

VENEZUELAN REFINERY CASE - EDITED

United States – Standards for Reformulated and Conventional Gasoline

World Trade Organization AB-1996-1

Report of the Appellate Body

I. Introductory

The United States appeals from certain conclusions on issues of law and certain legal interpretations contained in the Panel Report, *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, 29 January 1996 (the "Panel Report"). That Panel had been established to consider a dispute between the United States, on the one hand, and Venezuela, later joined by Brazil, on the other. The dispute related to the implementation by the United States of its domestic legislation known as the Clean Air Act of 1990 (the "CAA") and, more specifically, to the regulation enacted by the United States' Environmental Protection Agency (the "EPA") pursuant to that Act, to control toxic and other pollution caused by the combustion of gasoline manufactured in or imported into the United States. This regulation is formally entitled "*Regulation of Fuels and Fuel Additives - Standards for Reformulated and Conventional Gasoline*", Part 80 of Title 40 of the Code of Federal Regulations,^{1[1]} and is commonly referred to as the Gasoline Rule.

...

B. The Clean Air Act and its Implementation

^{1[1]} 40 CFR 80, 59 Fed. Reg. 7716 (16 February 1994).

The CAA and its implementation by the Gasoline Rule, are described fully at paragraphs 2.1- 2.13 of the Panel Report. However, it may be convenient to recall a number of the Panel's factual findings at this stage.

The CAA established two gasoline programs^{2[2]} to ensure that pollution from gasoline combustion does not exceed 1990 levels and that pollutants in major population centres are reduced. The first program concerns ozone "nonattainment areas", consisting of (i) nine large metropolitan areas that have experienced the worst summertime ozone pollution and (ii) various additional areas included at the request of the state governors concerned. All gasoline sold to consumers in these nonattainment areas must be "reformulated." The sale of conventional gasoline in nonattainment areas is prohibited. The second program concerns "conventional" gasoline, which may be sold to consumers in the rest of the United States. The implementation of both programs, which apply to gasoline sold by domestic refiners, blenders and importers, was entrusted to the EPA. As a result, the EPA adopted the Gasoline Rule, which relies heavily on the use of 1990 baselines as a means of determining compliance with the CAA requirements.

1. The Reformulated Gasoline Program

The CAA established certain compositional and performance specifications for reformulated gasoline.^{3[3]} Thus, the oxygen content must not be less than 2.0 per cent by weight, the benzene content must not exceed 1.0 per cent by volume and the gasoline must be free of heavy metals, including lead or manganese. The performance specifications of the CAA require a 15 per cent reduction in the emissions of both volatile organic compounds ("VOCs") and toxic air pollutants ("toxics"), and no increase in emissions of nitrogen oxides ("NOx"). Section 80.41 of the Gasoline Rule sets out two methods by which entities can certify their gasoline as meeting these requirements. From 1 January 1995 to 1 January 1998, domestic refiners, blenders and importers may use an interim method of certification called the "Simple Model", which requires compliance with fixed specifications concerning Reid Vapour Pressure, oxygen, benzene and toxics performance. In addition, compliance is required with certain "non-degradation requirements" by maintaining sulphur, olefins and T-90 qualities at or below 1990 baseline levels, on an average annual basis. As of 1 January 1998, these entities must comply

^{2[2]} Section 211(k).

^{3[3]} Section 211(k)(2)-(3).

with the "Complex Model", which more accurately predicts emissions performance. The Complex Model is not in issue in the present dispute.

2. The Conventional Gasoline Program

In order to prevent the "dumping" of pollutants extracted from reformulated gasoline into conventional gasoline, the CAA requires that conventional gasoline sold by domestic refiners, blenders and importers in the United States remains as clean as 1990 baseline levels.^{4[4]} Unlike the Simple Model for reformulated gasoline, the "non-degradation" from 1990 baseline requirements for conventional gasoline applies in respect of all conventional gasoline qualities, and not only sulphur, olefins and T-90. Compliance is measured by comparing emissions from the conventional gasoline sold by domestic refiners, blenders and importers against emissions from a 1990 baseline and is assessed on an annual average basis.^{5[5]}

3. Baseline Establishment Rules

In respect of both reformulated gasoline (for sulphur, olefins and T-90 requirements under the Simple Model) and conventional gasoline (for all requirements), 1990 baselines are an integral element of the Gasoline Rule enforcement process. Accordingly, the Gasoline Rule contains detailed baseline establishment rules.^{6[6]} Baselines can be either individual (established by the entity itself) or statutory (established by the EPA and intended to reflect average 1990 United States gasoline quality), depending on the nature of the entity concerned.

