UNITED STATES – CERTAIN COUNTRY OF ORIGIN LABELLING REQUIREMENTS

RECOURSE TO ARTICLE 21.5 OF THE DSU BY MEXICO (DS386/RW)

(AB-2014-10)

Executive Summary of Other Appeal Submission of Mexico

12 December 2014

I. INTRODUCTION

1. In December 2008 Mexico initiated its challenge against the mandatory country of origin labelling system (COOL) adopted by the United States. Almost six years later, Mexican cattle producers continue to face the higher costs and additional burdens created by the COOL measure compared to those faced by U.S. domestic cattle producers. Instead of bringing itself into compliance with its obligations, the United States amended its regulations to increase the incentive in favor of processing exclusively domestic livestock and against using imported Mexican livestock in the production of beef.

2. In the compliance proceedings under Article 21.5 of the DSU, the Panel rejected the United States' arguments that the detrimental impact of the amended COOL measure stems exclusively from a legitimate regulatory distinction. The Panel also found that the amended COOL measure violates Article III:4 of the GATT 1994. However, the Panel rejected Mexico's claim under Article 2.2 of the TBT Agreement, and exercised judicial economy and did not rule on Mexico's claim under Article XXIII:1(b) of the GATT 1994.

3. The Panel interpreted and applied Article 2.2 in a manner that renders the elements of the obligation meaningless. It is of great systemic importance that the Appellate Body clarifies the interpretation and application of each element of the test to be applied under Article 2.2.

II. PROCEDURAL AND FACTUAL BACKGROUND

4. The Panel and Appellate Body Reports in the original proceedings found that the "COOL Measure", particularly in relation to the muscle cut meat labels, was inconsistent with Article 2.1 of the TBT Agreement because it accorded less favourable treatment to imported livestock than to like domestic livestock. The DSB recommended that the United States bring the COOL measure into conformity with the United States' obligations under the covered agreements. On 23 May 2013, the USDA published the "Final Rule on Mandatory Country of Origin Labeling of Beef, Pork, Lamb, Chicken, Goat Meat, Wild and Farm-Raised Fish and Shellfish, Perishable Agricultural Commodities, Peanuts, Pecans, Ginseng, and Macadamia Nuts" (the "2013 Final Rule"). Although the COOL Statute was part of the measure found by the Panel and the Appellate Body to be inconsistent with Article 2.1 of the TBT Agreement, the United States did not modify the Statute. In this dispute the "measures taken to comply with the recommendations and rulings" of the DSB comprise the COOL Statute and the 2009 Final Rule, as amended by the 2013 Final Rule, which collectively are the "amended COOL measure".

5. The features of the relevant market remain unchanged from the original proceedings. Mexico generally exports "feeder cattle" to the United States immediately after the cow/calf stage to U.S. backgrounding and feeding operations. The average age of the Mexican cattle when exported is six to seven months, and the cattle are slaughtered in the United States at approximately 22 months. The muscle cuts derived from this process are sold as a final product in the United States or exported to Mexico and other countries for final consumption. The amended COOL measure adversely affects the entire production process of beef derived from cattle born in Mexico.

6. The amended COOL measure mandates that consumers be informed of the country of origin of certain categories of covered meat products. For muscle cuts of meat, origin must be reported not based on the final country of processing, but rather on the basis of stages of production of the animal from which the meat was processed: birth, raising, and

slaughtering. Other covered categories of beef products – in particular ground beef – have different labelling rules that do not require information on the stages of production, and over half of all meat products sold for consumption are exempt entirely from labelling requirements.

7. The COOL statute established five categories, consistent with the requirements of the COOL Statute: Category A muscle cuts, defined as from animals exclusively born, raised and slaughtered in the United States; Category B muscle cuts, which are from animals born, raised and slaughtered in more than one country; Category C muscle cuts, which are from animals born and raised in another country and imported into the United States for immediate slaughter; Category D muscle cuts, which are from animals slaughtered and processed in a foreign country before importation, and for which the regular customs origin rule is used (i.e., "substantial transformation"); and Category E for ground meat, for which the origin is all countries of origin that were in the processor's inventory for the 60 days prior to the production date. The COOL statute was not amended and these categories remain in effect.

