contention that its tax measures would be consistent with the NAFTA in making findings in this dispute. Whether Mexico's tax measures are inconsistent with the NAFTA is a complex *legal* determination and one this Panel is not in a position to make.²³ As Mexico itself has made very clear, determination of the rights and obligations of parties to the NAFTA is beyond the terms of reference of this Panel.²⁴

Question 59

To respond to the Panel's question of whether the NAFTA is part of US laws or regulations, Mexico states that "although NAFTA is an international treaty, it plainly has effects in the domestic legal orders of all three NAFTA Parties that go beyond implementing action taken by any particular signatory." Thus, when asked directly, Mexico did not assert that the NAFTA is a domestic law or

²⁰ IEPS Disposiciones Transitorias (transitional provisions), Jan. 1, 2002, Art. 2, para. I(a). The transitional provisions were enacted as part of the IEPS on December 30, 2001 and thus form a component of that measure. *See US First Written Submission*, para. 46 and Exh. US-4.

²¹ The United States also cites these regulations in its panel request and first written submission. *See WT/DS308/4; US First Written Submission*, paras. 4 and 47.

²² *See US First Written Submission*, para. 47.

²³ The United States does not share Mexico's view that a NAFTA Chapter 20 panel would find its tax measures consistent with the NAFTA, nor does it share Mexico's interpretation of the NAFTA in this regard. In addition, with all respect to the experience that the members of Mexico's delegation have with proceedings under Chapter 11 of the NAFTA, that chapter is simply not relevant to this dispute. It is not part of the WTO Agreement; its provisions are different from those at issue here; and it applies in investor-to-state investment disputes (not state-to-state trade disputes, such as, for instance, a hypothetical dispute between Mexico and the United States regarding Article 301 of the NAFTA).

²⁴ *See, e.g., Mexico Responses to Questions of the Panel After the Second Meeting*, p. 17 (revised courtesy translation).

regulation of the United States, as it seemed to be suggesting at the second panel meeting²⁵. Mexico now appears to agree that the NAFTA is not a US law or regulation.

Contrary to Mexico's assertion, whether there is a "strict dualist separation between international obligations and domestic law" is not the point. The point is whether "laws or regulations" as the phrase is used in Article XX(d) includes international obligations under an international agreement. As earlier US submissions and statements have explained, the ordinary meaning of the phrase interpreted in its context and in light of agreement's object and purpose means the domestic laws or regulations of the Member claiming the Article XX(d) exception.²⁶ Mexico's contention that international obligations affect domestic legal orders does not support its argument that the phrase "laws or regulations" means "international agreement" or "treaty." In fact, it would seem to suggest that Mexico recognizes that international obligations are different from the "domestic legal orders" they may affect.

Question 60

In its response, Mexico identifies several "common interests or values" it attributes to the NAFTA, for example the elimination of barriers to trade in goods and the promotion of conditions of fair competition in the free trade area. Ironically, Mexico's tax measures advance neither of these interests or values. Instead, Mexico's tax measures effectively block US exports of HFCS to Mexico and eliminate the possibility of fair competition between HFCS and cane sugar in the Mexican market. Mexico freely admits its tax measures were put in place to stop the displacement of Mexican cane sugar by imported HFCS (i.e., to protect its domestic industry from imports).

Mexico's citation to the US statements about simultaneous or redundant proceedings in multiple fora would appear to be inapposite.²⁷ The only dispute settlement forum to which the United States has submitted this dispute is the WTO dispute settlement mechanism. And, despite Mexico's arguments otherwise, this dispute is a dispute over the consistency of Mexico's tax measures with Mexico's WTO obligations. Mexico's NAFTA grievances against the United States with respect to market access for Mexican sugar are simply a different matter.

Mexico also states in its response that the United States has made "false statements" with regard to the status of the NAFTA proceeding. The United States trusts that this is an error in translation and that Mexico does not truly intend to make such a spurious charge. The United States cannot see how there is any dispute that: (1) the United States has engaged in consultations with Mexico, both bilaterally and under the auspices of the Free Trade Commission; (2) because the consultations did not resolve the dispute and because Mexico requested a panel, a NAFTA panel was established; (3) the parties have not agreed on panel composition and, because of the lack of automaticity in the panelist selection stage under the NAFTA, a panel has not yet been composed; and (4) the NAFTA dispute remains pending.