(i) *domestic refiners*

Any domestic refiner which was in operation for at least six months in 1990 must establish an individual baseline representing the quality of gasoline produced by that refiner in 1990. The Gasoline Rule provides three methods of establishment to be used

^{4[4]} Section 211(k)(8) of the CAA.

^{5[5]} Section 80.90 of the Gasoline Rule.

^{6[6]} Section 80.91.

for this purpose. Under Method 1, the domestic refiner must use the quality data and volume records of its 1990 gasoline. If Method 1 data is not available, the domestic refiner must use its 1990 gasoline blendstock quality data and 1990 blendstock production records (Method 2). In the event that Method 2 data is not available, the domestic refiner must establish an individual 1990 baseline on the basis of its post-1990 gasoline blendstock and/or gasoline quality data modeled in the light of refinery changes to show 1990 gasoline composition (Method 3).

Domestic refiners that were in operation for at least six months in 1990 are not permitted to forego their individual baseline and use the statutory baseline established by the EPA. However, domestic refiners that commenced operations after 1990, or operated for less than six months during 1990, are required to use the statutory baseline established by the EPA.

(ii) *blenders*

Blenders are required to establish an individual baseline representing the quality of their 1990 gasoline using Method 1 above. Failing this, they must use the statutory baseline established by the EPA. Blenders may not apply an individual baseline using Methods 2 or 3.

(iii) *importers*

Importers of foreign gasoline are required to establish an individual baseline in respect of gasoline imported by them during 1990, using Method 1. Like blenders, importers become subject to the statutory baseline if, as anticipated by the EPA, the data necessary for Method 1 is unavailable.

The Gasoline Rule does not provide for foreign refiner individual baselines, although the possible use of individual baselines for foreign refiners was examined by the EPA while drafting the Gasoline Rule. Indeed, the EPA continued to examine the possible use of individual baselines for foreign refineries after the adoption of the Gasoline Rule,

and prepared its May 1994 proposal^{7[7]} as a result. The May 1994 proposal provided for limited use by importers of individual baselines established for foreign refineries in order to demonstrate that gasoline produced at that foreign refinery complied with the reformulated (but not conventional) gasoline standards. The individual baselines would be determined using Methods 1, 2 or 3, as for domestic refineries under the Gasoline Rule. However, the use of individual baselines in such cases would be conditioned and limited in a number of ways. The EPA's May 1994 proposal never entered into force, as the United States Congress enacted legislation in September 1994 denying the funding necessary for its implementation.

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III. The Issue of Justification Under Article XX(g) of the General Agreement

Article XX(g) needs to be set out in full:

Article XX

General Exceptions

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

...

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

^{7[7]} 40 CFR 80, 59 Fed. Reg. at 22 800 (3 May 1994).

...

A. "Measures"

The initial issue we are asked to look at relates to the proper meaning of the term "measures" as used both in the chapeau of Article XX and in Article XX(g). The question is whether "measures" refers to the entire Gasoline Rule or, alternatively, only to the particular provisions of the Gasoline Rule which deal with the establishment of baselines for domestic refiners, blenders and importers.

Cast in the foregoing terms, the issue does not appear to be a live one. True enough the Panel Report used differing terms, or terms of shifting reference, in designating the "measures" in different parts of the Report. The Panel Report, however, held only the baseline establishment rules of the Gasoline Rule to be inconsistent with Article III:4, to the extent that such rules provided "less favourable treatment" for imported than for domestic gasoline. These are the same provisions which the Panel evaluated, and found wanting, under the justifying provisions of Article XX(g). The Panel Report did not purport to find the Gasoline Rule itself as a whole, or any part thereof other than the baseline establishment rules, to be inconsistent with Article III:4; accordingly, there was no need at all to examine whether the whole of the Gasoline Rule or any of its other rules, was saved or justified by Article XX(g). The Panel here was following the practice of earlier panels in applying Article XX to provisions found to be inconsistent with Article III:4: the "measures" to be analyzed under Article XX are the same provisions infringing Article III:4.^{8[8]} These earlier panels had not interpreted "measures" more broadly under Article XX to include provisions not themselves found inconsistent with Article III:4. In the present appeal, no one has suggested in their final submissions that the Appellate Body should examine under Article XX any portion of the Gasoline Rule other than the baseline establishment rules held to be in conflict with Article III:4. No one has urged an interpretation of "measures" which would encompass the Gasoline Rule in its totality.^{9[9]}

8[8] *Canada - Administration of the Foreign Investment Review Act*, BISD 30S/140, adopted 7 February 1984; *United States - Section 337 of the Tariff Act of 1930*, BISD 36S/345, adopted 7 November 1989; *United States - Taxes on Automobiles*, DS31/R (1994), unadopted.

