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TOBACCO PRODUCT REGULATION AND THE WTO: APPELLATE BODY REPORT, *US – CLOVE CIGARETTES*

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In 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 United States be asked to bring its laws into conformity with WTO law. The United States appealed the panel's decision. The Appellate Body of the WTO upheld the panel report on April 4, 2012. This briefing paper provides a basic overview of the Appellate Body's report and examines the implications for tobacco control and public health more generally.

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

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



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(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 to hear its complaint. Indonesia challenged the law on a number of grounds, including:

- that the effect of the law is to discriminate against Indonesian clove cigarettes in favor of like US menthol cigarettes, contrary to Article 2.1 of the Agreement on Technical Barriers to Trade (TBT Agreement); and
- that the law is more trade restrictive than necessary to protect human health, contrary to Article 2.2 of the TBT Agreement.

Indonesia also made arguments about the failure of the US to notify WTO Members of the change to its law and other procedural matters. This briefing paper does not address these and other issues that are not central to health concerns.

The Panel Report

The panel found in favor of Indonesia on the question of discrimination under Article 2.1, but in favor of the United States on the question of necessity under Article 2.2.

Discrimination under Article 2.1

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

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.

Indonesia argued that the effect of the United States prohibiting clove but not menthol cigarettes was to discriminate in favor of products of United States origin. Indonesia based this claim on the fact that clove cigarettes consumed in the United States were predominately of Indonesian origin and that menthol cigarettes consumed in the United States are predominately of domestic origin. The United States argued that its law is non-discriminatory and distinguishes between clove and menthol cigarettes for reasons other than the foreign origin of clove cigarettes. More specifically, the United States argued that clove cigarettes are a starter product particularly attractive to youth, whereas menthol cigarettes are attractive to youth and adult smokers in similar proportions.

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



The panel first analyzed whether clove and menthol cigarettes are “like products” in the US market. In examining this question the panel focused on whether the two product categories are like in terms of their effect on youth smoking in the United States (reducing youth smoking was the regulatory objective pursued). This approach departed from the approach used under the General Agreement on Tariffs and Trade 1994 (GATT 1994). Under the latter approach, the question of likeness is focused on the extent to which product categories compete in the marketplace. On the facts, the panel found that clove and menthol cigarettes are like in the United States. 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.³

The panel then analyzed whether the less favorable treatment element of Article 2.1 was established. The panel emphasized that less favorable treatment is not established by merely showing that some imported products are treated less favorably than some like domestic product⁴ and that the detrimental effect on a product must be related to the foreign origin of the product for a measure to be discriminatory.⁵ 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.⁶ The panel also concluded that the detrimental treatment of clove cigarettes as compared to menthol cigarettes was not based on menthol posing divergent risks to health and that other arguments concerning the risks of illicit trade in menthol cigarettes and risks to the US health care system did not excuse the discriminatory character of the measure.⁷

Necessity under Article 2.2

Article 2.2 of the TBT Agreement establishes a necessity requirement in the following terms:

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.

Indonesia argued that the prohibition of clove cigarettes was more trade restrictive than necessary to protect human health. The panel rejected a number of Indonesian arguments

³ Panel Report, *United States – Measures Affecting the Production and Sale of Clove Cigarettes*, (“Panel Report”), WT/DS406/R, Panel Report, para. 7.182

⁴ *Ibid*, para. 7.273

⁵ *Ibid*, para. 7.268

⁶ *Ibid*, para. 7.276

⁷ See *Ibid*, para. 7.291, where the panel refers to the measure as placing costs on Indonesian producers, but not the United States. This aspect of the panel report was criticized in the Appellate Body report for a number of reasons.



under this provision.

First, Indonesia failed to demonstrate that the ban on clove cigarettes exceeded the level of protection sought by the United States because Indonesia had not brought sufficient evidence to establish the level of protection actually pursued.⁸

Second, Indonesia failed to demonstrate that the ban on clove cigarettes makes no material contribution to the objective of reducing youth smoking. The panel 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.'⁹ After citing the relevant scientific evidence, the panel also stated that World Health Organization Framework Convention on Tobacco Control (WHO FCTC) Partial Guidelines on regulation of the contents of tobacco products and regulation of tobacco product disclosures 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.'¹⁰

Third, the panel rejected Indonesia's argument that there are less trade restrictive alternative measures to the ban. 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.¹¹ 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.¹² 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.'¹³

THE APPELLATE BODY REPORT

The United States appealed the findings of the panel on discrimination under Article 2.1 of the TBT Agreement and on other procedural issues that are not addressed in this briefing paper. Indonesia did not appeal the panel's findings with respect to Article 2.2.

