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## **Retaliation under the WTO Agreement: The “Sequencing Problem”**

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The topic of this article is one of the biggest problems associated with retaliation under the World Trade Organization dispute settlement procedure – the sequencing issue. Namely, despite very strict, precise, applicable and tractable procedural rules in the World Trade Organization dispute settlement system, one thing has remained unclear and unresolved thus far – the mismatch of articles 21.5 and 22 of the World Trade Organization Dispute Settlement Understanding. A critical reading of these two articles, aside from possible practical problems, is enough to conclude that these two articles must be brought in accordance; otherwise, problems in implementation may arise. More than a decade ago, such a problem occurred, involving important world trade “players” and lasting over a considerable period. In order to explore the aforementioned problem, this article will outline the procedural issues, identify the problem, indicate the substance of the problem and, finally, suggest possible solutions.

Keywords: World Trade Organization, Dispute Settlement Understanding, interpretation, compliance, retaliation, sequencing

## **Introduction**

Globalisation has largely transformed the world economy in the past half century. There have been remarkable growth and transformation of international trade of goods and services, especially new technologies, which have increased international flows of information, knowledge, ideas, and, above all, money.<sup>1</sup> In these circumstances, states, being already engaged international trade, either on a bilateral or a multilateral basis, need an efficient platform, legal framework, and unified set of rules that can provide them guarantees that the global market is open to all players on an equal basis and that they all have the same legal protection. No organization has gone as far in this direction as the World Trade Organization.<sup>2</sup>

In the context of the many changes that the WTO has made in the international trading system, none has drawn more attention than the mechanism it has established for settling disputes between member states.<sup>3</sup> A successful compliance rate of 83 percent<sup>4</sup> to the WTO rulings highlights this point. Still, throughout the history of the WTO dispute settlement mechanism, several issues have been raised as potential impediments to the efficient and effective operation of it: the costs and technical capabilities associated with initiating and litigating a dispute, transparency-related issues, security and predictability of the system,<sup>5</sup> as well as the implementation phase of the dispute settlement process.<sup>6</sup>

This article does not seek to examine all of the procedural issues that have arisen since the WTO dispute settlement mechanism has been in operation. Rather, the focus of this article is on a specific question of retaliation under the WTO dispute settlement mechanism: how does Article 22 of the WTO Dispute Settlement Understanding (hereinafter referred to as DSU) correlate with Article 21.5 of the DSU, what are possible solutions these provisions provide, and what can and needs to be changed?

In order to answer the questions posed, this article will firstly present the main features of the WTO dispute settlement mechanism. Secondly, it will deal with the main issue regarding retaliation – the “sequencing” problem. Finally, it will present concrete proposals for reform of the current provisions of the DSU.

## 1. Overview of the Current Dispute Settlement Mechanism

### 1.1 *The Dispute Settlement System in the WTO*

The WTO dispute settlement system is governed by the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), which is Annex II of the Agreement Establishing the World Trade Organization.<sup>7</sup> The DSU is “a central element in providing security and predictability to the multilateral trading system”<sup>8</sup> and its prime object and purpose is “the prompt settlement of disputes between WTO members concerning their respective rights and obligations under WTO law.”<sup>9</sup>

The DSU offers dispute settlement through the means of good offices, conciliation and mediation,<sup>10</sup> consultations,<sup>11</sup> without which parties cannot proceed to the adversarial proceeding before the panel,<sup>12</sup> and, finally, there is a possibility of arbitration.<sup>13</sup> However, aside from consultations, proceedings before the panel and arbitration are the most often used means of dispute settlement within WTO.