8. With respect to the information required to be on the labels, the original COOL measure required only the names of countries. Under the new regulations adopted as part of the 2013 Final Rule, the labelling requirements changed for Categories A, B and C. The 2013 Final Rule requires the labels for those categories to indicate the place where each production step of the animal (born, raised, slaughtered) occurred. The labels for Categories D and E remain unchanged.

9. The amended COOL measure retained in place the original COOL measure's three main exemptions from coverage. First, the measure does not apply to entities not meeting the applicable definition of "retailer," which is defined as an entity (i) that has shipped, received, or contracted to be shipped or receive in a single day perishable agricultural commodities in a quantity of at least 2,000 pounds (one ton) and (ii) that purchases perishable agricultural commodities with a cost over US$230,000 per year. Thus, entities that do not sell any fruits and vegetables (and therefore do not buy them) or who sell fruits and vegetable but do not purchase them in the required amount are not covered by the COOL provisions. For example, "butcher shops" that specialize in the sale of meat products are not covered by the amended COOL measure. Second, the measure does not apply to any meat product that is "an ingredient in a processed food item." Third, the measure does not apply to any meat products sold in "food service establishments", which is defined as "a restaurant, cafeteria, lunch room, food stand, saloon, tavern, bar, lounge, or other similar facility operated as an enterprise engaged in the business of selling food to the public." These exemptions remain in effect under the amended COOL measure.

10. Under the original COOL measure, as described above, it was possible to use the Category B label ("e.g., Product of United States, Mexico") if meat products made from cattle born in Mexico and the United States were commingled on the same production day (similarly if cattle born in the two countries were commingled in processing on the same production day). The amended COOL measure eliminated that flexibility, and therefore all situations involving muscle cuts (except for Category D) require precise tracking of the birth country of the cattle through all stages of production, if any of the resulting production will be muscle cuts to be sold in a covered retail establishment. The amended COOL measure also left in place the recordkeeping and verification rules of the original COOL measure, including the prohibition on the establishment of a traceback system.

11. In the original proceedings, the Panel found, and the Appellate Body affirmed, that the original COOL measure had a detrimental impact on competitive opportunities for

imported livestock. Specifically, the original Panel held that "in the context of muscle cut labels, the COOL measure *de facto* discriminate[d] against imported livestock by according less favorable treatment to … Mexican cattle, especially Mexican feeder cattle, than to like domestic livestock." It is undisputed that the amended the COOL measure was not intended to remove the original measure's detrimental impact on imports.

III. APPEAL OF THE PANEL'S FINDINGS AND CONCLUSIONS UNDER ARTICLE 2.2 OF THE TBT AGREEMENT

A. The Panel's Errors relating to the "Relational Analysis"

12. The Panel concluded that Mexico did not make a *prima facie* case that the amended COOL measure is more trade-restrictive than necessary within the meaning of Article 2.2 of the TBT Agreement. The Panel's conclusion was based on a number of erroneous findings on issues of law, related legal interpretations, and the Panel's failure to make an objective assessment of the matter before it as required by Article 11 of the DSU. Had the Panel applied the correct legal approach and made an objective assessment of the evidence and legal arguments, it would have concluded that the amended COOL measure is inconsistent with Article 2.2 of the TBT Agreement.

13. To start with, the Panel erred in its interpretation and application of the analytical approach outlined by the Appellate Body in *US – Tuna II (Mexico)* and in the original *US – COOL* dispute. The Appellate Body has established that the Article 2.2 legal analysis begins with a "relational analysis" that involves a weighing and balancing of a number of relevant factors that include: (i) the challenged measure's degree of contribution to the fulfilment of its objective; (ii) its trade-restrictiveness; and (iii) the nature of the risks at issue and the gravity of consequences that would arise from non-fulfilment of the objective. The Appellate Body has further held that "in most cases" an Article 2.2 analysis needs to also entail a comparison of the challenged measure with possible alternative measures. With respect to the phrase "in most cases", the Appellate Body has identified "at least two instances" in which it may not be necessary to undertake a comparative analysis of the challenged measure with proposed alternative measures: where a measure is not trade-restrictive at all (and may therefore be consistent with Article 2.2), and where a measure is trade-restrictive, but makes no contribution at all to the achievement of a legitimate objective (and may therefore be inconsistent with Article 2.2).

