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1 INTRODUCTION

The Peru – Agriculture Products case presents an issue of first impression for the relationship between Regional Trade Agreements (RTAs) and the World Trade Organization (WTO) and its substantive rules. While the provisions of the covered agreements cited by the complainant, Guatemala, were not unique to a WTO dispute, this case raised the puzzling spectre of one RTA member complaining against the other that a provision in their own Free Trade Agreement (FTA) violates the WTO. This poses the question whether, and if so under what allowable conditions, regional trade agreement members may modify (violate) WTO rights and obligations as between them only (inter se) in their trade treaty relations.

This note examines three of the issues raised on the appeal that affect the RTA / WTO relationship. The first considers the point of admissibility and asks whether the complainant had brought the proceedings in a manner contrary to good faith under Articles 3.7 and 3.10 of the Dispute Settlement Understanding (DSU). The second addresses the question of treaty interpretation – whether the panel erred in failing to consider the parties’ FTA (and its provisions) as either a subsequent agreement or as providing ‘relevant rules of international law’ as

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4 All RTAs modify the parties’ WTO rights and obligations, but by adopting trade liberalizing measures in accord with GATT Art. XXIV or GATS Art. V. The term ‘RTA’ is used here inclusively to refer to agreements notified under either or both of these Articles.

5 Issues raised in this appeal: a(ii), AB Report, p. 11.
The third takes up the underlying issue of this appeal: whether the RTA parties could, by means of their FTA, modify their WTO rights and obligations in a manner that violates provisions of the WTO annexed agreements.\(^6\)

2 THE ISSUE OF GOOD FAITH

The earlier panel found that there were no facts presented to demonstrate that Guatemala had brought the case before the panel in bad faith, as this notion is found in the DSU Articles 3.7 and 3.10.\(^7\) The panel did not, however, examine whether the FTA contained a waiver of Guatemala’s right to initiate WTO dispute settlement because the FTA (arguably containing Guatemala’s undertaking not to challenge the agreement’s Price Range System (PRS) before the WTO) was not yet in force between the parties.\(^8\)

The Appellate Body’s (AB) treatment of the DSU good faith articles followed two strands, both in the context of the requirements for upholding a mutually agreed solution as expressed in DSU Article 3.7. A first strand recounted previous WTO case law noting that an agreement containing such a waiver of a right to bring a case to the WTO cannot be lightly assumed, and quoting its earlier report, ‘if a member has not clearly stated that it would not take legal action with respect to a certain measure, it cannot be regarded as failing to act in good faith if it challenges that measure’.\(^9\)

Resolving this question in favour of the complainant, the Appellate Body proceeded to examine arguments made by the parties on the right of Peru to maintain the PRS under the FTA ‘regardless of its legal status’ if inconsistent with the WTO, concluding that it was ambiguous as to whether or not the FTA permitted the measure to be maintained.\(^10\) In addition, the choice of forum clause in the FTA allowed the complainant to choose either the FTA or the WTO dispute settlement mechanism.\(^11\) Thus, the Appellate Body concluded that

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\(^6\) Issues raised in this appeal: d(ii) and d(iii), AB Report p. 12, consecutively referring to Arts 31(3)(a) and 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT).

\(^7\) Issues raised in this appeal: e, AB Report, p. 12.

\(^8\) DSU Art. 3.7 states in part, ‘The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred.’ DSU Art. 3.10 states in part, ‘... if a dispute arises, all Members will engage in these procedures in good faith in an effort to resolve the dispute.’

\(^9\) Panel Report, para. 7.88, recounted in the AB Report, para. 5.20. The FTA was signed but not yet ratified. The price range system (PRS) duties and mechanism provided in the FTA were found by both the panel and Appellate Body to violate Art. 4 of the WTO Agreement on Agriculture and Art. II.1(b) of the GATT.


\(^12\) AB Report, para. 5.27.
Guatemala had not clearly stipulated a relinquishment of its right to have recourse to the WTO dispute settlement system, ‘irrespective of the status of the FTA as not being ratified by both parties’.13

The second strand of reasoning more briefly considered that a mutually acceptable solution consistent with DSU Article 3.7 must be one that is also consistent with the WTO covered agreements. Here, since the PRS measure was found inconsistent with cited WTO Articles by both the panel and the Appellate Body, it could not be accepted as a mutually agreeable solution in the WTO.14

It is not clear from this section of the report whether these two strands of analysis (providing the conditions required to validate a waiver in the form of a mutually agreed solution) are cumulative or sequential. If the latter, a properly executed waiver that passed the test of non-ambiguity could appear to foreclose admission of the case for a consideration of whether the mutually agreed solution was consistent with WTO provisions. If cumulative, a failure on either condition would fully admit the complaint on the charged WTO violation.15

