WTO Appellate Body Upholds Panel in China – Rare Earths Dispute

The Appellate Body of the World Trade Organization (WTO) has circulated its reports in *China – Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum* ("China – Rare Earths"), which affirmed a WTO dispute settlement panel’s March 2014 finding that China’s export restraints on rare earths, tungsten, and molybdenum are inconsistent with China’s WTO obligations.

This August 7, 2014 decision is the latest in a string of decisions by the WTO regarding export restrictions imposed by China. In a 2009 case, the United States, the European Union and Mexico challenged export restrictions imposed by China on certain forms of yellow phosphorus, bauxite, coke, fluorspar, magnesium, manganese, silicon metal, silicon carbide and zinc (“China – Raw Materials”).

In the present dispute, the United States, the European Union and Japan challenged China’s use of export quotas and export duties on other raw materials widely used in defense and high-tech industries (i.e., various forms of rare earths, tungsten and molybdenum). While the complainants portrayed the restrictions as protectionist measures, China maintained that they were necessary to protect the environment, to conserve finite resources and to ensure domestic supply. The Appellate Body affirmed the panel’s ruling rejecting China’s justifications for violating its WTO obligations, albeit for slightly different reasons.

**Background**

China has a system of export duties and quotas for a number of raw materials, including rare earths—a group of 17 minerals used in the production and manufacturing of products such as smartphones, flat screens and compact fluorescent bulbs. As these raw materials are produced predominantly in China (more than 90 percent in 2011), such export restrictions give China’s local industries a competitive advantage and exert pressure on foreign producers, particularly in defense and high-tech industries.

On March 13, 2012, the United States, the European Union and Japan launched WTO dispute settlement cases against China. On July 23, 2012, a single WTO panel was established to examine the three complaints. The panel report was issued on March 26, 2014, finding China’s export restrictions to be inconsistent with China’s obligations under the WTO Agreements. The United States filed an unprecedented “preemptive appeal” on April 11, 2014, before China’s anticipated appeal. China appealed the US panel report on April 25, 2014. They each raised certain issues of law in the US panel report (DS431).

In addition, China appealed certain issues of law found in the EU panel report (DS432) and in the Japan panel report (DS433). With one exception, the Appellate Body’s findings applied to all three panel reports.
The Panel Decision

When it appeared before the panel, China did not attempt to defend its measures as being compliant with its Accession Protocol or Article XI of the General Agreement on Tariffs and Trade (GATT). Instead, China argued that the measures were justified exceptions under GATT Article XX (b) and (g). As we reported earlier, the panel found that China violated its obligations under the GATT Article XI and the Accession Protocol by restricting exports of rare earths to manufacturers in other countries, thereby creating a competitive advantage for China’s domestic industry. The panel also found that China could not invoke the conservation or environmental protection justifications under GATT Article XX to justify violating its Accession Protocol and, in any case, that China had not satisfied the requirements of Article XX.

On the issue of whether the justification contained in GATT Article XX extends to violations of provisions not contained in the GATT itself (i.e., China’s Accession Protocol), the panel split 2-1. The majority held that paragraph 11.3 of Part I of China’s Accession Protocol is not subject to the general exceptions in GATT Article XX. The dissenting panelist agreed with the outcome in this particular case, but argued forcefully for a holistic approach in interpreting the applicability of Article XX to the accession protocols, which are part of a single undertaking of the WTO Agreements.

Noting the close relationship between paragraph 11.3 and GATT Articles II and XI, the dissenting panelist found that, in situations involving WTO-plus provisions, exceptions contained in Article XX of GATT should be available to recently acceded countries that have agreed to such WTO-plus commitments. In the dissent’s view, China’s ability to invoke Article XX could be denied only by explicit language in the Accession Protocol.

The Appellate Body Decision

WHETHER GATT ARTICLE XX GENERAL EXCEPTIONS EXTEND TO VIOLATIONS OF PROVISIONS NOT CONTAINED IN THE GATT ITSELF

China’s appeal was very narrow in scope and did not involve any challenge to the ultimate findings and conclusions reached by the panel regarding the inconsistency of China’s export duties with its WTO obligations. The key issue before the Appellate Body was the applicability of Article XX to claims based on paragraph 11.3 of China’s Accession Protocol, which oblige China to eliminate all export duties.

This is not the first time the WTO Appellate Body has been asked to look at the relationship between China’s Accession Protocol and GATT Article XX general exceptions. In the first of such cases, China – Publications and Audiovisual Products, the Appellate Body held that China is entitled to rely on GATT Article XX as a defense to a violation of paragraph 5.1 of Part I of China’s Accession Protocol. However, the applicability of Article XX there is premised on the wording and rationale of that particular provision, which states: “[w]ithout prejudice to China’s right to regulate trade in a manner consistent with the WTO Agreement.” This wording appeared to subject the obligations at issue to the general right to regulate.

However, in China – Raw Materials, the Appellate Body rejected China’s argument that its obligations under the Accession Protocol with respect to the elimination of export taxes should also be subject to Article XX general exceptions. In that case, there is no textual basis for the application of GATT Article XX exceptions, as was the case in China- Publications and Audiovisual Products. The Appellate Body left open the issue of which circumstances the obligations of an agreement other than the GATT can be subject to Article XX.