9[9] Although, in earlier submissions to the Appellate Body, the United States suggested that "the Gasoline Rule" should be examined in the context of Article XX(g), in its Post-Hearing Memorandum, dated 1 April 1996, the United States confirmed its understanding that the "measures" in issue are the baseline establishment rules contained in the Gasoline Rule.

Brazil stated, in its final submission to the Appellate Body, dated 1 April 1996, that "the 'measure' with which this appeal is concerned is the baseline methodology of the Gasoline Rule, not the entire rule itself." This would suggest a position similar to that adopted by the United States. Thereafter, Brazil

At the oral hearing and in its Post-Hearing Memorandum, the United States complained about the designation of the baseline establishment rules in the Panel Report and by the Appellees Venezuela and Brazil, in such terms as "the difference in treatment", "the less favourable treatment" or "the discrimination." It is, of course, true that the baseline establishment rules had been found by the Panel to be inconsistent with Article III:4 of the *General Agreement*. The frequent designation of those provisions by the Panel in terms of its legal conclusion in respect of Article III:4, in the Appellate Body's view, did not serve the cause of clarity in analysis when it came to evaluating the same baseline establishment rules under Article XX(g).

B. "relating to the conservation of exhaustible natural resources"

The Panel Report took the view that clean air was a "natural resource" that could be "depleted." Accordingly, as already noted earlier, the Panel concluded that a policy to reduce the depletion of clean air was a policy to conserve an exhaustible natural resource within the meaning of Article XX(g). Shortly thereafter, however, the Panel Report also concluded that "the less favourable baseline establishments methods" were *not* primarily aimed at the conservation of exhaustible natural resources and thus fell outside the justifying scope of Article XX(g).

The Panel, addressing the task of interpreting the words "relating to", quoted with approval the following passage from the panel report in the 1987 *Herring and Salmon* case:¹⁰[10]

as the preamble of Article XX indicates, the purpose of including Article XX:(g) in the General Agreement was not to widen the scope for measures serving trade policy purposes but merely to ensure that the commitments under the General Agreement do not hinder the pursuit of policies aimed at the conservation of exhaustive natural

continued to state that "Brazil and Venezuela did not challenge all portions of the Rule; they challenged only the discriminatory methods of establishing baselines."

Venezuela stated, in its summary statement, dated 29 March 1996, that "the measure to be examined is the discriminatory measure, that is, the aspect of the Gasoline Rule that denies imported gasoline the right to use the same regulatory system of baselines applicable to U.S. gasoline, namely, the system of individual baselines."

¹⁰[10] *Canada - Measures Affecting Exports of Unprocessed Herring and Salmon*, BISD 35S/98, para. 4.6; adopted on 22 March 1988, cited in Panel Report, para. 6.39.

resources. The Panel concluded for these reasons that, while a trade measure did not have to be necessary or essential to the conservation of an exhaustible natural resource, it had to be *primarily aimed* at the conservation of an exhaustible natural resource to be considered as "relating to" conservation within the meaning of Article XX:(g). (emphasis added by the Panel)

The Panel Report then went on to apply the 1987 *Herring and Salmon* reasoning and conclusion to the baseline establishment rules of the Gasoline Rule in the following manner:11[11]

The Panel then considered whether the precise aspects of the Gasoline Rule that it had found to violate Article III -- the less favourable baseline establishments methods that adversely affected the conditions of competition for imported gasoline -- were primarily aimed at the conservation of natural resources. The Panel saw no direct connection between less favourable treatment of imported gasoline that was chemically identical to domestic gasoline, and the US objective of improving air quality in the United States. Indeed, in the view of the Panel, being consistent with the obligation to provide no less favourable treatment would not prevent the attainment of the desired level of conservation of natural resources under the Gasoline Rule. Accordingly, it could not be said that the baseline establishment methods that afforded less favourable treatment to imported gasoline were primarily aimed at the conservation of natural resources. In the Panel's view, the above-noted lack of connection was underscored by the fact that affording treatment of imported gasoline consistent with its Article III:4 obligations would not in any way hinder the United States in its pursuit of its conservation policies under the Gasoline Rule. Indeed, the United States remained free to regulate in order to obtain whatever air quality it wished. The Panel therefore concluded that the less favourable baseline establishments methods at issue in this case were not primarily aimed at the conservation of natural resources.