As mentioned at the first meeting of the Panel,²⁸ the fact that a NAFTA panel has not been composed is not indicative of a lack of dedication on the part of the parties to resolve their differences under the NAFTA. Before and during these proceedings before the WTO, the United States and US sugar producers have continued to engage with Mexico and its industry on the NAFTA sugar issue.

²⁵ Mexico Closing Statement at the Second Meeting, paras. 8-16.

²⁶ See, e.g., US Answers to Questions of the Panel After the First Meeting, paras. 71-74; US Second Written Submission, paras. 42-48; US Opening Statement at the Second Meeting, paras. 5-7.

²⁷ See Mexico Response to Questions of the Panel After the Second Meeting, p. 15 (revised courtesy translation).

²⁸ US Closing Statement at the First Meeting of the Panel, para. 9.

The current WTO proceeding is to resolve a separate dispute over the consistency of Mexico's tax measures with Mexico's obligations under the WTO Agreement.

Question 61

Mexico has suggested in its response that "measures that *make some contribution*" to securing compliance with the law or regulation at issue which, in Mexico's view, "includes measures that are instruments to achieve the prevention or correction of a breach of the underlying law or regulation, can be justified under Article XX(d) of the GATT 1994."²⁹ In *Korea – Beef*, however, the Appellate Body explained that "a 'necessary' measure is . . . located significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to.'"³⁰ Mexico has made no attempt to explain how a measure that it concedes is merely at what the Appellate Body has called the "opposite pole" of "making [some] contribution to" securing compliance can meet the requirements of Article XX(d).

In this dispute, the only "contribution" Mexico claims its tax measures make to securing compliance with alleged NAFTA obligations is the harm such measures cause US HFCS exporters which Mexico asserts creates "the desired dynamic" to "induce" the United States to change its sugar regime.³¹ As the United States has previously stated, imposition of Mexico's discriminatory tax measures has not contributed to a resolution of concerns under the NAFTA.³² Mexico's response also implicitly concedes that Mexico does not claim that its tax measures do anything more than "make some contribution to" securing compliance, and in its closing statement at the second panel meeting, Mexico appears to acknowledge that any "effect aimed at resolution" its tax measures might have "has been a minor one."³³

Question 63

Mexico's response inexplicably continues to ignore Article 19.1 of the DSU. Article 3.1 of the DSU provides that "Members affirm their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of the GATT 1947, and the rules and procedures as further elaborated and modified herein." Thus, the DSU both affirmed the principles and modified the dispute settlement practices of the GATT, for instance adopting the negative consensus rule for adoption of panel reports and other important changes to GATT 1947 panel practice. Even assuming Article XXIII of the GATT provided GATT panels "flexibility" in the recommendations they might make,³⁴ such flexibility does not exist under the DSU, as Article 19.1 expressly states that "[w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." Article 19.1 further provides that "[i]n addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations." Therefore, even suggestions under Article 19.1 are limited

²⁹ Mexico Responses to Questions of the Panel After the Second Meeting, p. 16 (revised courtesy translation) (emphasis added).

³⁰ Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, adopted on Jan. 10, 2001, para. 161.

³¹ Mexico Second Written Submission, para. 83; *see also* Mexico Responses to Questions of the Panel After the Second Meeting, p. 28 (revised courtesy translation) (stating "the US HFCS obviously is not pleased with the measures and they have communicated that the US authorities").

³² US Answers to Questions of the Panel After the First Meeting, para. 78.

³³ Mexico Closing Statement at the Second Panel Meeting, para. 18.

³⁴ As the United States has already explained, any "flexibility" Article XXIII of the GATT continues to afford is vested in the Members acting jointly, not panels. *See* US Responses to the Questions of the Panel After the Second Meeting, para. 35.

to ways in which the Member could implement a recommendation to bring its measure into conformity and do not extend to the type of "recommendation" Mexico suggests.