### 1.2 *Consultations, Panel and Appellate Body Proceedings*

Consultations are regulated by Article 4 of the DSU, whereas the panel proceedings are regulated by articles 6 through 16, and 19, of the DSU.<sup>14</sup>

The parties to the dispute are first required to engage in consultations. If these consultations fail to settle a dispute and the consulting parties jointly consider that the consultations failed to provide the settlement, a complaining party can, within 60 days, request the establishment of a panel to hear the case.<sup>15</sup>

The panel shall examine the referred matter and issue its findings, in accordance with the terms of reference and review of the written submissions and oral arguments of the parties, in an interim report first, and then in a final one. The final report shall be adopted at a Dispute Settlement Body (hereinafter referred to as DSB) meeting, unless a party to the case notifies the DSB of its decision to appeal, or the DSB decides not to adopt the report by consensus.<sup>16</sup>

If, however, parties do appeal, the appeal can concern only “issues of law covered in the panel report and legal interpretations developed by the panel”.<sup>17</sup> The report of the Appellate Body, which some call “the supreme court”<sup>18</sup> of the WTO, may either uphold or modify or reverse the report of the panel, and such report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute, unless the DSB does not adopt the report by consensus.<sup>19</sup>

### ***1.3 Post-Dispute Settlement Phase and Surveillance of Implementation of Recommendations and Rulings***

Pursuant to Article 21.1 of the DSU “a prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.”<sup>20</sup>

In order to make countries act in accordance with the above mentioned obligation, the DSU requires the parties to the dispute to inform the DSB about their intentions regarding the implementation of the rulings and recommendations of the DSB, at a DSB meeting that should be held 30 days after the adoption of the panel or Appellate Body Report. The defending party shall have reasonable time to comply with the issued rulings and recommendations if it is impracticable to comply with them immediately.<sup>21</sup>

If, however, the defending party fails to comply with the WTO decision within the established compliance period, Article 22 of the DSU permits the complaining party to request that the defending party negotiate a compensation agreement.<sup>22</sup> If such a request is made and no satisfactory compensation is agreed within 20 days after the expiry of the reasonable period of time, the complaining party may request authorization from the DSB to retaliate; that is, to suspend concessions or obligations owed the defending party under a WTO agreement.<sup>23</sup>

On the other hand, Article 21.5 of the DSU allows, in case of a disagreement regarding the existence or consistency of measures taken to comply with the recommendations and rulings, a recourse to the dispute settlement procedures of the WTO.<sup>24</sup> Wherever possible, the original panel should be reconvened. The panel then has 90 days to issue its report, or more than 90 days in case it does not manage to do so within the prescribed time. In the latter case, the DSB must be informed.<sup>25</sup>

Here is the problem. Timeframes and possibilities that the parties are offered in Articles 21.5 and 22.2, as well as the possible divergent interpretations and implementation of these provisions, may conflict, and such conflicts have already appeared in practice in very important cases. Nevertheless, thus far, nothing concrete has been done to eliminate possible future conflicts, although there have been some attempts.<sup>26</sup>

## **2. The Sequencing Problem**

**A**lthough many WTO rulings have been satisfactorily implemented, difficult cases have tested DSU implementation articles, highlighting deficiencies in the system.<sup>27</sup> Specifically, the textual conflict over the interpretation of and the relationship between the compliance review under DSU Article 21.5 and the

suspension of concessions under DSU Article 22,<sup>28</sup> which, as some notice, “may provide that an authorization to retaliate should be given priority over an application of the procedure for the special implementation panel”,<sup>29</sup> has resulted in the so called sequencing conflict.<sup>30</sup>

Thomas A. Zimmermann claims that the key question is whether a “compliance panel” must first review the implementation measures undertaken by a defendant before a complainant may seek authorization to retaliate on grounds of the defendant’s alleged noncompliance.<sup>31</sup>

Still, “straightforward as that procedure may seem, it obviously hides an apparent dilemma.”<sup>32</sup> Article 22 allows a prevailing party to request authorization to retaliate within 20 days after a compliance period ends,<sup>33</sup> while Article 21.5<sup>34</sup> provides that disagreements over the existence or adequacy of compliance measures are to be decided using WTO dispute procedures, including resort to panels. A compliance panel’s report is due within 90 days after the dispute is referred to it and may be appealed. However, the DSU does not integrate the Article 21.5 procedure into the 30-day Article 22 deadline, nor does it expressly state how compliance is to be determined so that a prevailing party may pursue retaliatory action under Article 22.

