

Briefing Paper - 12 September 2011 Tobacco Product Regulation and the WTO: US – Clove Cigarettes

On 2 September 2011, the World Trade Organization (WTO) released the report of a panel tasked with considering a complaint brought by Indonesia concerning prohibitions on certain flavored tobacco products implemented by the United States (US). The panel concluded that the US violated WTO law and recommended that the US be asked to bring its laws into conformity with WTO law. This briefing paper gives some background to those aspects of the dispute most relevant to public health, explains the panel's decision, examines the implications for tobacco control and public health more generally and outlines the options open to the US.

Background

In 2009, the *Family Smoking Prevention and Tobacco Control Act* amended the *Federal Food, Drug, and Cosmetic Act*.¹ Among other things, the change to the law created a prohibition on cigarettes containing a constituent that is a characterizing flavor of the tobacco or tobacco smoke, other than menthol or tobacco. Section 907(a)(1)(A) of the former Act states:

a cigarette or any of its component parts (including the tobacco, filter, or paper) shall not contain, as a constituent (including a smoke constituent) or additive, an artificial or natural flavor (other than tobacco or menthol) or an herb or spice, including strawberry, grape, orange, clove, cinnamon, pineapple, vanilla, coconut, licorice, cocoa, chocolate, cherry, or coffee, that is a characterizing flavor of the tobacco product or tobacco smoke. Nothing in this subparagraph shall be construed to limit the Secretary's authority to take action under this section or other sections of this Act applicable to menthol or any artificially or natural flavor, herb, or spice not specified in this subparagraph.²

Indonesia, which is an exporter of clove cigarettes, objected to the law and requested the establishment of a WTO panel. Indonesia argued that the law treats Indonesian clove cigarettes less favorably than like menthol cigarettes of US origin, in violation of Article 2.1 of the Agreement on Technical Barriers to Trade (TBT Agreement) and Article III:4 of the General Agreement on Tariffs and Trade (GATT 1994). Indonesia also argued that the US measure is not necessary to achieve a legitimate objective, such as protection of human life or health, and that accordingly, the measure results in violation of Article 2.2 of the TBT Agreement, and is not defensible under Article XX(b) of the GATT 1994.

The US argued that the measure is non-discriminatory and that the law draws a distinction between clove cigarettes and menthol cigarettes on health grounds (rather than based on the origin of the products). More specifically, the US argued that clove cigarettes are a starter product especially attractive to youth, whereas menthol cigarettes are not starter products because they are attractive to youth and adult smokers in similar proportions. After the US had made its first and second written submissions to the panel, this argument was undermined by a report of the Tobacco Products Scientific Advisory Committee (TPSAC). This body was mandated by the *Family Smoking*

¹ *Federal Food, Drug, and Cosmetic Act*. 21 U.S.C. § 387g(a)(1)(A)

² *Family Smoking Prevention and Tobacco Control Act*, HR 1256, section 907(a)(1)(A)

Prevention and Tobacco Control Act to report to the US Food and Drug Administration (FDA). Notably, the report concluded that the availability of menthol cigarettes increases initiation among youth.

TPSAC does conclude that the availability of menthol cigarettes has led to an increase in the number of smokers and that this increase does have adverse public health impact in the United States. TPSAC found evidence that the availability of menthol cigarettes increases initiation; of particular concern was the high rate of menthol cigarette smoking among youth and the trend over the last decade of increasing menthol cigarette smoking among 12 to 17 year olds, even as smoking of non-menthol cigarettes declines. TPSAC also concluded that cessation is less likely to be successful among smokers of menthol cigarettes. Thus, the availability of menthol cigarettes increases initiation and reduces cessation, thereby increasing the number of people who are smoking. This increase in the number of smokers represents an adverse impact of the availability of menthol cigarettes on public health.³

Although this development moved the ground beneath the US arguments, the US had also argued that a regulatory distinction was drawn between clove and menthol cigarettes because the extent of menthol consumption in the US means that prohibiting menthol could create significant risks of illicit trade as well as problems for the US health system (given the addictive character of nicotine).