3 THE ISSUE OF TREATY INTERPRETATION: THE FTA AS A SUBSEQUENT AGREEMENT OR AS ‘APPLICABLE RULES’ USED TO INTERPRET WTO PROVISIONS

Peru’s claim on appeal was that the panel erred in failing to use the provisions of the FTA to interpret Article 4.2 the WTO Agriculture Agreement and Article II of the GATT. More specifically that the words ‘shall not maintain’ found in Article 4.2 should be read in the light of the FTA’s provision stating that ‘Peru may maintain its Price Range System’16 within the meaning of VCLT Article 31(3)(a) and (c).17

In rejecting these points of appeal, the Appellate Body first dealt with the general object of interpretation encompassed by the Vienna Convention. It emphasized that an interpretation exercise is made to determine the common intentions of all the parties to a treaty. Part III, section 3 of the Vienna Convention is meant to assist the interpreter to ascertain the ordinary meaning of treaty terms reflecting the ‘common intentions’ to the treaty. The point was made that that

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13 AB Report, para. 5.28.
14 AB Report, para. 5.26. The question of WTO consistency was not at issue in EC – Bananas III.
15 A point supporting the latter (cumulative) view is the Appellate Body’s phrase, ‘In any event . . .’ that prefaces its point on the need for a mutually agreed solution to be consistent with WTO rules. AB Report, para. 5.25.
16 AB Report, para. 5.91. The FTA provision quoted is found in para. 9 of Annex 2.3.
17 Vienna Convention on the Law of Treaties, VCLT 31(3), ‘There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; . . . (c) any relevant rules of international law applicable in the relations between the parties.’
VCLT Article 31 cannot be used to develop interpretations based on either subsequent agreements or applicable rules ‘that appear to subvert the common intention of the parties as reflected in the text…’.\(^\text{18}\) Related, the Appellate Body also indicated that the interpretation was made to determine of the common intentions of all the parties ‘and not just the intentions of some of the parties’.\(^\text{19}\)

The Appellate Body’s conclusion on this aspect of the interpretation issue was to indicate that Peru’s argument was essentially one of modification (rather than interpretation), that the FTA between Guatemala and Peru had modified between themselves their obligations under the relevant WTO provisions.\(^\text{20}\)

While this conclusion would seem to dispose of the entire issue of interpretation, the AB then turned to consider whether the FTA provision and ILC Articles 20 and 45\(^\text{21}\) constituted relevant rules of international law applicable in the relations between the parties, within the meaning of VCLT Article 31(3)(c), or whether the FTA constituted a subsequent agreement between the parties under VCLT Article 31(3)(a).\(^\text{22}\) The Appellate Body’s approach here was not to first determine whether the FTA provision and the ILC Articles were rules applicable between the parties, but to examine whether they could be considered as ‘relevant’ to the interpretation of either Article 4.2 of the Agreement on Agriculture or Article II:1(b) of the GATT 1994, and in the same manner, whether the FTA could be considered a subsequent agreement ‘regarding the interpretation’ of those WTO provisions.\(^\text{23}\)

As such, the focus of the examination made was not on the ‘rules’ or the parties’ agreement, but on the relevance of either the rules or the FTA on the interpretation of the WTO provisions. The Appellate Body reviewed its prior treatment of the US – EEC Civil Aircraft Agreement in the *Large Civil Aircraft* case that found an absence of relevance of that agreement to the interpretation of the WTO Subsidies Agreement (SCM) provision on the concept of ‘benefit’ in its provisions,\(^\text{24}\) as well as citing other previous WTO cases that found that agreements ‘regarding the interpretation’ of a treaty are ‘agreements bearing specifically upon the interpretation of a treaty’.\(^\text{25}\)

\(^{18}\) AB Report, paras 5.93 and 5.94.
\(^{19}\) AB Report, para. 5.95.
\(^{20}\) AB Report, para. 5.96.
\(^{22}\) AB Report, para. 5.98. Peru argued that ‘parties’ in VCLT 31(3)(a) should be understood to mean parties to the dispute. AB Report para. 5.99.
\(^{23}\) AB Report para. 5.100.
\(^{24}\) AB Report para. 5.101.
\(^{25}\) AB Report *Ibid.*, and note 294, including the US – *Tuna II* case, which found that the TBT Committee’s Decision was a subsequent agreement relevant for the interpretation of the TBT Agreement. ‘...the extent to which the Decision would inform the interpretation . . . would depend
The AB reviewed the interpretation issues before the earlier panel for both Article 4.2 and Article II:1(b) and found that neither the FTA nor the ILC Articles provided relevant interpretation guidance for them, as they could not be considered as rules concerning the same subject matter of the WTO Articles in question.\(^{26}\)

This reasoning and its conclusions appears to raise the bar – if perhaps not a nearly prohibitive one – for a regional trade agreement to be available as a subsequent agreement for the purpose of interpreting a WTO agreement provision.