It is not easy to follow the reasoning in the above paragraph of the Panel Report. In our view, there is a certain amount of opaqueness in that reasoning. The Panel starts with positing that there was "*no direct connection*" between the baseline establishment rules which it characterized as "less favourable treatment" of imported gasoline that was chemically identical to the domestic gasoline and "the US objective of improving air quality in the United States." Shortly thereafter, the Panel went on to conclude that "*accordingly, it could not be said that the baseline establishment rules that afforded less favourable treatment to imported gasoline were primarily aimed at the conservation of natural resources*" (emphasis added). The Panel did not try to clarify whether the phrase "direct

11[11] Panel Report, para. 6.40.

connection" was being used as a synonym for "primarily aimed at" or whether a new and additional element (on top of "primarily aimed at") was being demanded.

One problem with the reasoning in that paragraph is that the Panel asked itself whether the "less favourable treatment" of imported gasoline was "primarily aimed at" the conservation of natural resources, rather than whether the "measure", i.e. the baseline establishment rules, were "primarily aimed at" conservation of clean air. In our view, the Panel here was in error in referring to its legal conclusion on Article III:4 instead of the measure in issue. The result of this analysis is to turn Article XX on its head. Obviously, there had to be a finding that the measure provided "less favourable treatment" under Article III:4 before the Panel examined the "General Exceptions" contained in Article XX. That, however, is a conclusion of law. The chapeau of Article XX makes it clear that it is the "measures" which are to be examined under Article XX(g), and not the legal finding of "less favourable treatment."

Furthermore, the Panel Report appears to have utilized a conclusion it had reached earlier in holding that the baseline establishment rules did not fall within the justifying terms of Articles XX(b); i.e. that the baseline establishment rules were not "necessary" for the protection of human, animal or plant life. The Panel Report, it will be recalled, found that the baseline establishment rules had not been shown by the United States to be "necessary" under Article XX(b) since alternative measures either consistent or less inconsistent with the *General Agreement* were reasonably available to the United States for achieving its aim of protecting human, animal or plant life.¹²[12] In other words, the Panel Report appears to have applied the "necessary" test not only in examining the baseline establishment rules under Article XX(b), but also in the course of applying Article XX(g).

A principal difficulty, in the view of the Appellate Body, with the Panel Report's application of Article XX(g) to the baseline establishment rules is that the Panel there overlooked a fundamental rule of treaty interpretation. This rule has received its most authoritative and succinct expression in the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*")¹³[13] which provides in relevant part:

ARTICLE 31

12[12] Panel Report, paras. 6.25-6.28.

13[13] (1969), 8 International Legal Materials 679.

General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

The "general rule of interpretation" set out above has been relied upon by all of the participants and third participants, although not always in relation to the same issue. That general rule of interpretation has attained the status of a rule of customary or general international law.¹⁴[14] As such, it forms part of the "customary rules of interpretation of public international law" which the Appellate Body has been directed, by Article 3(2) of the *DSU*, to apply in seeking to clarify the provisions of the *General Agreement* and the other "covered agreements" of the *Marrakesh Agreement Establishing the World Trade Organization*¹⁵[15] (the "*WTO Agreement*"). That direction reflects a measure of recognition that the *General Agreement* is not to be read in clinical isolation from public international law.

Applying the basic principle of interpretation that the words of a treaty, like the *General Agreement*, are to be given their ordinary meaning, in their context and in the light of the treaty's object and purpose, the Appellate Body observes that the Panel Report failed to take adequate account of the words actually used by Article XX in its several paragraphs. In enumerating the various categories of governmental acts, laws or regulations which WTO Members may carry out or promulgate in pursuit of differing legitimate state policies or interests outside the realm of trade liberalization, Article XX uses different terms in respect of different categories:

"necessary" - in paragraphs (a), (b) and (d); "essential" - in paragraph (j);

14[14] See, e.g., *Territorial Dispute Case (Libyan Arab Jamahiriya v. Chad)*, (1994), *I.C.J. Reports* p. 6 (International Court of Justice); *Golder v. United Kingdom*, *ECHR, Series A*, (1995) no. 18 (European Court of Human Rights); *Restrictions to the Death Penalty Cases*, (1986) 70 *International Law Reports* 449 (Inter-American Court of Human Rights); Jiménez de Aréchaga, "International Law in the Past Third of a Century" (1978-I) 159 *Recueil des Cours* 1, p. 42; D. Carreau, *Droit International* (3è ed., 1991) p. 140; *Oppenheim's International Law* (9th ed., Jennings and Watts, eds. 1992) Vol. 1, pp. 1271-1275.