These and other arguments were litigated against the backdrop of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), which has 174 states parties. Although neither the US nor Indonesia is a Party to the WHO FCTC (the US has signed but not ratified), the Convention gives expression to the public health goals pursued through tobacco control and the strength of support for tobacco control among states. The Fourth Session of the Conference of Parties to the WHO FCTC adopted Partial Guidelines on Regulation of the Contents of Tobacco Products and Regulation of Tobacco Product Disclosures. The Partial Guidelines address the use of flavorings and other substances as means of making tobacco products more attractive or palatable. The Partial Guidelines state:

Masking tobacco smoke harshness with flavours contributes to promoting and sustaining tobacco use. Examples of flavouring substances include benzaldehyde, maltol, menthol and vanillin.

Spices and herbs can also be used to improve the palatability of tobacco products. Examples include cinnamon, ginger and mint.

The Partial Guidelines then make the following recommendation:

Parties should regulate, by prohibiting or restricting, ingredients that may be used to increase palatability in tobacco products.

Ingredients indispensable for the manufacturing of tobacco products and not linked to attractiveness should be subject to regulation according to national law.⁴

³ Menthol Cigarettes and Public Health: Review of the Scientific Evidence and Recommendations (as reviewed at the TPSAC meeting on March 18, 2011) <http://www.fda.gov/downloads/AdvisoryCommittees/CommitteesMeetingMaterials/TobaccoProductsScientificAdvisoryCommittee/UCM247689.pdf>, p. 204 (in the PDF version)

⁴ Partial Guidelines for Implementation of Article 9 and 10 of the WHO FCTC, Regulation of the Contents of Tobacco Products and Regulation of Tobacco Product Disclosures, available at http://www.who.int/entity/fctc/protocol/guidelines/adopted/article_9and10/en/index.html, para. 3.1.2.2

In addition to the arguments mentioned above, the panel was confronted with arguments about the failure of the US to notify WTO Members of the change to its law. This and other issues not central to health concerns are not addressed in this briefing paper.

The Panel's Analysis

The panel elected to consider Indonesia's claims under the TBT Agreement first. As it happened, the panel found a violation of Article 2.1 of the TBT Agreement and determined that it was unnecessary to also consider the claims under the GATT 1994. In essence, the panel found that the US violated Article 2.1 by prohibiting clove, but not menthol cigarettes.

Article 2.1 of the TBT Agreement establishes a principle of non-discrimination:

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

Article III:4 of the GATT 1994 also establishes a principle of non-discrimination with respect to internal regulation. The provision prohibits a WTO Member from discriminating against imported goods in favor of domestic goods. There are three requirements to be met for a violation of Article III:4 to be established. A measure must be a law, regulation or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution or use of a good. The imported and domestic goods in question must be considered like. Finally, the imported products in question must be accorded treatment less favorable than the like domestic products. The limited case law applying the TBT Agreement meant that the panel had to draw some initial conclusions of law concerning how Article 2.1 applies. In doing so, the panel compared the TBT Agreement to the GATT 1994 and drew upon the case law of the latter agreement.

Although the elements of Articles 2.1 and III:4 are similar, the panel concluded that a different approach to Article 2.1 should be taken. Under Article III:4, whether products are like turns on the extent to which they are in a competitive relationship.⁵ In contrast, the panel concluded that likeness analysis under Article 2.1 should be permeated by the regulatory objective pursued.⁶ Put another way, the panel sought to determine whether the products were like in terms of their effect on youth smoking (the risk the US was seeking to address). This emphasis on the regulatory objective pursued preserves some degree of regulatory autonomy in the context of a provision for which there is arguably no health exception.

On the facts, the panel concluded that clove and menthol cigarettes are like in terms of the regulatory objective pursued. The panel found that each type of cigarette imparts a characterizing flavor that reduces the harshness of tobacco, and that each is attractive to youth.⁷ In drawing this conclusion, the panel determined that evidence presented by both parties concerning the tastes and habits of youth smokers in the US could not be relied upon for purposes of determining market share.⁸ Rather than engaging with the evidence presented on questions of market share, to determine

⁵ For discussion see Benn McGrady, *Trade and Public Health: The WTO, Tobacco, Alcohol and Diet*, New York, Cambridge University Press, 2011, pp 91 - 94

⁶ Panel Report, *United States – Measures Affecting the Production and Sale of Clove Cigarettes*, [hereinafter *US – Clove Cigarettes*], WT/DS406/R, para. 7.119

⁷ *Ibid*, para. 7.182

⁸ *Ibid*, para. 7.210

whether the products are like the panel drew on the TPSAC report, on the work of a WHO scientific advisory committee and on the WHO FCTC Partial Guidelines.