4 THE ISSUE OF MODIFICATION

The final issue treated here is the question whether the regional parties could modify their WTO obligations \textit{inter se} in a manner that would otherwise violate a WTO provision. The AB commences this analysis by repeating its earlier conclusion that whether the parties could maintain a WTO unlawful PRS was not clear in the FTA itself, but was instead ambiguous. In addition, the Appellate Body noted that the FTA also had a provision that confirmed the parties' existing WTO rights and obligations, and a provision stating that in the event of inconsistency of FTA provisions with the WTO covered agreements, that the provisions of the FTA should prevail to the extent of any inconsistency.\(^{27}\) Thus, the AB did not agree that it could be argued that the parties, by means of their FTA, had agreed between themselves to modify the WTO agreement provisions in question.\(^{28}\)

While that finding alone could have ended the matter entirely, the Appellate Body rather chose to proceed \textit{arguendo}, as if the provisions of the FTA \textit{did} allow Peru to maintain a WTO-inconsistent PRS. In this vein, the AB first indicated, but without elaboration, that it was not convinced that such a modification between the RTA parties would be subject to VCLT Article 41, as had been argued before the panel by Peru.\(^{29}\) Instead, it was noted that the "WTO agreements contain specific provisions addressing amendments, waivers, or exceptions for RTAs, which prevail over the general provisions of the Vienna

\(^{26}\) AB Report, para. 5.103.
\(^{27}\) AB Report, paras 5.108 and 5.109.
\(^{28}\) AB Report, para. 5.10.
\(^{29}\) AB Report, para. 5.111. VCLT Art. 41, ‘Agreements to modify multilateral treaties between certain of the parties only’. The Article grants a permissive right to modify where the multilateral treaty provides for the possibility of such a modification (Art. 41.1(a)); and where the multilateral treaty neither provides nor prohibits modification (Art. 41.1(b)).
Convention, such as Article 41. Further, that Article XXIV of the GATT 1994 ‘specifically permits departures from certain WTO rules in FTAs’, and noting Article XXIV’s own requirement that duties and other regulations of commerce relating to the trade of non-FTA members could not be higher or more restrictive than those applicable prior to the formation of the FTA. Thus, the AB considered that the proper avenue to assess whether an FTA provisions may depart from the WTO rules is to be found, for trade in goods, in GATT Article XXIV or the Enabling Clause (for developing countries), and for services, in GATS Article V.

At this juncture, the Appellate Body noted that Peru had not invoked GATT Article XXIV as a defence, but in its appellant submission and panel argument, had raised the earlier Turkey – Textiles AB report to claim that Article XXIV demonstrated that regional parties could modify their WTO rights by means of a regional trade agreement. In contrast, the AB also recounted Guatemala’s argument on this point, that the consequences of Peru’s argument would render GATT Article XXIV requirements redundant, that bilateral agreements could amend the parties obligations under the WTO ‘regardless of whether the conditions for exceptions or defences under WTO law under Articles XXIV or XX of the GATT 1994 have been established’.

To consider this, the AB went on to outline its earlier holding from the Turkey – Textiles case, that Article XXIV could justify a measure inconsistent with other GATT provisions when the measure was introduced on the formation of an FTA, which fully met the requirements of Article XXIV, and that the formation of the FTA would be prevented if not allowed to introduce the measure at issue. The Appellate Body further recounted its reliance in Turkey Textiles on paragraph 4 of Article XXIV, which states that the purpose of a customs union or FTA is to ‘facilitate trade’ between the constituent territories, and ‘not to raise barriers’ to the trade of third countries. In noting that paragraph 4 qualifies customs unions or FTAs as ‘agreements of closer integration between the economies of the countries parties to such agreements’, the AB then concluded as follows:

In our view, the references in paragraph 4 to facilitating trade and closer integration are not consistent with an interpretation of Article XXIV as a broad defence for measures in FTAs that roll back on Members’ rights and obligations under the WTO covered agreements.