The Appellate Body rejected the US appeal concerning Article 2.1, thereby upholding the panel's finding that the law in question is discriminatory.

⁸ *Ibid*, paras 7.373 – 7.374

⁹ *Ibid*, para. 7.401

¹⁰ *Ibid*, para. 7.414

¹¹ *Ibid*, para. 7.422

¹² *Ibid*, para. 7.425

¹³ *Ibid*, para. 7.427



With respect to likeness, the Appellate Body followed the approach adopted under the GATT and stressed that a determination of likeness under Article 2.1 is ‘a determination about the nature and extent of a competitive relationship between and among the products at issue.’¹⁴ Hence, the Appellate Body rejected the panel’s earlier approach of determining whether the products were like in terms of the regulatory objective pursued. In doing so, the Appellate Body reinforced the approach developed in *EC – Asbestos* whereby divergent risks posed by products are relevant only to determining the competitiveness of those products. That is, the fact that products pose divergent risks to health will not in and of itself mean that they are not like products. Despite interpreting the likeness test differently from the panel, the Appellate Body upheld the panel’s finding that clove and menthol cigarettes are like for purposes of this dispute.¹⁵

With respect to the less favorable treatment element, the Appellate Body elaborated a test that seeks to balance the right to regulate with the obligation not to discriminate.¹⁶ The Appellate Body emphasized that the less favorable treatment element of Article 2.1 is not established by mere detriment to some imported products.¹⁷ In this respect, the Appellate Body stated that ‘Article 2.1 should not be interpreted as prohibiting any detrimental impact on competitive opportunities for imports in cases where such detrimental impact on imports stems exclusively from legitimate regulatory distinctions.’¹⁸ To determine whether this is the case panels will need to scrutinize ‘the design, architecture, revealing structure, operation and application of the technical regulation at issue, and, in particular, whether that technical regulation is even-handed’.¹⁹

In light of this test, the Appellate Body upheld the panel’s finding that the law results in less favorable treatment contrary to Article 2.1. The Appellate Body noted that the prohibited products consist primarily of clove cigarettes from Indonesia whereas the permitted products consist primarily of domestically produced menthol cigarettes.²⁰ In addition, the Appellate Body stated that it was not persuaded that the detrimental impact on competitive opportunities for imported cigarettes stems from a legitimate regulatory distinction.²¹ The Appellate Body relied on the panel’s findings that both menthol and clove mask the harshness of tobacco and that ‘menthol cigarettes have the same product characteristic that, from the perspective of the stated objective of Section 907(a)(1)(A), justified the prohibition of clove cigarettes.’²² The Appellate Body also rejected the argument that risks posed to the United States health system and in terms of illicit trade (if menthol were to be banned) constitute grounds for a legitimate regulatory distinction between clove and menthol cigarettes.

¹⁴ Appellate Body Report, *United States – Measures Affecting the Production and Sale of Clove Cigarettes*, (“Appellate Body Report”), WT/DS406/AB/R, 4 April 2012, para. 120

¹⁵ *Ibid.*, para. 160

¹⁶ *Ibid.*, para. 96

¹⁷ *Ibid.*, para. 192

¹⁸ *Ibid.*, para. 174

¹⁹ *Ibid.*, para. 215; See also para. 182

²⁰ *Ibid.*, para. 224

²¹ *Ibid.*, para. 225

²² *Ibid.*



Specifically, the Appellate Body stated ‘it is not clear that the risks that the United States claims to minimize by allowing menthol cigarettes to remain in the market would materialize if menthol cigarettes were to be banned, insofar as regular cigarettes would remain in the market.’²³

IMPLICATIONS FOR DOMESTIC REGULATORY AUTONOMY

Because the prohibition on discrimination in Article 2.1 is not subject to an exception there is a risk that an overly broad interpretation of the provision will impede domestic regulatory autonomy in significant ways. In particular, there is a concern that WTO Members engaging in legitimate regulation may violate Article 2.1 inadvertently. The specific concern is that circumstances may arise where a Member distinguishes between two products for regulatory reasons and the effect of the measure happens to fall hardest on imports, thereby resulting in a violation.