15[15] Done at Marrakesh, Morocco, 15 April 1994.

"relating to" - in paragraphs (c), (e) and (g); "for the protection of" - in paragraph (f);

"in pursuance of" - in paragraph (h); and "involving" - in paragraph (i).

It does not seem reasonable to suppose that the WTO Members intended to require, in respect of each and every category, the same kind or degree of connection or relationship between the measure under appraisal and the state interest or policy sought to be promoted or realized.

At the same time, Article XX(g) and its phrase, "relating to the conservation of exhaustible natural resources," need to be read in context and in such a manner as to give effect to the purposes and objects of the *General Agreement*. The context of Article XX(g) includes the provisions of the rest of the *General Agreement*, including in particular Articles I, III and XI; conversely, the context of Articles I and III and XI includes Article XX. Accordingly, the phrase "relating to the conservation of exhaustible natural resources" may not be read so expansively as seriously to subvert the purpose and object of Article III:4. Nor may Article III:4 be given so broad a reach as effectively to emasculate Article XX(g) and the policies and interests it embodies. The relationship between the affirmative commitments set out in, e.g., Articles I, III and XI, and the policies and interests embodied in the "General Exceptions" listed in Article XX, can be given meaning within the framework of the *General Agreement* and its object and purpose by a treaty interpreter only on a case-to-case basis, by careful scrutiny of the factual and legal context in a given dispute, without disregarding the words actually used by the WTO Members themselves to express their intent and purpose.

The 1987 *Herring and Salmon* report, and the Panel Report itself, gave some recognition to the foregoing considerations of principle. As earlier noted, the Panel Report quoted the following excerpt from the *Herring and Salmon* report:

as the preamble of Article XX indicates, the purpose of including Article XX(g) in the General Agreement was not to widen the scope for measures serving trade policy purposes but merely *to ensure that the commitments under the General Agreement do*

not hinder the pursuit of policies aimed at the conservation of exhaustible natural resources.^{16[16]} (emphasis added)

All the participants and the third participants in this appeal accept the propriety and applicability of the view of the *Herring and Salmon* report and the Panel Report that a measure must be "primarily aimed at" the conservation of exhaustible natural resources in order to fall within the scope of Article XX(g).^{17[17]} Accordingly, we see no need to examine this point further, save, perhaps, to note that the phrase "primarily aimed at" is not itself treaty language and was not designed as a simple litmus test for inclusion or exclusion from Article XX(g).

Against this background, we turn to the specific question of whether the baseline establishment rules are appropriately regarded as "primarily aimed at" the conservation of natural resources for the purposes of Article XX(g). We consider that this question must be answered in the affirmative.

The baseline establishment rules, taken as a whole (that is, the provisions relating to establishment of baselines for domestic refiners, along with the provisions relating to baselines for blenders and importers of gasoline), need to be related to the "non-degradation" requirements set out elsewhere in the Gasoline Rule. Those provisions can scarcely be understood if scrutinized strictly by themselves, totally divorced from other sections of the Gasoline Rule which certainly constitute part of the context of these provisions. The baseline establishment rules whether individual or statutory, were designed to permit scrutiny and monitoring of the level of compliance of refiners, importers and blenders with the "non-degradation" requirements. Without baselines of some kind, such scrutiny would not be possible and the Gasoline Rule's objective of stabilizing and preventing further deterioration of the level of air pollution prevailing in 1990, would be substantially frustrated. The relationship between the baseline establishment rules and the "non-degradation" requirements of the Gasoline Rule is not negated by the inconsistency, found by the Panel, of the baseline establishment rules with the terms of Article III:4. We consider that, given that substantial relationship, the baseline establishment rules cannot be regarded as merely incidentally or inadvertently aimed at the conservation of clean air in the United States for the purposes of Article XX(g).

^{16[16]} *Canada - Measures Affecting Exports of Unprocessed Herring and Salmon*, BISD 35S/98, para. 4.6; adopted 22 March 1988, cited in Panel Report, para. 6.39.

