Stewart and Stewart

Memorandum

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Jon Wooster, President, United States Cattlemen's Association
Wenonah Hauter, Executive Director, Food & Water Watch
Lori Wallach, Director, Public Citizen's Global Trade Watch
From: Stewart and Stewart
Re: Options for Coming into Compliance with WTO Ruling on Country of Origin Labeling (COOL)
Date: February 4, 2013

This memo reviews options for the United States to come into compliance with the WTO Appellate Body ("AB") ruling on country of origin labeling ("COOL"). The memo explains how the United States can come into compliance with the AB ruling my amending the COOL regulations; changes to the COOL legislation are not necessary to acheive compliance. The AB ruled that the current COOL regime violates the obligations of the United States under Article 2.1 of the Agreement on Technical Barriers to Trade ("TBT Agreement").[1] While the AB rejected the legal basis upon which the Panel found that the current COOL regime violates Article 2.2 of the TBT Agreement, it was unable to complete the analysis to determine on its own whether COOL violates Article 2.2. This memo explains how the United States can come into compliance with its obligations under Article 2.1 of the TBT Agreement, as well as maintain compliance with Article 2.2, by strengthening the COOL regulations to provide more accurate and complete origin information to consumers.

[1] Appellate Body Report, *United States – Certain Country of Origin Labelling (COOL) Requirements*, WT/DS384/AB/R, WT/DS386/AB/R, adopted 23 July 2012 (hereinafter "*COOL AB Report*"), at para. 496(a).

First, the memo reviews the AB decision, including the basis for its finding that the current COOL regime violates Article 2.1 of the TBT Agreement. Second, the memo explains how the U.S. can come into compliance with the AB's finding by strengthening the regulations that implement the COOL regime without making a legislative change. Third, the memo explains how the recommended compliance steps will also ensure that the U.S. remains in compliance with Article 2.2 of the TBT Agreement, as interpreted by the AB.

I. The Appellate Body Ruling on Article 2.1 of the TBT Agreement

In December of 2008, Canada and Mexico challenged the U.S. law and regulations implementing COOL, arguing, *inter alia*, that they violated U.S. obligations under Articles 2.1 and 2.2 of the TBT Agreement. The dispute settlement panel found that the COOL regime violated both articles,[2] and those findings were appealed to the AB. The AB upheld the Panel's conclusion regarding Article 2.1, but on a different legal basis than the Panel.[3] The AB rejected the legal basis for the Panel's finding under Article 2.2, but was unable to complete the analysis to determine whether the COOL regime violates Article 2.2 under the proper legal framework.[4] The United States has until May 23, 2013 to come into compliance with the AB ruling.[5]

Article 2.1 of the TBT Agreement requires WTO Members to:

> ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favorable than that accorded to like products of national origin and to like products originating in any other country.

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[2] Panel Reports, *United States – Certain Country of Origin Labelling (COOL) Requirements*, WT/DS384/R, WT/DS386/R, adopted 23 July 2012, as modified by Appellate Body Report WT/DS384/AB/R, WT/DS386/AB/R (hereinafter "*COOL Panel Reports*"), at para. 8.3.

[3] *COOL AB Report* at para. 496(a).

[4] *Id.* at para. 496(b).

[5] Award of the Arbitrator, *United States – Certain Country of Origin Labelling (COOL) Requirements – Arbitration under Article 21.3(c) of the DSU*, WT/DS384/24, WT/DS386/23, 4 December 2012, at para. 123.