14. The Panel erroneously interpreted the two above-referenced examples to suggest that "only in exceptional circumstances" would it be possible to determine an Article 2.2 claim without undertaking a "comparative analysis". The Panel specifically defined such "exceptional circumstances" to mean "where consistency or inconsistency with Article 2.2 may be deduced by looking solely at certain aspects of the challenged measure." In doing so, the Panel incorrectly replaced the holistic weighing and balancing process of the "relational analysis" with an "exceptional circumstances" test that looks only at "certain aspects" of the challenged measure. Instead of correctly drawing conclusions as to the necessity of the amended COOL measure's trade-restrictiveness at the conclusion of the "relational analysis", the Panel found that Mexico had not sufficiently identified an "exceptional scenario" that would render the "comparative analysis" redundant.

15. On this basis, the Panel erroneously determined that it would only draw conclusions as to the consistency of the amended COOL measure with Article 2.2 of the TBT Agreement after having considered the "comparative analysis" of the amended COOL measure with possible alternative measures. The Panel's reasons suggest that it rejected the two-step approach to the Article 2.2 necessity test and instead combined the "relational analysis" and

the "comparative analysis", conceptually, into a single analysis comprising six "relevant factors". In this respect, the Panel erred in concluding the "relational analysis" without drawing any conclusions, whether provisional or final, as to the necessity of the amended COOL measure's trade-restrictiveness.

16. In Mexico's view, the weighing and balancing process in the "relational analysis" is crucial because it determines whether the trade-restrictiveness of the measure, in itself and on its own merits, is "necessary" in the first place to fulfil the legitimate objective. Eliminating a conclusion under the "relational analysis" creates a substantial gap in the necessity test under Article 2.2, as it leaves unresolved the question of whether the trade-restrictiveness of the challenged measure is "necessary" in the first place.

17. The Panel further erred in deciding to exclude from consideration the design and application of Label E (the ground beef labelling rule) in its assessment of the amended COOL measure's degree of contribution to the fulfilment of the legitimate objective of "providing consumer information on origin". While Mexico does not claim that Label E is inconsistent with the covered agreements in these proceedings, the Panel erroneously excluded Label E from its Article 2.2 analysis on the mistaken basis that to take Label E into account in assessing the amended COOL measure's degree of contribution in the "relational analysis" would create misalignment with the "comparative analysis" because the scope of comparison with the possible alternative measures was limited to Labels A, B and C. This is incorrect because the operation of Label E remains a constant, neutral factor throughout the amended COOL measure and the four proposed alternative measures; contrary to the Panel's mistaken understanding, the operation of Label E would be neither absent nor any different in any of the alternative measures. Further, the Panel compounded this error by inadvertently including ground beef sold under Label E in its evaluation of the amended COOL measure's degree of contribution to the objective. Specifically, in support of its finding that Labels A, B and C of the Amended COOL measure make a "considerable but necessarily partial" degree of contribution in the "relational analysis", the Panel determined that the "the amended COOL measure …. covers between 33.3% and 42.3% of all beef consumed in the United States"[1]; however, this figure includes all beef sold under Labels A through E.[2] The Panel therefore erred in its assessment of the degree of contribution of the muscle cut labelling rules to the fulfilment of the objective.

18. An error of critical importance to the Panel's decision is that it entirely failed to ascertain the "gravity of the consequences that would arise from non-fulfilment" of the amended COOL measure's objective in its assessment of the risks non-fulfilment would create. Specifically, the Panel erred in failing to find on the record before it that the gravity of the consequences that would arise from non-fulfilment is very low. Moreover, in failing to make <u>any</u> overall finding with respect to the gravity of the consequences of non-fulfilment, the Panel not only erroneously declined to properly complete the "relational analysis", but it also prevented itself from properly completing the subsequent "comparative analysis" in the second step of the necessity test. In this respect, the Panel compounded its errors by finding that it was unable to take into account "the specific implications of risks of non-fulfilment" in order to resolve the comparisons of the different degrees of contribution

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1 Panel Reports, *US – COOL (Article 21.5)*, para. 7.347 and footnote 785.

2 Separately, the Panel found that "[o]f total US beef consumption, between 16.3% and 24.5% are muscle cuts carrying Labels A-D, and between 16.6% and 17.8% are ground meat carrying Label E." See Panel Reports, *US — COOL (Article 21.5)*, para. 7.258.

between the amended COOL measure and the first and second proposed alternative measures. This error effectively ended the comparative analyses of the first and second alternative measures before any conclusions could be drawn.