It is true that in the 1971 *Jamaica – Margins of Preference* dispute Mexico cites, the panel decided to provide a ruling on Jamaica's obligations, and then drafted a waiver decision and left it to the GATT Council to decide whether to adopt the waiver. But if a WTO panel today were to make such a recommendation, or to make the type of recommendations sought by Mexico during these panel proceedings, that panel would be acting inconsistently with DSU Article 19. The panel in the recent *EC – Sugar* report, presented with a request to permit the defending party to correct its schedule of export subsidy commitments, refused to grant that request, finding that:

"In the Panel's view, the European Communities' assertion that in the light of the circumstances the only course of action is for the Complainants to agree to the correction or revision of the European Communities' Schedule is not a matter for which the Panel has any authority as it goes beyond the scope of a panel recommendation which, under Article 19.1 of the DSU, should be limited to recommending the concerned Member "bring the measure into conformity with the Agreement on Agriculture."³⁵

Question 64

In its response, Mexico lists several "facts" that it asserts the Panel can "see and consider" without having to determine whether the United States is in breach of its NAFTA obligations. The "facts" Mexico asks the panel to "see and consider," however, do not establish the elements Mexico would need to establish for a defense under Article XX(d). To sustain its defense under Article XX(d), Mexico must show that its tax measures are "necessary to secure compliance" with laws or regulations. Even under Mexico's theory, if the United States is already in compliance with its obligations under the NAFTA with respect to market access for Mexican sugar – as it maintains it is – Mexico's tax measures could not be "necessary to secure compliance" with those obligations. The Panel, therefore, cannot assess whether Mexico's tax measures are "necessary" or are designed to "secure compliance" without resolving the question of whether the United States is in breach of its NAFTA obligations.

Mexico's response also appears to contradict itself. On the one hand Mexico is quite clear in stating that the Panel does not have "jurisdiction" to decide "whether the United States has breached its obligations established under NAFTA Annex 703.2," but, on the other hand, asks the Panel to "determine whether ... [the United States] failed to comply with its obligation to submit Mexico's grievance to dispute settlement."³⁶ Mexico protests that this latter inquiry "does not involve fine points of law peculiar to the FTA" and "is essentially one of fact to be determined by reference to the plain text of Chapter Twenty and does not involve the kind of evidence and interpretation that would be put before the NAFTA panel on the other issues."³⁷ Yet such an undertaking would manifestly constitute interpretation and application of the NAFTA. The mere fact that Mexico believes the question of whether the United States is in breach of its obligations under Chapter 20 is less complicated than whether the United States is in breach of its NAFTA market access obligations does not mean the former is any less a request for this Panel to engage in interpretation and application of the NAFTA – something Mexico has been very clear this Panel may not do.

³⁵ Panel Report, *EC – Export Subsidies on Sugar*, WT/DS265/R, circulated on October 15, 2004 (pending Appellate Body Report on other issues) para. 7.353.

³⁶ Mexico Response to Questions of the Panel After the Second Meeting, p. 18-19 (revised courtesy translation).

³⁷ *Id.* at 19 (revised courtesy translation).

Mexico is also incorrect in what it identifies as "facts" and that these alleged "facts" have not been disputed by the United States.³⁸ Mexico's assertion that "Mexico's attempts to find solution through the institutional mechanism [of the NAFTA] have been frustrated by the United States' acts and omissions"³⁹ is not a fact. It is a conclusion drawn by Mexico and based on an opinion – that the United States does not share – of what the NAFTA dispute settlement provisions required and how dispute settlement under such provision should proceed.

Mexico also asserts that "[i]t is incorrect to suggest that a Panel can never state an opinion on an international treaty other than the WTO."⁴⁰ The US position, however, is not that "a Panel can never state an opinion on an international treaty other than the WTO" Agreement, but rather that nothing in this dispute calls, or provides a basis, for the Panel to do so. This Panel was established to resolve a WTO dispute over the consistency of Mexico's tax measures with Mexico's WTO obligations. Opinions as to what the NAFTA obligates parties to do, and whether the United States is compliance with those obligations, are not relevant to this inquiry.