While no party contested that COOL qualifies as a "technical regulation," the U.S. contested various aspects of the Panel's findings, including whether COOL accords less favorable treatment to imported over domestic livestock and whether the measure discriminates against imported livestock in accordance with the AB's interpretation of Article 2.1 in the *Clove Cigarettes* case.[6] The AB agreed with the Panel's conclusion that COOL modifies the conditions of competition in the U.S. market to the detriment of imported livestock and thus has a detrimental impact on imported livestock.[7]

The AB found, however, that the Panel erred in ending its analysis there and finding a violation of Article 2.1 based solely on detrimental impact. Instead, the AB explained, that detrimental impact must also be found to reflect discrimination in order to establish a violation of Article 2.1.[8] This principle was explained more fully by the AB in the *Clove Cigarettes* case. There, the AB explained that a detrimental impact on imports, by itself, is not sufficient to establish a violation of Article 2.1 of the TBT Agreement.[9] According to the AB, Article 2.1 of the TBT Agreement "only prohibits *de jure* and *de facto* discrimination against" imports; Article 2.1 does not prohibit a "detrimental impact on competitive opportunities for imports that stems exclusively from legitimate regulatory distinctions."[10] Therefore, even if a measure does change the conditions of competition so as to have a detrimental impact on imports, that measure can still comply with Article 2.1 of the TBT Agreement if it "stems exclusively from a legitimate

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[6] *COOL AB Report* at para. 265.

[7] *Id.* at para. 292.

[8] *Id.* at para. 327.

[9] Appellate Body Report, United States – Measures Affecting the Production and Sale of Clove Cigarettes, WT/DS406/AB/R, adopted 24 April 2012 (hereinafter "*Clove Cigarettes AB Report*"), at paras. 174.

[10] *Id.* at paras. 175, 182.

regulatory distinction rather than reflecting discrimination against the group of imported products."[11] To determine whether a measure reflects discrimination against imports or stems exclusively from a legitimate regulatory distinction, the AB examines the design, architecture, structure, operation, and application of the measure, examining, in particular, the even-handedness of the measure.[12]

The AB in the COOL dispute found that the detrimental impact of COOL on imported livestock does not stem exclusively from a legitimate regulatory objective but instead reflects discrimination, thus violating Article 2.1 of the TBT Agreement.[13] This conclusion was based on the Appellate Body's finding that COOL's recordkeeping and verification requirements, which are the source of detrimental impact on imported livestock, impose a burden on upstream producers and processors that is disproportionate to the level of origin information conveyed to consumers under the regime.[14] In other words, these recordkeeping and verification requirements were not found to stem exclusively from a legitimate regulatory objective, because the origin information tracked under these requirements is not necessarily conveyed to consumers under each of the labels that may be used under the COOL regime.[15]

The AB identified at least three ways in which the COOL regime fails to fully convey the origin information tracked by producers to consumers. First, the prescribed labels do not expressly identify specific production steps; instead, the COOL measure "does not require the labels to mention production steps at all."[16] Second, labels B and C (the mixed origin labels)

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[11] *Id.* at para. 182.

[12] *Id.* at para.182.

[13] *COOL AB Report* at paras. 349, 350.

[14] *Id*. at para. 349.

[15] *Id*.

[16] *Id*. at para. 343.

contain confusing or inaccurate origin information, not only because they do not require identification of which production step occurred in which country, but also because they may list countries of origin in any order and because the commingling flexibilities allowed under the regime may indicate that meat is of mixed origin when it in fact is of exclusively U.S. origin.[17] Third, and finally, upstream producers are required to track the origin of the cattle and meat they produce regardless of its end use (which they often will not know at their upstream stage of production), yet COOL exempts processed food items, items sold in food service establishments, and items not sold through a "retailer" from labeling requirements.[18]

As a result of these weaknesses in the COOL labeling regime, the AB concluded that, "the detail and accuracy of the origin information that upstream producers are required to track and transmit … { is } significantly greater than the origin information that retailers of muscle cuts of beef and pork are required to convey to their consumers."[19] Because the AB could adduce no rational basis for this disconnect, it concluded that the manner in which COOL seeks to provide information to consumers is "arbitrary" and the disproportionate recordkeeping and verification requirements imposed on producers was "unjustifiable."[20] As a result, the AB concluded that the detrimental impact of the COOL measure on imports reflects discrimination, does not stem exclusively for a legitimate regulatory distinction, and thus violates Article 2.1 of the TBT Agreement.[21]

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[17] *Id*.

[18] *Id*. at para. 344.

[19] *Id*. at para. 346.

[20] *Id*. at para. 347.

[21] *Id*. at para. 349.