The panel also drew some conclusions about how the less favorable treatment standard applies under Article 2.1. The panel stated that it was not sufficient for Indonesia to demonstrate that the measure affected competition between imported clove and domestic menthol cigarettes to the detriment of imported clove cigarettes. Indonesia also had to demonstrate that the adverse effects on clove were related to the foreign origin of the product.⁹ The panel emphasized that less favorable treatment is not established by merely showing that some imported products are treated less favorably than some domestic like product.¹⁰ Nonetheless, on the facts, the panel concluded that the less favorable treatment requirement was met. The panel noted that the vast majority of Indonesian exports of cigarettes to the US were prohibited.¹¹ Because the panel had already concluded that the exemption of menthol was not based on menthol posing different risks to human health than clove, the US was forced to rely on the argument that the differential treatment of clove and menthol was based on the risk of illicit trade and risks to the US health system, rather than on the foreign origin of clove. The panel rejected this argument and concluded that the purpose of Article 2.1 would be defeated 'if Members were allowed to remove their domestic products from the application of those same regulations to avoid potential costs that it might otherwise incur.'¹²

In summary, the panel concluded that the US measure violates Article 2.1 and recommended that the Dispute Settlement Body of the WTO request the US to bring its laws into conformity with WTO law.

The panel also addressed Indonesian arguments under Article 2.2 of the TBT Agreement. This provision states:

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objectives are, inter alia: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, inter alia: available scientific and technical information, related processing technology or intended end-uses of products.

As with Article 2.1, the limited case law on Article 2.2 meant that the panel had to draw some preliminary conclusions of law. The panel noted that the approach to analyzing Article XX(b) of the GATT is relevant to Article 2.2.¹³ Article XX(b) protects measures that, among other things, are necessary to protect human life or health. Based on this conclusion, the panel examined three questions.

First, the panel examined whether Indonesia had demonstrated that the ban on clove cigarettes exceeds the level of protection sought by the US. The panel concluded that Indonesia had not brought sufficient evidence to establish the level of protection actually pursued by the US.¹⁴ On this

⁹ *Ibid*, para. 7.268

¹⁰ *Ibid*, para. 7.273

¹¹ *Ibid*, para. 7.276

¹² *Ibid*, para. 7.291

¹³ *Ibid*, para. 7.369

¹⁴ Panel Report, *US – Clove Cigarettes*, paras 7.373 – 7.374

basis, there was not sufficient evidence for the panel to conclude that the measure exceeded the level of protection pursued.

Second, the panel examined whether Indonesia had demonstrated that the ban on clove cigarettes makes no material contribution to the objective of reducing youth smoking. In rejecting Indonesia's argument, one issue the panel considered is whether youth smoke clove cigarettes in insignificant numbers. The evidence brought by the US and Indonesia on this issue conflicted. The US evidence suggested that youth smoke clove cigarettes at higher rates than was suggested in evidence presented by Indonesia. In evaluating the evidence, the panel stated that 'the survey evidence before the Panel is susceptible to different interpretations. However, even if we accept Indonesia's numbers, these numbers do not show that an insignificant number of youth smoke clove cigarettes.'¹⁵

The panel also considered whether the scientific evidence supports Indonesia's argument that banning clove cigarettes will do little to deter youth from smoking. In rejecting Indonesia's argument, the panel concluded that 'this is a case in which the measure actually represents at least the majority view, and potentially the unanimous view.'¹⁶ After citing the relevant scientific evidence, the panel also stated that the WHO FCTC Partial Guidelines reinforced its understanding. The panel quoted from the Partial Guidelines to the effect that they draw on the best available scientific evidence and the experience of Parties, before noting that they 'show a growing consensus within the international community to strengthen tobacco-control policies through regulation of the content of tobacco products, including additives that increase the attractiveness and palatability of cigarettes.'¹⁷