^{17[17]} We note that the same interpretation has been applied in two recent unadopted panel reports: *United States - Restrictions on Imports of Tuna*, DS29/R (1994); *United States - Taxes on Automobiles*, DS31/R (1994).

C."if such measures are made effective in conjunction with restrictions on domestic production or consumption"

The Panel did not find it necessary to deal with the issue of whether the baseline establishment rules "are made effective in conjunction with restrictions on domestic production or consumption", since it had earlier concluded that those rules had not even satisfied the preceding requirement of "relating to" in the sense of being "primarily aimed at" the conservation of clean air. Having been unable to concur with that earlier conclusion of the Panel, we must now address this second requirement of Article XX(g), the United States having, in effect, appealed from the failure of the Panel to proceed further with its inquiry into the availability of Article XX(g) as a justification for the baseline establishment rules.

The claim of the United States is that the second clause of Article XX(g) requires that the burdens entailed by regulating the level of pollutants in the air emitted in the course of combustion of gasoline, must not be imposed solely on, or in respect of, imported gasoline.

On the other hand, Venezuela and Brazil refer to prior panel reports which include statements to the effect that to be deemed as "made effective in conjunction with restrictions on domestic production or consumption", a measure must be "primarily aimed at" making effective certain restrictions on domestic production or consumption.¹⁸[18] Venezuela and Brazil also argue that the United States has failed to show the existence of restrictions on domestic production or consumption of a natural resource under the Gasoline Rule since clean air was not an exhaustible natural resource within the meaning of Article XX(g). Venezuela contends, finally, that the United States has not discharged its burden of showing that the baseline establishment rules make the United States' regulatory scheme "effective." The claim of Venezuela is, in effect, that to be properly regarded as "primarily aimed at" the conservation of natural resources, the baseline establishment rules must not only "reflect a conservation purpose" but also be shown to have had "some positive conservation effect."¹⁹[19]

¹⁸[18] *Canada - Measures Affecting Exports of Unprocessed Herring and Salmon*, BISD 35S/98, paras. 4.6-4.7; adopted 22 March 1988. Also, *United States - Restrictions on Imports of Tuna*, DS29/R (1994), unadopted; and *United States - Taxes on Automobiles*, DS31/R (1994), unadopted.

¹⁹[19] Venezuela's Appellee's Submission, dated 18 March 1996; Venezuela's Statement at the Oral Hearing, dated 27 March 1996.

The Appellate Body considers that the basic international law rule of treaty interpretation, discussed earlier, that the terms of a treaty are to be given their ordinary meaning, in context, so as to effectuate its object and purpose, is applicable here, too. Viewed in this light, the ordinary or natural meaning of "made effective" when used in connection with a measure - a governmental act or regulation - may be seen to refer to such measure being "operative", as "in force", or as having "come into effect."²⁰[20] Similarly, the phrase "in conjunction with" may be read quite plainly as "together with" or "jointly with."²¹[21] Taken together, the second clause of Article XX(g) appears to us to refer to governmental measures like the baseline establishment rules being promulgated or brought into effect together with restrictions on domestic production or consumption of natural resources. Put in a slightly different manner, we believe that the clause "if such measures are made effective in conjunction with restrictions on domestic product or consumption" is appropriately read as a requirement that the measures concerned impose restrictions, not just in respect of imported gasoline but also with respect to domestic gasoline. The clause is a requirement of *even-handedness* in the imposition of restrictions, in the name of conservation, upon the production or consumption of exhaustible natural resources.

There is, of course, no textual basis for requiring identical treatment of domestic and imported products. Indeed, where there is identity of treatment - constituting real, not merely formal, equality of treatment - it is difficult to see how inconsistency with Article III:4 would have arisen in the first place. On the other hand, if *no* restrictions on domestically-produced like products are imposed at all, and all limitations are placed upon imported products *alone*, the measure cannot be accepted as primarily or even substantially designed for implementing conservationist goals.²²[22] The measure would simply be naked discrimination for protecting locally-produced goods.

²⁰[20] The New Shorter Oxford English Dictionary on Historical Principles (L. Brown, ed., 1993), Vol. I, p. 786.

²¹[21] Id., p. 481.