II. Strengthening COOL Rules to Comply with the Appellate Body Ruling

As explained above, the AB found that the COOL regime violated Article 2.1 of the TBT Agreement because the recordkeeping and verification requirements for producers required the tracking of more origin information than is ultimately provided to the consumer. The U.S. can bring itself into compliance by strengthening the COOL regulations to ensure that more of the origin information tracked by producers is in fact provided to consumers. This will bring the recordkeeping and verification requirements into proportion with the amount of origin information provided to consumers, and it will ensure that, to the extent any detrimental impact on imports results from COOL, that impact "stems exclusively from a legitimate regulatory distinction rather than reflecting discrimination against the group of imported products." Finally, to the extent there is any origin information tracked by producers that is still not provided to consumers under a revised COOL regime, the United States should provide an explanation for that disconnect so that it no longer appears arbitrary.

The AB identified several ways in which the current COOL regime denies complete origin information to consumers. The first three of these can be fully addressed by strengthening the COOL regulatory regime, and the fourth can be partially addressed through a strengthening of the regulatory regime. The AB identified the following deficiencies in the current COOL regime:

- The lack of information on COOL labels regarding specific production steps;[22]
- The fact that labels B and C (the mixed origin labels) allow countries of origin to be listed in any order;[23]
- The fact that meat that is of exclusively U.S. origin may instead be labeled as mixed origin due to the commingling flexibilities in the regime;[24] and

[22] *Id*. at para. 343.

[23] *Id*.

- Exemption from labeling requirements for processed food items, items sold in food service establishments, and items not sold through a "retailer."[25]

Regulatory improvements that would address each of these deficiencies are proposed below.

The COOL statute does not specify the level of detail that COOL labels must provide regarding the origin of muscle cuts. Instead, the statute limits the use of an exclusively U.S. origin label to meat that is derived from an animal that was exclusively born, raised, and slaughtered in the United States, specifies that meat from animals that underwent the three production steps in the United States and one or more other countries be labeled with those countries, and requires that meat from an animal that did not undergo any production steps in the United States be labeled with its foreign country of origin.[26] An origin label that lists the country in which each of the production steps occurred would meet these statutory requirements while also conveying more origin information to consumers and thus improving the measure's compatibility with Article 2.1 of the TBT Agreement.

The COOL regulations can be revised to require that all muscle cuts bear a label that specifies the country in which each production step took place. The four labels would be revised to state as follows:

Label A: "Product of an animal born, raised, and slaughtered in the United States."

Label B: "Product of an animal born in [Country X], and raised and slaughtered in the United States."

Label C: "Product of an animal born and raised in [Country X], and slaughtered in the United States."

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[24] *Id*.

[25] *Id*. at para. 344.

[26] 7 U.S.C. § 1638a(a)(2).

Label D: "Product of an animal born, raised, and slaughtered in [Country X]."[27] In addition, where an animal is raised in more than one country, the B or C label for that animal would read: "Product of an animal born in [Country X], raised in [Country X and Country Y] and slaughtered in the United States." The revised labeling regime would also prohibit commingling of product from different origins to ensure the accuracy of the origin information provided to consumers.

Strengthening the labeling regulations in this manner would fully address three of the four deficiencies identified by the AB. It would provide information regarding specific production steps. It would no longer permit countries in mixed origin labels to be listed in any order. And it would eliminate the commingling flexibility that currently permits meat of exclusively U.S. origin to be labeled as mixed origin meat.

With respect to the fourth deficiency identified by the AB, unfortunately not all of that deficiency can be fully addressed through rulemaking. The COOL statute itself exempts food service establishments from passing origin information on to consumers,[28] and this exception cannot be addressed without amending the statute. Revised rules could, however, require producers to pass on origin information to food service establishments. This would permit restaurants to provide that information to consumers if they so choose.