Question 66

Article XXIV of the GATT states that the GATT "shall not prevent ... the formation of ... a free trade area ... [p]rovided that" certain conditions are met. Mexico's citation to Article XXIV, however, does not resolve the dilemma Mexico creates by reading "laws or regulations" in Article XX(d) to mean obligations under an international agreement. If "laws or regulations" includes obligations under an international agreement, as Mexico contends, then it includes obligations under any international agreement, including the WTO Agreement. There is nothing about Mexico's interpretation of the phrase "laws or regulations" that limits it to agreements concerning free trade areas. Mexico's interpretation of Article XX(d), therefore, remains in conflict with Article 23 of the DSU and, if accepted, would render Article 23 meaningless. WTO Members would no longer be required to use and abide by DSU rules in seeking to redress a violation of obligations under the covered agreements, but would, by way of Article XX(d), be permitted to decide on their own accord when such a breach has occurred and the remedies to be taken therefor.

Question 68

In the opinion of the parties, does Article 60 of the Vienna Convention on the Law of Treaties codify a principle of international law by which a material breach of a bilateral treaty by one of the parties may allow the other to invoke that breach as a ground for, inter alia, suspending the operation of that treaty in whole or in part, but not for suspending the operation of a different multilateral treaty? From its response, it appears Mexico shares the US view that Article 60 is not relevant to this dispute.

FOR MEXICO:

Question 82(a)

In response to the Panel's question, Mexico states that the "distribution of goods that are subject to the IEPS tax is exempt from the tax payment unless services of commercial intermediation, which involve the participation of a third party through which the transfer of the goods takes place, are used." Although it is true that the distribution tax does not apply to goods distributed by the soft drink or syrup producer, this is not because the IEPS "exempts" goods distributed by the soft drink or syrup producer from the distribution tax. Rather, this is because the distribution tax applies to goods

³⁸ See, e.g., US Responses to Questions of the Panel After the Second Meeting, paras. 61-67.

³⁹ Mexico Response to Questions of the Panel After the Second Meeting, p. 18 (revised courtesy translation).

⁴⁰ *Id.*

transferred through the use of distribution, representation, brokerage, agency and consignment services. Therefore, if a soft drink or syrup producer acted as its own distributor, this would not constitute a transfer of goods through the use of distribution services. Mexico's response to Questions 82(b) and 82(c) confirm this interpretation. Mexico's response to Question 82(b) states that the distribution tax is not applicable when the services concerned "are related to the transfer of goods that are not subject to the IEPS tax."⁴¹ Question 82(c) states that individuals and legal persons that supply distribution services are subject to the IEPS "with regard to the transfers of ... soft drinks and its concentrates."⁴²

Question 82(c)

Although the "intent" of Mexico's tax measures does not answer the question of whether Mexico's tax measures are "applied so as to afford protection to domestic production" within the meaning of Article III of the GATT, the numerous statements made by Mexico's legislators at the time of the IEPS's enactment demonstrate a very clear intent to protect Mexico's cane sugar industry.⁴³ Mexico's Supreme Court reached the same conclusion on multiple occasions stating quite plainly that the intent of Mexico's tax measures is to "protect the sugar industry."⁴⁴ Mexico's assertions in this dispute that the purpose of its tax measures is to enforce alleged US NAFTA obligations appear to be simply an attempt to rationalize the imposition of Mexico's tax measures *post hoc*.

Question 84

During the second substantive meeting, Mexico made reference to specific provisions in the WTO covered agreements that use expressions such as "laws", "regulations", "international law" in different forms. Could Mexico identify more precisely those specific provisions.

Mexico's response argues that there are many references to "laws and regulations" in the WTO Agreement, and that when the drafters intended to limit these references to a Member's own domestic measures they did so explicitly, and that therefore the reference to "laws or regulations" in the text of Article XX(d) includes not just the domestic laws or regulations of the Member whose measure is at issue (here, Mexico), but also the domestic laws or regulations of other Members, and international law as such.