²²[22] Some illustration is offered in the *Herring and Salmon* case which involved, *inter alia*, a Canadian prohibition of exports of unprocessed herring and salmon. This prohibition effectively constituted a ban on purchase of certain unprocessed fish by foreign processors and consumers while imposing no corresponding ban on purchase of unprocessed fish by domestic processors and consumers. The prohibitions appeared to be designed to protect domestic processors by giving them exclusive access to fresh fish and at the same time denying such raw material to foreign processors. The Panel concluded that these export prohibitions were not justified by Article XX(g). BISD 35S/98, para. 5.1, adopted 22 March 1988. See also the Panel Report in the *United States - Prohibition of Imports of Tuna and Tuna Products from Canada*, BISD 29S/91, paras. 4.10-4.12; adopted on 22 February 1982.

In the present appeal, the baseline establishment rules affect both domestic gasoline and imported gasoline, providing for - generally speaking - individual baselines for domestic refiners and blenders and statutory baselines for importers. Thus, restrictions on the consumption or depletion of clean air by regulating the domestic production of "dirty" gasoline are established jointly with corresponding restrictions with respect to imported gasoline. That imported gasoline has been determined to have been accorded "less favourable treatment" than the domestic gasoline in terms of Article III:4, is not material for purposes of analysis under Article XX(g). It might also be noted that the second clause of Article XX(g) speaks disjunctively of "domestic production *or* consumption."

We do not believe, finally, that the clause "if made effective in conjunction with restrictions on domestic production or consumption" was intended to establish an empirical "effects test" for the availability of the Article XX(g) exception. In the first place, the problem of determining causation, well-known in both domestic and international law, is always a difficult one. In the second place, in the field of conservation of exhaustible natural resources, a substantial period of time, perhaps years, may have to elapse before the effects attributable to implementation of a given measure may be observable. The legal characterization of such a measure is not reasonably made contingent upon occurrence of subsequent events. We are not, however, suggesting that consideration of the predictable effects of a measure is never relevant. In a particular case, should it become clear that realistically, a specific measure cannot in any possible situation have any positive effect on conservation goals, it would very probably be because that measure was not designed as a conservation regulation to begin with. In other words, it would not have been "primarily aimed at" conservation of natural resources at all.

IV. The Introductory Provisions of Article XX of the General Agreement: Applying the Chapeau of the General Exceptions

Having concluded, in the preceding section, that the baseline establishment rules of the Gasoline Rule fall within the terms of Article XX(g), we come to the question of whether those rules also meet the requirements of the chapeau of Article XX. In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions - paragraphs (a) to (j) - listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX.

The chapeau by its express terms addresses, not so much the questioned measure or its specific contents as such, but rather the manner in which that measure is applied.^{23[23]} It is, accordingly, important to underscore that the purpose and object of the introductory clauses of Article XX is generally the prevention of "abuse of the exceptions of [what was later to become] Article [XX]."^{24[24]} This insight drawn from the drafting history of Article XX is a valuable one. The chapeau is animated by the principle that while the exceptions of Article XX may be invoked as a matter of legal right, they should not be so applied as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the *General Agreement*. If those exceptions are not to be abused or misused, in other words, the measures falling within the particular exceptions must be applied reasonably, with due regard both to the legal duties of the party claiming the exception and the legal rights of the other parties concerned.

The burden of demonstrating that a measure provisionally justified as being within one of the exceptions set out in the individual paragraphs of Article XX does not, in its application, constitute abuse of such exception under the chapeau, rests on the party invoking the exception. That is, of necessity, a heavier task than that involved in showing that an exception, such as Article XX(g), encompasses the measure at issue.

The enterprise of applying Article XX would clearly be an unprofitable one if it involved no more than applying the standard used in finding that the baseline establishment rules were inconsistent with Article III:4. That would also be true if the finding were one of inconsistency with some other substantive rule of the *General Agreement*. The provisions of the chapeau cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred. To proceed down that path would be both to empty the chapeau of its contents and to deprive the exceptions in paragraphs (a) to (j) of meaning. Such recourse would also confuse the question of whether inconsistency with a substantive rule existed, with the further and separate question arising under the chapeau of Article XX as to whether that inconsistency was nevertheless justified. One of the corollaries of the "general rule of interpretation" in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.^{25[25]}

23[23] This was noted in the Panel Report on *United States - Imports of Certain Automotive Spring Assemblies*, BISD 30S/107, para. 56; adopted on 26 May 1983.

24[24] EPCT/C.11/50, p. 7; quoted in *Analytical Index: Guide to GATT Law and Practice*, Volume I, p. 564 (1995).