In addition, the exception from labeling requirements for ingredients in a processed food item can be revised through rulemaking alone. One way to limit the range of products that are

[27] If only the country of slaughter is known for such exclusively foreign product, the regulations should permit the product to be labeled "Product of [Country X]." This is consistent with the statutory provision that permits a retailer of a covered commodity to use an existing origin label on goods already individually labeled for retail sale under 19 U.S.C. § 1638a(c)(2). In addition, it does not raise any concerns about disproportionality since it communicates the amount of origin information that is tracked – when an animal is slaughtered outside of the United States, there is no need to track its place of birth or where it is raised.

[28] 7 U.S.C. § 1638a(b).

excluded from labeling under this provision would be to specify that roasting, curing, smoking, and other steps that make raw commodities more suitable for consumer use are not sufficient to exempt those products from labeling. Similarly, the exception could be tightened to specify that any food item that consists only of one or more covered commodities must still bear origin information. Finally, the exception could be revised to specify that any item currently considered a processed food item that is derived from only one muscle cut of meat (*e.g.*, a marinated steak), must still bear its origin information.

The revised labels proposed above would clearly inform consumers of the country in which each step in the production process occurred, would prohibit commingling and mislabeling of product, and would reduce the amount of product exempt from labeling requirements. Strengthening the COOL regulations as outlined above would convey to consumers the full amount of origin information tracked by producers, bringing the recordkeeping and verification requirements into proportion with the level of information consumers receive. This would ensure that any detrimental impact on imports that may result from the COOL regime would stem exclusively from a legitimate regulatory purpose, and thus that the measure would comply with Article 2.1 of the TBT Agreement.

In addition, it is worth noting that strengthening the origin labels in this manner can be achieved without imposing significant additional recordkeeping or verification requirements, and thus would not substantially increase the measure's potential detrimental impact on imports. As noted by the AB, producers are already required to track the origin of animals from which meat is derived. The panel and AB also found that the current regulatory flexibilities for mixed origin labels and commingling did not eliminate the need to segregate animals in the production process, and thus did not sufficiently reduce or eliminate the measure's detrimental impact on

imports. Thus, the commingling flexibility, far from inoculating the COOL regime from a finding of inconsistency, actually undermined the ability of the regime to serve its legitimate regulatory purpose and contributed to the AB's finding of inconsistency. Eliminating that flexibility will thus impose only limited additional requirements on processors while dramatically improving the amount and accuracy of origin information provided to consumers, thus making the measure more proportional and more consistent with Article 2.1 of the TBT Agreement.

III. Maintaining Compliance with Article 2.2 of the TBT Agreement

The revisions to the COOL regulations proposed above would not only help bring the U.S. into compliance with Article 2.1 of the TBT Agreement, they can also help ensure that the U.S. remains in compliance with Article 2.2 of the TBT Agreement.

The panel found that the COOL measure also violated Article 2.2 of the TBT Agreement; the AB set aside this finding, but it was unable to complete the analysis as to whether the measure is more trade restrictive than necessary to fulfill a legitimate objective.[29] The AB noted that the relevant considerations in performing such an analysis include the contribution the measure makes to the objective of providing consumers with origin information, the trade-restrictiveness of the measure, and the consequences that may arise from the non-fulfilment of the objective.[30] The AB found that the current COOL measure made "some" contribution to providing consumers with origin information, had a "considerable degree" of trade-restrictiveness, and that the consequences of non-fulfilment were not particularly grave.[31] The AB stressed, however, that it lacked information regarding the degree to which COOL

[29] *COOL AB Report* at para. 491

[30] *Id*. at para. 479.

[31] *Id*.

contributed to the provision of consumer information, and thus was unable to complete its analysis under Article 2.2.

Strengthening the COOL regulations as outlined in Section II, above, would improve the degree to which COOL contributes to the legitimate regulatory objective of providing consumers with information on origin. The revisions would do so by ensuring that consumers have information on the country in which each production step occurs, ensuring that meat of exclusively U.S. origin is not labeled as mixed origin meat due to commingling, and reducing the range of food items exempt from labeling requirements. Each of these improvements will provide more complete and accurate origin information to consumers, without appreciably increasing the trade restrictiveness of the COOL measure. Thus, each of these reforms would help to further insulate the COOL regime from challenge under Article 2.2 of the TBT Agreement.