Restating Mexico's argument fully, as above, illustrates how far Mexico's textual argument reaches, and how many consequences would follow from endorsing it. Any Member could take measures necessary to secure compliance with *another* Member's laws or regulations, or to secure compliance with any obligation arising under an international agreement.

Mexico has submitted a list of provisions referring to "laws and regulations," although it has not provided any analysis of that list (and the United States has not been able to review each and every entry on the list). It is obvious, however, that while a number of the examples cited in Mexico's list (such as Article III:4 of the GATT) do not include provisions explicitly limiting their scope to *domestic* law, they are implicitly so limited based on the context and the function that the provision performs. Article III:4, for instance, can by definition only concern *domestic* measures.

Where the drafters intended to address an international agreement or international law generally, or the laws or regulations of a Member other than the Member to which the right or

⁴¹ Mexico's Responses to the Questions of the Panel After the Second Panel Meeting, p. 25 (revised courtesy translation) (emphasis added).

⁴² *Id.* at 26 (revised courtesy translation) (emphasis added).

⁴³ US First Written Submission, para. 48.

⁴⁴ *Id.*, paras. 49-53, Exh. US-31.

obligation in the relevant provision applied, they provided so explicitly and on an exceptional basis. As an example, the United States recalls the provisions in Article X:1 of the GATT requiring publication of international agreements affecting trade in services or goods, *explicitly in addition* to publication of "laws or regulations." With respect to the measures of other Members, the United States notes as an example the provisions in Article 12.8 of the *Agreement on Safeguards* regarding cross-notification of other Members' measures.

Question 85

In its response to the Panel's question, Mexico states that it is due to its own constitutional and legal system that the NAFTA has direct effect in Mexican law. Just as it is Mexico's own constitutional and legal system that makes the NAFTA have direct effect in Mexico, it is the US constitutional and legal system that makes the NAFTA not have direct effect in the United States.

Question 86

Please see comments on question 61.

Question 87

In response to the Panel's question, Mexico states: "There are two breaches of the NAFTA at issue here: the denial of market access and the persistent refusal to submit that grievance to dispute settlement when the United States has a positive obligation to do so under Chapter Twenty."⁴⁵ Mexico's assertion that the United States is in breach of NAFTA dispute settlement provisions, however, appears to contradict Mexico's earlier acknowledgment of the "lack of automaticity in the operation of [dispute settlement under] NAFTA's Chapter Twenty" and the "fault in the panelist appointment process under NAFTA's Chapter Twenty."⁴⁶ Mexico cannot conflate what it obviously perceives as shortcomings of the NAFTA's dispute settlement provisions with allegations that the United States has breached those provisions.

The United States also points out that Mexico's allegation that the United States is in breach of the NAFTA – either with respect to provisions on market access for sugar or relating to dispute settlement⁴⁷ – are just that: allegations. They are not legal determinations (or "illegal acts") that this Panel may take as a "fact" in this dispute.

Question 90

Mexico's response to this question has listed five measures by name, but has not provided any information on them, and has not provided texts of the measures. The United States provides these comments and the texts of the measures listed by Mexico.

⁴⁵ Mexico Responses to the Questions of the Panel After the Second Meeting, p. 28 (revised courtesy translation).

⁴⁶ Mexico Closing Statement at the Second Meeting of the Panel, para. 27.

⁴⁷ Mexico's response appears to be the first time Mexico has alleged that the United States has breached, in addition to market access provisions with respect to sugar, the dispute settlement provisions of Chapter 20. As the United States has read Mexico's Article XX(d) defense, Mexico claims its tax measures are necessary to secure compliance with alleged US obligations under the NAFTA with respect to market access for Mexican sugar. Mexico's contention here that the United States is also allegedly in breach of NAFTA Chapter 20 provisions demonstrates the unfortunate readiness with which Mexico is willing to shift its position to try to sustain an unsustainable defense.