Kym Anderson explained this problem through the following hypothetical situation: “Suppose the respondent takes the full ‘reasonable period of time’ before announcing a reform of the offending policy measure. If the complainant believes the reform is insufficient to make the policy WTO consistent, there is the opportunity to refer the matter to a Panel (again, preferably the original one). The Panel in turn must report within 90 days of that request (DSU Article 21.5). If the respondent is unhappy with the Panel’s ruling, another 45 days could be required for the Appellate Body to consider the matter. The apparent dilemma is that even if the Panel or Appellate Body finds the reformed policy still WTO-inconsistent, the 20 days after the ‘reasonable period of time’ for a complainant to lodge a request to retaliate will have expired. This interpretation of DSU Articles 21.5 and 22 suggests there could be an endless loop of litigation.”<sup>35</sup>

An alternative interpretation is provided by Petros C. Mavroidis,<sup>36</sup> who argues “(a) that Article 22.2 includes the possibility that the losing party does nothing to bring its measures into compliance, in which case there is a 20-day deadline to request countermeasures, and (b) that Article 21.5 deals with the situation where the losing party does something to bring its measures into compliance and there is disagreement as to the adequacy of that reform, in which case the 20-day period to request countermeasures starts at the end of the Article 21.5 (Panel or Appellate Body) proceedings if the finding is against the respondent. With this interpretation there is no

dilemma in law: the compliance Panel's mandate under Article 21.5 is simply to decide if the reform is adequate. If so, end of story; if not, the complaining party can request countermeasures.”

Commenting on the above quoted “alternative interpretation” Kym Anderson points out that “even this [second] interpretation leaves open the possibility for a respondent to make an endless series of inadequate reforms – although the retaliatory measures would remain in place until the complainant or a Panel is satisfied with the reform.”<sup>37</sup>

This problem actually happened in practice – in the dispute concerning the European Communities’ (hereinafter referred to as EC) regime for the importation of bananas<sup>38</sup> – and “evolved into a near constitutional crisis over the systemic implications of the issues involved.”<sup>39</sup>

Namely, the EC had this difficulty with regard to the implementation of its banana regime. After the regular proceedings before the WTO, the EC was obliged to bring its measures into compliance with WTO standards within a reasonable period. The EC did not do it. Consequently, three proceedings were initiated at the same time before the members of the original panel<sup>40</sup> – the EC’s Article 21.5 review,<sup>41</sup> Ecuador’s Article 21.5 review,<sup>42</sup> and the EC’s Article 22.6 arbitration.<sup>43</sup> Faced with the confusion of the parallel proceedings, the chair of the DSB stated, “There remains the problem of how the Panel and the Arbitrators would coordinate their work, but as they will be the same individuals, the reality is that they will find a logical way forward, in consultation with the parties.”<sup>44</sup> In finding their way, the panel and arbitrators issued the report by merging deadlines for Article 21.5 and Article 22.6 proceedings.<sup>45</sup> This was achieved by issuing an “initial decision” in the Article 22.6 arbitration stating that there was a need for more information before they were able to release their final report. Thus, procedural setback was averted by the timely reaction of the panel and arbitrators. The arbitrators found a “logical way forward” in deciding the dispute by extending the time limit for Article 22.6 arbitration in such a way that it fell after the Article 21.5 determination of the consistency of the measure taken by the EC with the WTO Agreement.<sup>46</sup>

Still, the problem of the conflict between the wording and purpose of articles 21.5 and 22 of the DSU remains, so the following presents some suggested changes that have been proposed in order to eliminate the existing ambiguity.