In some ways, the Appellate Body report reduces concern about the risk of inadvertent violation. As a matter of principle, the Appellate Body recognizes that pursuit of legitimate regulatory objectives plays a role in analysis under Article 2.1. The Appellate Body stated:

The balance set out in the preamble of the TBT Agreement between, on the one hand, the desire to avoid creating unnecessary obstacles to international trade and, on the other hand, the recognition of Members’ right to regulate, is not, in principle, different from the balance set out in the GATT 1994, where obligations such as national treatment in Article III are qualified by the general exceptions provision of Article XX.²⁴

In its analysis of the like products test, the Appellate Body was at pains to note that the panel’s approach to likeness ‘does not, necessarily, leave more regulatory autonomy for Members.’²⁵ The reasoning offered is that a likeness analysis oriented around regulatory purpose requires a panel to identify which of the various objectives pursued by a Member ‘are more important, or which of these objectives should prevail in determining likeness or less favorable treatment in the event of conflicting objectives.’²⁶ Leaving aside the question of how multiple regulatory objectives play into the analysis, the Appellate Body is ultimately making the point that there is a degree of arbitrariness in panels identifying a Member’s regulatory objective or objectives. Although this type of analysis has been problematic in the past, the Appellate Body’s approach to less favorable treatment is not immune from the same concerns about arbitrariness and uncertainty.

The Appellate Body stressed that less favorable treatment will not be established if a detrimental impact on imports stems *exclusively* from a legitimate regulatory distinction. Hence, in theory at least, there is no risk of truly inadvertent discrimination arising so

²³ *Ibid*, para. 225

²⁴ *Ibid*, para. 96

²⁵ *Ibid*, para. 115

²⁶ *Ibid*.



long as the regulatory distinctions drawn are legitimate in terms of the objective pursued. Although this is comforting in principle, it remains to be seen how this approach to less favorable treatment will be applied in practice where a WTO Member is drawing a legitimate regulatory distinction and the effect falls hardest on imported products. It also remains to be seen how the test will be applied where a Member acts with mixed motives, some legitimate and others not. The Appellate Body has directed panels to look at the objective features of a measure to determine whether it is even handed and whether it stems exclusively from a legitimate regulatory distinction.

Under the panel's approach, the existence of a legitimate regulatory distinction between products could end the analysis at the likeness stage. Hence, the Appellate Body's approach not only calls for a very similar analysis of the legitimacy of regulatory distinctions, but also marginalizes that analysis by requiring that a detrimental effect on imports stem *exclusively* from that legitimate regulatory distinction.

In summary, it appears that the Appellate Body has attempted to strike a balance between the right to regulate and respect for trade commitments, albeit one that is less deferential to regulation than the panel's approach. How this will be applied to hard cases in the future remains to be seen.

SPECIFIC IMPLICATIONS FOR TOBACCO CONTROL

As was the case with the panel report, the implications for tobacco control are mixed. On the positive side for advocates of tobacco control:

- The outcome of the dispute binds only the United States and Indonesia.
- The outcome was fact specific in that the dispute was decided on grounds specific to the partial form of regulation implemented by the United States and not on the grounds that prohibiting a specific category of tobacco product is more trade restrictive than necessary to protect human health. Accordingly, the outcome does not prevent other WTO Members from implementing non-discriminatory tobacco product regulations.
- The panel's analysis under Article 2.2 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 to protect human health.
- The panel report made extensive use of the WHO Framework Convention on Tobacco Control and its Partial Guidelines for Implementation of Articles 9 and 10 in the analysis.
- The Appellate Body sought to elaborate a test under Article 2.1 balancing the right to regulate with the obligation of non-discrimination.
- Some public health advocates might view this decision as an endorsement of the argument that menthol cigarettes should be prohibited.