HFCS

The first measure listed by Mexico, a notice published in the official gazette (*Diario Oficial*) on October 11, 2001, raised Mexico's MFN applied tariff on fructose to 156% for HS 1702.4099 and 210% for HS 1702.5001, 1702.6001, 1702.6002 and 1702.6099, effective October 12, 2001. It is attached as Exhibit US-59.

The second measure listed by Mexico is attached as Exhibit US-60. In this decree, published on December 31, 2001 in the *Diario Oficial*, the Mexican government published its 2002 tariff rates under various preferential trade agreements. Article 49 of this decree, at page 114, requires an import license issued by the Secretary of Economy ("SE") as a condition for importation of goods of North American origin at the preferential rate. It provides that this license is to be issued automatically except that if SE determines to suspend benefits under NAFTA, as a result of non-compliance by the United States with its obligations regarding sweeteners, then SE shall limit or cease to grant such licenses.

The third measure listed by Mexico is attached as Exhibit US-61. In this measure, published in the *Diario Oficial* on April 22, 2002, Ernesto Derbez, Secretary of the Economy, refers *inter alia* to the December 31, 2001 decree, alleged US denial of sugar market access through limitation of Mexican sugar to a 148,000 MT TRQ, alleged frustration of means under the NAFTA to settle disputes, and the purpose of this measure as reestablishing the balance in the sweeteners sector. Through the notice, SE terminates automatic licensing and establishes a tariff rate quota of 148,000 MT valid only through September 30, 2002, for imports at the preferential duty rate of U.S.-origin merchandise classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002 and 1702.6099.

The fourth measure listed by Mexico is the Ley del Impuesto Especial Sobre Producción y Servicios (IEPS), which the United States has submitted as Exhibit US-1 (with its amendments at Exhibits US-2, -3 and -4).

The fifth measure is Mexico's revocation of its WTO- and NAFTA-inconsistent antidumping duties on HFCS, published on May 13, 2002.

Because Mexico has failed to provide information on other significant measures responsive to the Panel's request, the United States submits information on those measures as comments to Mexico's response.

- (1) A resolution published in the *Diario Oficial* on March 1, 2002: *Acuerdo que modifica el similar que establece la clasificación y codificación de mercancías cuya importación y exportación está sujeta al requisito de permiso previo por parte de la Secretaría de Economía*. This resolution establishes a prior import licensing requirement for all imports of NAFTA originating goods of US origin classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002, 1702.6099 and 1702.9099. The *Acuerdo que establece la clasificación y codificación de mercancías cuya importación y exportación está sujeta al requisito de permiso previo por parte de la Secretaría de Economía* (Resolution establishing the classification and codification of merchandise whose importation and exportation is subject to a requirement of a prior licensing permit from the Secretariat of the Economy), as published in the *Diario Oficial* on March 26, 2002 amended to December 15, 2003, is available on the SE website at <http://www.economia.gob.mx/pics/p/p1376/A60.pdf>. Article 4 of this resolution provides an import licensing requirement applying to NAFTA originating goods of US origin classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002, 1702.6099 and 1702.9099. A copy of the March 1, 2002 resolution is

provided as Exhibit US-62 and a copy of the amended import licensing resolution is provided as Exhibit US-63.