19. In undertaking its analysis of the risks non-fulfilment of the amended COOL measure would create, including ascertaining the gravity of the consequences that would arise from non-fulfilment, the Panel made the following errors:

20. First, the Panel erred in its decision to strictly limit its assessment of the risks that non-fulfilment would create to only two criteria relating to consumer demand for country of origin information – namely, (i) consumer interest in country of origin information, and (ii) the willingness of consumers to pay the costs of obtaining country of origin information on product labels – to the exclusion of all other relevant considerations. The Panel incorrectly described these criteria as separate "facets" of consumer demand. In Mexico's view, consumers' willingness to pay is an indicator of the significance of consumers' interest in country of origin information, and not a separate "facet" or element.

21. Second, the Panel erred by omitting the relative importance of the interests or values furthered by the amended COOL measure from its assessment of the risks non-fulfilment would create. This is a consideration that defines the risks that would arise in the event of non-fulfilment of the objective, and it is especially relevant to ascertaining the gravity of the consequences that would arise from non-fulfilment.

22. Third, the Panel erred by omitting the design, structure and architecture of the amended COOL measure from its assessment of the risks non-fulfilment would create. More than half of all beef products that are sold for consumption in the United States are entirely exempt from the country of origin labelling requirements under the provisions of the amended COOL measure. Similarly, ground beef products are required to provide potentially ambiguous country of origin information under Label E. The very existence of these exemptions and different rules for ground beef in the design, architecture and revealing structure of the amended COOL measure, and their substantial effects in operation and application in the U.S. market, constitutes demonstrative evidence that the gravity of the consequences of providing little or no information on the origin of beef products to consumers is very low to the point of being insignificant or trivial.

23. Fourth, the Panel erred in not making a finding on the gravity of the consequences of non-fulfilment. In this respect, the Panel failed to make an objective assessment of the matter and the facts before it, including evidence that was material to the assessment of the gravity of the consequences that would arise from non-fulfilment, and thereby acted inconsistently with Article 11 of the DSU. Had the Panel made an objective assessment of the material evidence before it, it would have found that the gravity of the consequences that would arise from non-fulfilment of the amended COOL measure's objective is very low and, in turn, that the risks non-fulfilment would create are very low.

24. Despite these errors, the Panel did make an overall finding on the risks non-fulfilment would create, concluding that "we find that there is <u>some risk</u> associated with the non-fulfilment of the amended COOL measure's legitimate objective."[3] Therefore, notwithstanding the foregoing errors, at the very least this finding should have been taken into account in the weighing and balancing process with the other relevant factors in the

[3] Panel Reports, *US – COOL (Article 21.5)*, para. 7.417 (emphasis added).

"relational analysis", and then further taken into account in the "comparative analysis" to find that the first and second proposed alternative measures make an equivalent degree of contribution, but are less trade restrictive, taking into account the degree of only "some risk" that non-fulfilment would create. The Panel erred in doing neither.

25. Finally, the Panel erred by failing to undertake a rigorous and complete "relational analysis" in the first step of the Article 2.2 necessity test and by failing to render a conclusion as to the "necessity" of the trade-restrictiveness of the amended COOL measure. Had the Panel properly completed the holistic weighing and balancing analysis, it would have found that the very considerable trade-restrictiveness of the amended COOL measure is entirely disproportionate to the very low risks non-fulfilment would create. As the gravity of the consequences that would arise from non-fulfilment is very low, the risks non-fulfilment would create are insufficient to justify the measure's very considerable trade-restrictiveness. Thus, the amended COOL measure is more trade-restrictive than necessary and an unnecessary obstacle to international trade.

B. The Panel's Errors relating to the "Comparative Analysis"

26. Mexico appeals various errors committed by the Panel with respect to both the interpretation and application of the elements of the comparative analysis forming the second step of the two-part "necessity test", as explained below.

27. The Panel's failure to determine the gravity of the consequences of non-fulfilment of the amended COOL measure's objective under the relational analysis had the effect of rendering the comparative analysis unworkable. Specifically, the Panel held that it was unable to take into account "the specific implications of risks of non-fulfilment" in order to resolve the comparisons of the different degrees of contribution between the amended COOL measure and Mexico's first and second alternative measures. As a result, the Panel failed to complete the comparative analysis of these proposed alternative measures.