30 AB Report, para. 5.112. The Art. XXIV requirement indicated is drawn Art. XXIV:5.
31 AB Report, para. 5.113.
32 AB Report, para. 5.114, quote cited to Guatemala’s appellee’s submission, para. 204.
34 AB Report, para. 116, citing Turkey – Textiles, para. 57.
35 AB Report, para. 116, italicized emphasis added in the AB report.
5 COMMENTS AND CONCLUSION

The Appellate Body did not choose to make a treaty law analysis of the relationship between VCLT Article 41 (modifications) and the regional exception rules of the WTO. It also did not analyse the requirements of VCLT Article 41 to determine whether Article XXIV of the GATT was a modification provision in the GATT (within the meaning of VCLT Article 41.1(a)), or whether the GATT (or WTO) does or does not contain express modification provisions. Rather, it summarily noted that WTO has its own provisions for amendments, waivers and exceptions, and went directly on to raise Article XXIV as an exceptional provision with its own requirements. Public international law experts can argue that a more careful construction could have been rendered on the relationship of the Vienna Convention’s provisions to the WTO on both the interpretation and modification issues raised in this report. Less arguable is the report’s strong character in relying on WTO provisions themselves as the source of law to be applied in the case, and the markers being generated to demonstrate WTO’s ‘pre-eminence’ in a case where parties are seeking to invoke other international treaties. That is evident from the interpretation section of the report in which the entire question of the VCLT’s general framework for interpretation was directed to the purpose of interpreting the ‘common intentions’ of all the parties to the WTO. That would seem to have disposed of both of the sub questions of subsequent agreements and applicable rules, but the AB instead went on to demonstrate that any such application of another agreement to a WTO provision must be directed specifically to the interpretation of that provision.

The report’s muscular character is even more evident in the Appellate Body’s treatment of modification by considering Article XXIV’s application in arguendo, given that the AB had already determined that the FTA itself was ambiguous on the question whether a WTO unlawful price system had been agreed to be maintained at all by the FTA members. The AB could have left it there, or simply have begged off the issue entirely, as the panel did in refusing to examine a treaty not yet in force. Instead, the AB went on to outline what could be characterized as a hierarchical relationship between the WTO’s rules for regional exceptions and the provisions of Members’ RTAs. Even though Article XXIV was not invoked in this case as an exception for the violating measure, the Turkey – Textiles case was raised and applied anyway to dispose of the legality of any trade agreement provision that installs a WTO violating measure. The rather stunning reach of this holding is enhanced if one considers that the party context of the Turkey – Textiles test was not the same as the context in this case. In Turkey – Textiles, the test was applied to set the conditions for validating a measure that violated a third party’s
rights in the WTO. Here, the test was applied to a measure that violated the WTO only between the *regional members* themselves.

One gets the sense from this section on modification that this may be the sort of case the Appellate Body has been waiting for, that the elements of a claim of one RTA member against the other for a WTO violation was the ‘slow and easy pitch’ to which the AB was pleased to swing a large bat. On the substance, there appears to be no remaining avenue open for validating a WTO violating modification in a regional trade agreement or for using principles of interpretation to raise a subsequent agreement containing such a violating measure.

What remains open is the question whether a properly composed waiver contained in a mutually agreed solution would successfully foreclose any consideration of whether the agreed solution contains a measure, which violates WTO rules. In its third party submission before the panel, the EU argued that whether regional parties could modify their WTO rights and obligations should not be foreclosed as a possibility, but that the assessment needed to occur on a case-by-case basis, and noting (as did the AB in this report) that there were inconsistencies in the provision of the parties’ FTA in this case.\(^{36}\) This suggests that a waiver of the right to invoke the WTO dispute settlement system might be accomplished, but the provision providing for that waiver has to be clear and absolutely explicit, not subject to any reasonable argument over its interpretation. In addition, other RTA provisions, like the choice of forum clause or a clause affirming the parties’ WTO rights and obligations, need to be also referenced to the waiver. Any resulting contextual ambiguity – and a panel will be looking for that possibility – will be resolved in favour the complainant and the admission of the case. To the extent an acceptably waiver alone is adequate to preclude admission of the case, then arguably there would be no panel examination of the consistency of the mutually agreed solution with the rules of the WTO.\(^{37}\)

This raises a consideration for trade negotiators that are considering text to modify their WTO rights in an RTA. It would seem that any such WTO violating provision would need to be heavily flagged to insure the clarity necessary to insulate it from a WTO dispute. One can surmise that such a level of textual clarity might run counter to the incumbent instincts of drafting such a provision in a trade agreement. The more obvious the waiver, the more likely is the attention to be called to it not only by the other regional party, but also by other WTO Members.

Finally, a larger point can be made regarding the Appellate Body’s treatment (or non-treatment) of other international treaties, particularly those in the form of


\(^{37}\) A panel may not interpret the AB’s stated conditions in this sequential manner. See *infra* n. 15.
RTAs. Prior to this case, one could fairly make the observation that the AB was unwilling to interpret non-WTO agreements. Its own renunciation of determining the parties’ rights and obligation under the NAFTA agreement in the Mexico – Soft Drinks case comes to mind. In Peru – Agriculture, however, while the Appellate Body does not apply the provisions of the FTA, it certainly and actively interpreted those provisions as needed for its own analysis throughout this report.

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38 DS308/AB/R, 6 Mar. 2006, para. 56.