Given the current challenges to plain packaging of tobacco products at the WTO,²⁷ it is worth noting that there is nothing in the Appellate Body or Panel Reports to support those challenges. If anything, the Appellate Body's conclusions on application of Article 2.1 in paragraph 235 would suggest that Australia is on firm ground:

In reaching this conclusion, we wish to clarify the implications of our decision. We do not consider that the TBT Agreement *or any of the covered agreements* is to be interpreted as preventing Members from devising and implementing *public health policies generally*, and tobacco-control policies in particular, through the regulation of the content of tobacco products, including the prohibition or restriction on the use of ingredients that increase the attractiveness and palatability of cigarettes for young and potential smokers. *Moreover, we recognize the importance of Members' efforts in the World Health Organization on tobacco control.* (italics added)

The approach taken by the Appellate Body with respect to interpretation of the Doha Ministerial Decision on Implementation-Related Issues and Concerns is also likely to support plain packaging. The Appellate Body examined this decision in a part of its analysis unrelated to Article 2.1 and concluded that for procedural reasons the decision does not constitute an authoritative interpretation under Article IX:2 of the WTO Agreement. Nonetheless, the Appellate Body concluded that the decision could still constitute a subsequent agreement of the parties within the meaning of Article 31(3)(a) of the Vienna Convention on the Law of Treaties.

What is the relevance to plain packaging? The Doha Declaration on the TRIPS Agreement and Public Health could also constitute a subsequent agreement of this type for purposes of interpreting the TRIPS Agreement. If this were the case, TRIPS obligations concerning protection of trademarks would be interpreted in light of the Doha Declaration. The most relevant passage is in paragraph 4:

We agree that the TRIPS Agreement does not and should not prevent members from taking measures to protect public health. Accordingly, while reiterating our commitment to the TRIPS Agreement, we affirm that the Agreement can and should be interpreted and implemented in a manner supportive of WTO members' right to protect public health and, in particular, to promote access to medicines for all.

In this connection, we reaffirm the right of WTO members to use, to the full, the provisions in the TRIPS Agreement, which provide flexibility for this purpose.

On the other hand, some aspects of the Appellate Body report suggest that compliance with Article 2.1 may be difficult where the effect of tobacco product regulation falls hardest on imported products.

In its discussion of like products, the Appellate Body made some observations that suggest

²⁷ See http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds434_e.htm



tobacco products in different product categories will ordinarily be considered like products. First, the Appellate Body recognized that satisfying an addiction to nicotine is one end use shared by clove and menthol cigarettes. This is true for all tobacco products and many substitutes. Second, in discussing the relevance of consumers' tastes and habits the Appellate Body noted that it is not necessary to demonstrate that products are substitutable for all consumers. Rather, if products are highly substitutable for some consumers but not for others, this may be sufficient to show likeness.²⁸ For example, the fact that one product category is particularly attractive to children may not be significant to likeness if children use that product category interchangeably with another category of tobacco products.

In the discussion of less favorable treatment, the Appellate Body, like the panel, dismissed out of hand the idea that the risk of illicit trade in menthol cigarettes is a legitimate reason for exempting those products from the ban. This appears to limit the justifications WTO Members may use for drawing regulatory distinctions between tobacco products under the less favorable treatment element. The Appellate Body report suggests that WTO Members will have to justify regulatory distinctions between tobacco and nicotine products on health grounds alone. Given scientific uncertainty concerning the harm caused by some tobacco products, it may be difficult for Members to argue that distinctions between product categories are based on distinctions in the inherent harmfulness of different products. Rather, in order to justify regulatory distinctions between product categories, Members may have to rely on scientific uncertainty, or on the argument that different products pose different risks in terms of their capacity to stimulate consumption. Either way, WTO Members engaging in tobacco product regulation would be wise to seek appropriate legal assistance throughout the regulatory process.

As it stands, the United States has a few options. One option is to conform with WTO law by removing the restrictions on sale of clove cigarettes, or extending the existing restrictions to menthol cigarettes. In theory, non-conformity is another option. However, if the United States refuses to comply the Dispute Settlement Body would authorize retaliatory action by Indonesia. More broadly, non-conformity would raise systemic issues of United States trade policy within the WTO system. ●

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²⁸ Appellate Body Report, para. 142