28. The evaluation of whether a proposed alternative measure makes an "equivalent contribution" to the relevant objective can only be properly carried out where consideration is given to the risks that non-fulfilment would create. In the context of this proceeding, Mexico established that the risks non-fulfilment would create are low, or not grave. To the extent that any of Mexico's proposed alternative measures make a somewhat lesser contribution to the consumer information objective, they nonetheless fulfil the "equivalent contribution" requirement because the low risks of non-fulfilment associated with the lesser contribution are insignificant so as not to outweigh the alternative measures' less trade restrictive effects.

29. As its first alternative measure, Mexico proposed a combination of mandatory labelling using the substantial transformation rule and voluntary labelling of more specific information pertaining to the birth and raising production steps. This alternative measure removes the three exemptions maintained by the amended COOL measure, and does not affect Labels D and E. Taking into account the low risks non-fulfilment would create, Mexico's first alternative measure makes an equivalent contribution to the consumer information objective given that it would provide origin information based on the substantial transformation rule for those beef products which are currently exempted under the

amended COOL measure – which constitute between 57.7% and 66.7% of total beef consumption – in addition to origin information for the products covered by Labels A-C.[4]

30. Whereas the amended COOL measure's trade-restrictive effects outweigh its limited contribution to the consumer information objective, Mexico's first alternative measure resolves this imbalance. It has been established that the costs that arise form segregation are the principal source of the amended COOL measure's trade-restrictiveness. By employing the substantial transformation rule as the basis for the mandatory country of origin labeling component, this alternative measure reduces the significant segregation costs and accordingly results in a reduction in trade-restrictiveness. With respect to the voluntary country of origin labeling component, no trade-restrictive effect is entailed as there is no governmental measure that would have the effect of restricting trade. As such, Mexico's first alternative measure is less trade-restrictive than the amended COOL measure.

31. Mexico's first alternative measure is reasonably available to the United States. Prior to the implementation of the original COOL measure, the USDA permitted meat products to be labelled "Product of US" if they were substantially transformed (i.e., if the animals were slaughtered) within the United States.[5] As such, the mandatory labeling component of this alternative measure would impose no "undue burden" on the United States. Likewise, in view of the existence of successful and long-standing voluntary labeling programs currently in place in the U.S., it cannot be said that the first alternative measure's voluntary labeling component is not reasonably available. Finally, the amended COOL measure itself contains labelling requirements for imported muscle cuts of beef that consist of both mandatory and voluntary labelling components. This confirms the reasonable availability of Mexico's first alternative measure.

32. As its second alternative measure, Mexico proposed to extend the ground beef labelling rules to muscle cuts from US-slaughtered animals, while again eliminating the three exemptions maintained by the amended COOL measure. Pursuant to this alternative, the amended COOL measure's ground beef 60-day inventory allowance would be extended to all covered beef products. Consequently, Mexico's second alternative measure provides country of origin information for a significantly more broad range of beef products than the amended COOL measure. By extending the amended COOL measure's ground beef labeling rules to muscle cuts of beef and processed food items made of beef, Mexico's second alternative measure would have the effect of limiting the costs associated with segregation for an even broader subset of beef products, thereby further reducing the incentive to discriminate against imported beef products and limiting any trade-restrictiveness.

33. Because the flexibility inherent in the 60-day inventory allowance has the result of reducing the segregation entailed by the ground beef label, "thus limits any additional costs of implementing the COOL measure with regard to ground meat,"[6] an extension of this labeling system to other beef products would have the effect of similarly limiting the need for the segregation, and consequently limiting the attendant implementation costs, for a wider range of beef products. In light of the fact that this labeling system already forms part of the amended COOL measure, it is clear that Mexico's second alternative measure is reasonably available to the United States.

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4 Panel Reports, *US – COOL (Article 21.5)*, para. 7.258.

5 66 Fed. Reg. 41160-41161 (August 7, 2001) (Exhibit MEX-47).