Third, the panel considered whether Indonesia had demonstrated that there are less trade restrictive alternative measures that would make an equivalent contribution to achievement of the objective at the level of protection sought by the US. In this respect, the panel concluded that Indonesia had merely listed a number of tobacco control measures as alternatives, but had not demonstrated that these measures would make an equivalent contribution to achieving the level of protection pursued by the US.¹⁸ The panel also noted that many tobacco control measures are already in place in the US, suggesting that these measures may be complementary rather than alternative measures.¹⁹ Finally, the panel noted that 'prohibiting the sale of flavoured cigarettes is actually one of the measures that has been recommended in the WHO [FCTC] Partial Guidelines.'²⁰

In summary, the panel concluded that Indonesia had not established that the US measure was more trade restrictive than necessary to protect human health under Article 2.2.

Implications for Public Health and Tobacco Control

Although the outcome of the dispute binds only the US and Indonesia, the broader implications of the panel report for public health are mixed. On the one hand, five aspects of the report reinforce the extent to which WTO Members possess the autonomy to regulate in the interests of public health.

¹⁵ *Ibid*, para. 7.389

¹⁶ *Ibid*, para. 7.401

¹⁷ *Ibid*, para. 7.414

¹⁸ *Ibid*, para. 7.422

¹⁹ *Ibid*, para. 7.425

²⁰ *Ibid*, para. 7.427

First, because the case was decided on principles of non-discrimination, the result will not necessarily be the same for another WTO Member implementing the same measures. In this dispute, the US was susceptible to claims of discrimination due to the fact that menthol cigarettes sold in the US are predominantly of US origin. For other WTO Members, the make-up of their tobacco market may be such that they are not as susceptible to claims of this type.

Second, the panel offered an interpretation of Article 2.1 of the TBT Agreement that seeks to balance the interests of domestic regulatory autonomy with enforcement of trade commitments. Prior to the panel report, WTO Members had little guidance on how Article 2.1 would be interpreted. In contrast to the GATT where the principle of non-discrimination in Article III:4 is subject to a health exception in Article XX(b), the principle of non-discrimination in Article 2.1 stands alone, without the safe haven offered by an exception. However, the approach taken by the panel emphasizes whether products are like in terms of the risks they pose in the context of youth smoking, rather than the extent to which they compete. This approach offers an avenue through which the regulatory autonomy of WTO Members may be protected to some degree because the focus on risk will limit the circumstances in which products are considered like.

Third, the use of case law under Article XX(b) of the GATT in interpreting Article 2.2, gives greater certainty in terms of how that provision will be applied. The application of the provision to Indonesia's arguments also demonstrates how difficult it will be for WTO Members to challenge measures under Article 2.2. Unlike Article XX(b) where the Member defending the measure bears the burden of proof, Article 2.2 places the burden on the complainant. The panel's analysis suggests that it will often be difficult for a complainant to meet its burden of proving that another Member's measure is more trade restrictive than necessary. This will be particularly so in the context of narrowly tailored health measures with a strong evidence base.

Fourth, the panel drew on the WHO FCTC in ways that reinforce the importance of that regime in trade disputes concerning tobacco control measures. The reliance placed on the WHO FCTC suggests that the Convention will be used by WTO panels in assessing legal issues, such as the necessity of tobacco control measures. This would also appear to weaken the position of WTO Members questioning the legitimacy of tobacco control measures such as plain packaging of tobacco products.

Finally, some public health advocates might view this decision as an endorsement of the argument that menthol cigarettes should be prohibited. In this respect, there has been some dispute in the public health community concerning whether the US law goes far enough. The panel's decision, drawing heavily on the TPSAC report, groups menthol with clove and other flavored cigarettes in terms of the risk of youth smoking.

On the other hand, there are aspects of the panel report that are worrying from a public health perspective. Most obviously, in losing the dispute the US is likely to be ordered to bring its laws into conformity with WTO law. One way to do so would be to permit sale of clove cigarettes, which would be regressive for public health. Although more comprehensive product restrictions, such as a prohibition on menthol, could bring the US into conformity, the political difficulty of prohibiting menthol may limit the responses truly available to the US.