- (2) A decree published in the *Diario Oficial* on December 31, 2002: the *Decreto por el que establece la Tasa Aplicable durante 2003, del Impuesto General de Importación, para las mercancías originarias de America del Norte*. The text of this decree is provided as Exhibit US-64. In this decree, the Mexican government published the NAFTA tariff rates to go into effect on January 1, 2003. January 1, 2003 was the final date for tariff elimination for many products under NAFTA, including fructose. The second transitory provision to this decree, at pages 8-9, provides that in conformity with the international rights and obligations of Mexico, from January 1, 2003 onward, the duty-free importation of U.S.-origin products classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002 and 1702.6099 require an import license from SE to be accorded under terms and conditions to be established by SE in a resolution (acuerdo) to be published in the *Diario Oficial*. The relevant resolution appears to be the resolution published on March 20, 2003, discussed below.
- (3) A resolution published in the *Diario Oficial* on March 20, 2003: *Acuerdo que establece los criterios para otorgar permisos previos por parte de la Secretaría de Economía, a las importaciones definitivas de fructosa originarias de los Estados Unidos de América*. Article 2 of this resolution provides that for U.S.-origin products classified under HS 1702.4099, 1702.6001, 1702.6002 and 1702.6099, in conformity with the international rights and obligations of Mexico, criteria for granting licenses for importation for these products will be published "when the necessary conditions exist for that purpose" (and not until that time). Article 1 of this resolution provides for automatic licensing of small amounts of crystalline pure fructose classified in HS 1702.5001; the recitals make it clear that the automatic licensing is only provided because crystalline pure fructose is not produced in Mexico, it is not substitutable with sugar, and users of this product outside the bottling industry had been negatively affected by the duty on imports of this input. Articles 3 and 4 of the March 20 resolution provide that automatic import licensing will continue for temporary importation of HFCS (for use in products to be exported) and for imports of HS 1702.9099. A copy of this resolution is attached as Exhibit US-65.

As the above measures indicate, imports of HFCS of US origin are subject to non-automatic import licensing, except for imports under HS 1702.5001 and 1702.9099 and temporary imports. No criteria for obtaining non-automatic licenses have been published. In addition, imports of HFCS of US origin are subject to the MFN duty rate unless SE has issued a license. In early January, a large US exporter sent a truckload of HFCS as a test shipment to the Mexican border. The truckload was denied entry without reference to duty liability, because the shipment lacked an import license. The company then applied to SE for an import license. At the end of January, SE informed the company that the license was denied because of alleged US denial of market access for Mexican sugar, and that the license would not be granted until the bilateral sugar issue has been resolved. Representatives of the company then met in Mexico City with a senior level official from SE, who informed them that the official had been instructed to deny the import licenses for HFCS indefinitely, until the sugar market access issue is resolved. Another company importing HFCS into Mexico has also informed the United States that SE has denied it import licenses for HFCS, on the basis that importation of HFCS is subject to a licensing requirement and the criteria for such licenses have not been published.

Sugar

On September 26, 2003, the Mexican government published in the *Diario Oficial* a decree establishing a tariff rate quota for sugar for the period until December 31, 2003. This decree was

submitted by the United States as Exhibit US-9 and is discussed in footnote 30 of the First US Submission. On November 12, 2004, the Mexican government published a decree establishing a tariff rate quota for sugar, and a separate tariff rate quota for sugar of Costa Rican origin, for the period until December 31, 2004. In both cases, imports within the TRQ were channeled exclusively through FEESA, a Mexican government entity, as discussed in footnote 30 of the First US Submission.

ANNEX C-7*

**RESPONSES BY GUATEMALA TO QUESTIONS POSED BY
THE PANEL AFTER THE FIRST SUBSTANTIVE MEETING**

(20 December 2004)

FOR GUATEMALA:

1. In paragraph 14 of the written version of its oral statement dated 3 December, Guatemala stated that "it is incumbent on the Panel to carefully examine the [United States'] request, in order to make sure that it complies with the letter and spirit of Article 6.2 of the DSU". Could Guatemala elaborate its statement and explain to the Panel if it has any additional views on whether, in its opinion, the United States' request complies with Article 6.2 of the DSU.

It is not for Guatemala to establish whether the United States' request complies with Article 6.2 of the DSU.

2. In paragraph 6 of the written version of its oral statement dated 3 December, Guatemala stated that "the Panel should respond to Mexico's request and consider, in its deliberations, the importance that the sugar activity has in Mexico and the implications for the country of the reforms undertaken in this sector". Could Guatemala share any views it may have regarding this statement and, particularly, in what manner, if any, should the Panel consider in its deliberations the factors highlighted by Guatemala.

Guatemala has no additional comments on the matter, beyond what was said orally during the course of the substantive meeting.

* Annex C-7 contains the responses by Guatemala to questions posed by the Panel after the first substantive meeting. This text was originally submitted in Spanish by Guatemala.