6 Panel Reports, *US – COOL*, para. 7.435.

34. Throughout its comparative analysis of Mexico's third and fourth alternative measures, the Panel erred in its interpretation and application of the correct standard of proof required to "adequately identify" a proposed alternative measure. In both cases, this error resulted in the Panel's failure to complete the comparative analysis under the second step of the Article 2.2 necessity test.

35. Although the "adequate identification" of a proposed alternative measure is a precondition to the meaningful assessment of its degree of contribution to the relevant objective, reasonable availability and trade-restrictiveness, the Panel incorrectly required the complainants to meet a standard of proof requiring that precise and detailed explanations be provided with respect to the third and fourth alternative measures' implementation and the costs associated with implementation.

36. In fact, there is no authority for the Panel's determination that precise and complete cost estimates are a prerequisite to the "adequate identification" of an alternative measure, either as an initial step or as a requirement in establishing a *prima facie* case with respect to an alternative measure's reasonable availability. Though the Panel cited reasons provided by the Appellate Body in *EC – Seal Products*, it misinterpreted and misapplied this jurisprudence. In doing so, the Panel required a standard of proof that was impossible for the complainants to satisfy, and effectively relieved the United States of its burden to adduce evidence and arguments demonstrating significant and prohibitive obstacles facing the implementation of Mexico's third and fourth alternative measures. The Panel's interpretation of the appropriate standard of proof required to establish a *prima facie* case in this context constitutes a clear error with serious systemic implications for the comparative analysis to be carried out under the second step of the Article 2.2 "necessity test."

IV. APPEAL OF THE PANEL'S FINDING THAT LABEL E IS NOT RELEVANT TO THE ARTICLE 2.1 EVEN-HANDEDNESS ANALYSIS

37. In this Other Appeal, Mexico challenges the finding made by the Panel regarding the relevance of Label E to the Panel's assessment of the even-handedness of the relevant regulatory distinction under Article 2.1. By improperly failing to recognize the relevance of Label E as an integral component of the design and architecture of the amended COOL measure, the Panel engaged in an incomplete and partial assessment of the measure's even-handedness.

38. The "broad appraisal" of the amended COOL measure's design and application which is required in order to correctly assess its even-handedness cannot be carried out if the labelling rules that govern approximately half of the covered beef products are excluded from consideration. For the same reasons that the Panel determined the amended COOL measure's exemptions to be relevant to the inquiry into whether its detrimental impact stems exclusively from a legitimate regulatory distinction, the labelling requirements imposed upon Category E beef products are directly relevant to an assessment of the even-handedness (or in this case, lack thereof) of the amended COOL measure as a whole.

39. The flexibility built into the Label E 60-day inventory allowance is not replicated in the labelling rules that apply to muscle cuts of beef, thereby creating a significant imbalance in the accuracy of the origin information provided to consumers of the two forms of beef products. This imbalance begs the question of why this lower standard of accuracy is acceptable for beef that happens to be ground, but is not acceptable for muscle cuts of beef, particularly in light of the fact that meat from the same animal may be used in both. The absence of any legitimate justification for this asymmetry is a clear indication of a lack of

even-handedness and, consequently, it indicates further arbitrariness in the amended COOL measure.

V. CONDITIONAL APPEAL

40. In its review of the non-violation nullification and impairment claim brought by Mexico, the Panel engaged in an analysis of whether exercising judicial economy in relation to this claim would be appropriate. The Panel concluded that compliance by the United States with the finding of violation of Article III:4 would require eliminating the detrimental impact on competitive opportunities for Canadian and Mexican livestock altogether. This situation would remove the basis of nullification or impairment claimed under Article XXIII:1(b). On that basis, the Panel exercised judicial economy with respect to the complainants' non violation claims.

41. Notwithstanding its exercise of judicial economy, the Panel made sufficient conditional factual findings to support the conclusion that the amended COOL measure is contrary to Article XXIII:1(b) of the GATT 1994.

42. Should the Appellate Body conclude that the Panel erred in its findings of violation under Article III:4 of the GATT 1994 and Article 2.1 of the TBT Agreement and further determine that the amended COOL measure is not inconsistent with these provisions, Mexico appeals the Panel's decision to exercise judicial economy in respect of Mexico's claim under Article XXIII:1(b) of the GATT 1994, and requests that the Appellate Body complete the analysis of this claim and find that the amended COOL measure is inconsistent with Article XXII:1(b).