In China – Rare Earths, the panel examined this issue in the light of new arguments that,
according to China, had not been asserted or addressed previously. China’s four new arguments were that (i) the absence of a textual basis cannot be taken as the common intention of the parties that Article XX defense should not be available to China; (ii) paragraph 11.3 of China’s Accession Protocol must be treated as an integral part of the GATT 1994; (iii) the phrase “nothing in this Agreement” in the chapeau of Article XX of the GATT 1994 does not exclude the availability of Article XX to defend a violation of paragraph 11.3 of China’s Accession Protocol; and (iv) an appropriate holistic interpretation, taking due account of the object and purpose of the WTO Agreement, confirms that China may justify export duties through recourse to Article XX of the GATT 1994.7 None of these arguments were considered by the panel to be “cogent reasons” to justify a departure from the Appellate Body’s decision in China – Raw Materials.8 However, the dissenting panelist agreed with the argument that paragraph 11.3 forms an integral part of the WTO Agreement. It was solely on that point that China appealed.

On that issue, the Appellate Body held that Article XII:1 of the Marrakesh Agreement provides the general rule for acceding to the WTO, and not the nature of the substantive relationship between the “terms” of accession and the WTO Agreement. Article XII:1 itself does not speak to the question of the specific relationship between individual provisions of an accession protocol and individual provisions of the Marrakesh Agreement and the Multilateral Trade Agreements.9

The Appellate Body took the opportunity to provide guidance on the relationship between individual provision of China’s Accession Protocol and the provisions of the WTO Agreement. It stated that questions concerning specific relationships between agreements:

must be answered through a thorough analysis of the relevant provisions on the basis of the customary rules of treaty interpretation and the circumstances of the dispute. The analysis must start with the text of the relevant provision in China’s Accession Protocol and take into account its context, including that provided by the Protocol itself and by relevant provisions of the Accession Working Party Report, and by the agreements within the WTO legal framework. The analysis must also take into account the overall architecture of the WTO system as a single package and any other relevant interpretative elements, and must be applied to the circumstances of each dispute, including the measure at issue and the nature of the alleged violation.10 Thus, the Appellate Body did not rule out the possibility that certain provisions of China’s Accession Protocol may be justified by Article XX of the GATT, such as in China – Publications and Audiovisual Products. Essentially, it reaffirmed its finding in China – Publications and Audiovisual Products that:

whether China may, in the absence of a specific claim of inconsistency with the GATT 1994, justify its measure under Article XX of the GATT 1994 must in each case depend on the relationship between the measure found to be inconsistent with China’s trading rights commitments, on the one hand, and China’s regulation of trade in goods, on the other hand.11

Although the Appellate Body’s ruling focused on China’s Accession protocol, it will have certain implications on the relationship of other WTO agreements (such as the SCM Agreement) with Article XX of the GATT.

WHETHER THE PANEL ERRED IN ITS ANALYSIS OF ARTICLE XX(G) OF THE GATT 1994

GATT Article XX (g) provides an exception, subject to the chapeau, for measures “relating to the conservation of exhaustible natural resources if such measures are made effective in
conjunction with restrictions on domestic production or consumption.” The key difficulty identified by the panel for China was that the export quota system—purportedly initiated in order to conserve the natural resources—did not have a corollary for domestic producers.

The Appellate Body found that the panel did not limit its analysis to an examination of the design and structure of the export restrictions and did not consider itself precluded from taking into account evidence presented by China on the effects of the restrictions. However, it ruled that the panel erred in interpreting Article XX(g) as imposing a separate requirement of “even-handedness” that must be fulfilled in addition to the conditions expressly specified in subparagraph (g), and in interpreting Article XX(g) as requiring Members seeking to invoke Article XX(g) to prove that the burden of conservation is evenly distributed, for example between foreign consumers, on the one hand, and domestic producers or consumers, on the other hand. However, despite this flaw, the Appellate Body did not find that the panel committed an error in its conclusion because the panel did not engage in such an assessment in making its determinations.

Conclusion

The question of whether, and under what circumstances, the general exceptions under Article XX of the GATT apply to non-GATT agreements is one of particular relevance to recently acceded countries that have agreed to “WTO -plus” commitments in their accession protocols. This question has long been a subject of debate among trade commentators. Many have argued in favor of using Article XX as a general “fall-back option” in order to resolve questions at the intersection of environment and trade on those grounds, rather than in a fragmented way under individual WTO law provisions. Diverging opinions have escalated to the panel level as seen from the opinion of the dissenting panelist in China – Rare Earths.

In this context, the Appellate Body’s decision provides much-needed clarification. It is now clear that a case-by-case analysis is required to determine the specific relationship between an individual provision in China’s Accession Protocol and the GATT 1994. Although the Appellate Body’s ruling focused on China’s Accession protocol, its opinion will have implications for the relationship of other WTO agreements (such as the SCM Agreement) with Article XX of the GATT.

For the limited number of acceding countries, the ruling provides a valuable lesson: be sure to have a reference to Article XX in all the provisions that they want covered by the justifications for measures taken in the interest of the environment, resource conservation, human health or public morality.

Finally, this case is important in light of the precedential nature of Appellate Body reports because it reopened the decision of a previous Appellate Body. This report preserves the precedential value of previous Appellate Body reports, while confirming that an issue of law may be re-examined if new arguments present “cogent reasons” for departing from the adopted panel and Appellate Body findings on the same question of law.

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Endnotes


2 Appellate Body Report, China – Rare Earths, at para. 4.12

3 The Accession Protocol dictates the terms of China’s accession to WTO Membership. Such agreements allow countries that were not involved in the original negotiation of the WTO Agreements to attain Member status.


5 “WTO-plus” refers to provisions contained in agreements other than the GATT 1994, such as China’s Accession Protocol.


7 Appellate Body Report, China – Rare Earths, para. 5.5

8 Panel Reports, China – Rare Earths, para. 7.115

9 Appellate Body Reports, China – Rare Earths, para. 5.34

10 Appellate Body Reports, China – Rare Earths, para. 5.31


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