### **3. Proposals for Reform**

**T**he problem that arose in the Bananas III case has been a subject of interest for the members of the WTO ever since it arose. However, the DSU still does not

spell out clear procedures for handling future possible disagreements on whether the accused government has implemented the DSB's ruling fully or not.<sup>47</sup>

With regard to the sequencing issue within the context of DSU review, Canada made a straightforward proposal simply saying that the procedures in Article 21.5 of the DSU shall be completed before the procedures in Article 22 of the DSU are initiated.<sup>48</sup> Furthermore, the European Communities and Japan presented two similar suggestions advocating a compulsory "compliance panel" as a prerequisite to any suspension of concessions or other obligations.<sup>49</sup> They also proposed that Article 22 of the DSU should be amended, saying that the complainant may only request authorization to retaliate after the compliance panel or the Appellate Body finds the measure still to be inconsistent with the WTO Agreement.<sup>50</sup>

On the other hand, some authors agree that despite the possibility in practice for the members to conclude bilateral agreement with regard to the sequencing issue, it is still desirable to amend the DSU to reflect such practice, as it could help reduce legal uncertainty in the system. It should be made clear in the DSU, as a matter of principle, that multilateral determination of non-compliance is a prerequisite to any suspension of concessions or other obligations.<sup>51</sup>

In conclusion, a lesson that can be derived from non-compliance cases is that the existing DSU text contains obvious ambiguities and the drafting oversights need to be corrected.<sup>52</sup> If one refers to cases such as the one pertaining to the EU banana import regime, it might be correct to conclude that the system is not efficient.<sup>53</sup> For this reason, "it would be desirable to include in the DSU a provision designed to stipulate clear rules with a precise time frame that prevents any 'loop' in the litigation."<sup>54</sup>

## **Conclusion**

**A**s mentioned in the introduction, the purpose of this article was to give an overview of the WTO dispute settlement mechanism with emphasis on one of the most ambiguous matters that has arisen from the DSU provisions – the sequencing issue.

It is clear that there has not yet been a consensus on the solution to the ambiguity, neither among the WTO member states nor in doctrine, but it is likely it will eventually be reached, and it should be. Why must it be resolved? First of all, even on the "first reading" of the provisions of articles 21.5 and 22 of the DSU, one may notice that they overlap, especially in terms of timing, so for the purpose of the simplicity and consistency of the WTO dispute settlement system, the wording and purpose of these provisions should be put in order. Secondly, despite the fact that all the statistics<sup>55</sup> show a very high level of efficiency of the DSU, as well as of

compliance, we are of the opinion that, if the situation remains the same, some countries, especially the major world trade “players” may abuse it. If these changes set more strict and compatible deadlines and resolve the problem of the interpretation of articles 21.5 and 22 in the DSU, then there will at least be a clear provision that countries can rely on, more legal certainty, and lower costs for all the market players, irrespective of their economic power, influence, and participation in world trade. Finally, as trade changes, so the law must follow it, both for the purpose of the legal certainty of the WTO legal framework as well as for the further development of the world market.

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  48. Communication from Canada TN/DS/W/49, dated 14 February 2003.

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49. Communication from the European Union, TN/DS/W/1, dated 13 March 2002, Proposal by Japan, TN/DS/W/32, dated 22 January 2003, pp. 5-6, para. 4, Communication from the European Union, TN/DS/W/38, dated 23 January 2003.
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  51. Virachai Plasai, “Compliance and Remedies against Noncompliance under the WTO System. Towards a More Balanced Regime for All Members”, ICTSD Dispute Settlement and Legal Aspects of International Trade, Issue Paper 3 (2007): 31-32.
  52. *Supra note* 39 reciting Decision regarding the Understanding Rule and Procedures Governing the Settlement of the Dispute, WT/MIN (99) Draft [2 December 1999], 711.
  53. Aida Gugu, “The review compliance proceedings under Article 21.5 of the DSU”, Amsterdam Law School, [http://pdc.ceu.hu/archive/00006166/01/055\\_AidaGugu\\_1.pdf](http://pdc.ceu.hu/archive/00006166/01/055_AidaGugu_1.pdf) (accessed May 13, 2013).
  54. *Supra note* 50.
  55. Between 1947 – April 1995, there were 132 adopted GATT cases. As of 5 October 2011, there have been 105 Appellate Body decisions at the WTO, [http://www.wto.org/english/tratop\\_e/dispu\\_e/stats\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/stats_e.htm) (accessed May 13, 2013).