From a systemic point of view, the greatest concern is the way in which the panel addressed the element of less favorable treatment, and US arguments concerning the risk of illicit trade and risks to the US health system stemming from a prohibition on menthol. The panel characterized each of these objectives as relating to 'the costs that might be incurred by the United States were it to ban

menthol cigarettes.²¹ The panel stressed that by excluding menthol from the scope of the product ban, the US sought to minimize or eliminate costs it may incur while triggering costs to producers of like products in the territory of other Members.

This analysis could be read in a number of ways. Under one reading, the panel observed that the costs of the measure fall almost exclusively on importers and imported goods, suggesting that the measure discriminates based on the foreign origin of the goods rather than for other reasons. Another reading is that the panel engaged in a crude form of cost benefit analysis, weighing the costs to Indonesian tobacco producers against the costs the US would incur if it prohibited menthol. This would arguably be an improper approach given that the WTO Agreement is not a system for the positive integration of its Members.

Either way, the quick dismissal of the risks posed by illicit trade is questionable. Even if the risks of illicit trade associated with banning menthol would fall on the US, those risks may still constitute evidence that regulatory distinctions are drawn for reasons other than the foreign origin of clove cigarettes. How compelling that evidence would be in the specific factual context of the measure is another question, but the evidence should be considered all the same.

In this respect, WTO Members are likely to have the risk of illicit trade in mind as they consider the prohibition of particular tobacco and nicotine products. This is arguably one of the core reasons that tobacco flavored cigarettes and other entrenched tobacco products are not prohibited despite the risks they pose to health. WTO Members may actually prohibit emerging tobacco and nicotine products and ‘starter’ products with a view to preventing rises in the prevalence of tobacco use (use of established products). Depending on a Member’s tobacco market, emerging products to be prohibited might include flavored cigarettes, oral snuff, electronic cigarettes and nicotine water. Regulatory distinctions between products occur not only across flavors, but also across product classes and it will often be difficult to identify the risks those classes pose to public health, either in terms of the inherent risks of a product or the capacity of the product to increase prevalence. In this context, the risks of illicit trade associated with prohibiting established addictive products need to be given due weight in analysis under WTO law.

The seriousness of illicit trade in many countries is also reflected in the fact that WHO FCTC Parties are negotiating an optional protocol to the WHO FCTC on illicit trade in tobacco products. The risks are also not simply costs borne by the Member prohibiting particular products. Rather, there are spill-over effects for other countries in terms of transnational criminal activity. All of these factors suggest that the panel may have been overly dismissive of US concerns regarding illicit trade.

Options open to the US

There are three obvious approaches available to the US. One approach is to appeal the decision. Given the conclusions of the TPSAC on menthol, it would appear that any appeal would turn on how the less favorable treatment standard in Article 2.1 of the TBT Agreement was applied, rather than on questions of likeness.

Another approach is for the US to bring its laws into conformity with WTO law. The US could do this in one of two ways. First, the US could lift the prohibition on clove cigarettes, an approach that is regressive in terms of public health. Second, the US could prohibit menthol-flavored cigarettes. Doing so would bring the US into conformity with the panel report. Were the US to choose this

²¹ *Ibid*, para. 7.289

approach, Indonesia could, in theory, bring a second claim to the effect that Indonesian clove cigarettes are treated less favorably than like tobacco-flavored cigarettes of US origin. The panel did not examine this issue in its report because Indonesia had not initially framed its complaint in this way.²² At first glance, however, it would appear that the US would be on stronger ground if it were forced to defend such a claim, given differences between the products.²³

The third approach available to the US is to refuse to bring its laws into conformity with WTO law (an unlikely approach in the absence of an appeal). If the US chooses this approach, the WTO Dispute Settlement Body will most likely authorize the suspension of concessions at a level equivalent to the extent that Indonesia's benefits under the agreement are nullified or impaired as a consequence of the initial violation. Put another way, Indonesia will most likely be authorized to impose retaliatory tariffs on importation of US cigarettes.

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²² *Ibid*, paras 7.124 – 7.148

²³ The evidence discussed by the panel, and in the TPSAC report, suggest that menthol cigarettes are particularly attractive to youth, as compared to tobacco flavored cigarettes.