25[25] *E.g.*, *Corfu Channel Case* (1949) *I.C.J. Reports*, p.24 (International Court of Justice); *Territorial Dispute Case (Libyan Arab Jamahiriya v. Chad)* (1994) *I.C.J. Reports*, p. 23 (International

The chapeau, it will be seen, prohibits such application of a measure at issue (otherwise falling within the scope of Article XX(g)) as would constitute

- (a)"arbitrary discrimination" (between countries where the same conditions prevail);
- (b)"unjustifiable discrimination" (with the same qualifier); or
- (c)"disguised restriction" on international trade.

The text of the chapeau is not without ambiguity, including one relating to the field of application of the standards it contains: the arbitrary or unjustifiable discrimination standards and the disguised restriction on international trade standard. It may be asked whether these standards do not have different fields of application. Such a question was put to the United States in the course of the oral hearing. It was asked whether the words incorporated into the first two standards "between countries where the same conditions prevail" refer to conditions in importing and exporting countries, or only to conditions in exporting countries. The reply of the United States was to the effect that it interpreted that phrase as referring to both the exporting countries and importing countries and as between exporting countries. It also said that the language spoke for itself, but there was no reference to third parties; while some thought that this was only between exporting countries *inter se*, there is no support in the text for that view. No such question was put to the United States concerning the field of application of the third standard - disguised restriction on international trade. But the United States put forward arguments designed to show that in the case under appeal, it had met all the standards set forth in the chapeau. In doing so, it clearly proceeded on the assumption that, whatever else they might relate to in another case, they were relevant to a case of national treatment where the Panel had found a violation of Article III:4. At no point in the appeal was that assumption challenged by Venezuela or Brazil. Venezuela argued that the United States had failed to meet all the standards contained in the chapeau. So did Norway and the European Communities as third participants. In short, the field of application of these standards was not at issue.

The assumption on which all the participants proceeded is buttressed by the fact that the chapeau says that "*nothing in this Agreement shall be construed to prevent the*

Court of Justice); 1966 Yearbook of the International Law Commission, Vol. II at 219; Oppenheim's International Law (9th ed., Jennings and Watts eds., 1992), Volume 1, 1280-1281; P. Dallier and A. Pellet, Droit International Public, 5è ed. (1994) para. 17.2); D. Carreau, Droit International, (1994) para. 369.

adoption or enforcement by any contracting party of measures ..." The exceptions listed in Article XX thus relate to all of the obligations under the *General Agreement*: the national treatment obligation and the most-favoured-nation obligation, of course, but others as well. Effect is more easily given to the words "nothing in this Agreement", and Article XX as a whole including its chapeau more easily integrated into the remainder of the *General Agreement*, if the chapeau is taken to mean that the standards it sets forth are applicable to all of the situations in which an allegation of a violation of a substantive obligation has been made and one of the exceptions contained in Article XX has in turn been claimed.

Against this background, we see no need to decide the matter of the field of application of the standards set forth in the chapeau nor to make a ruling at variance with the common understanding of the participants.²⁶[26]

"Arbitrary discrimination", "unjustifiable discrimination" and "disguised restriction" on international trade may, accordingly, be read side-by-side; they impart meaning to one another. It is clear to us that "disguised restriction" includes disguised *discrimination* in international trade. It is equally clear that *concealed* or *unannounced* restriction or discrimination in international trade does *not* exhaust the meaning of "disguised restriction." We consider that "disguised restriction", whatever else it covers, may properly be read as embracing restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally within the terms of an exception listed in Article XX. Put in a somewhat different manner, the

²⁶[26] We note in this connection that two previous panels had occasion to apply the chapeau. In *United States - Imports of Certain Automotive Spring Assemblies*, BISD 30S/107; adopted on 26 May 1983, the panel had before it a ban on imports, and an exclusion order of the United States' International Trade Commission, of certain automotive spring assemblies which the Commission had found, under Section 337 of the Tariff Act of 1930, to have infringed valid United States patents. The panel there held that the exclusion order had *not* been applied in a manner which would constitute a means of "arbitrary or unjustifiable discrimination against countries where the same conditions prevail," because that order was directed against imports of infringing assemblies "from all foreign sources, and not just from Canada." At the same time, the same order was also examined and found *not* to be "a disguised restriction on international trade." *Id.*, paras. 54-56. See also *United States - Prohibition of Imports of Tuna and Tuna Products*, BISD 29S/91, para. 4.8; adopted 22 February 1982.

It may be observed that the term "countries" in the chapeau is textually unqualified; it does not say "foreign countries", as did Article 4 of the 1927 League of Nations *International Convention for the Abolition of Import and Export Prohibitions and Restrictions*, 97 L.N.T.S. 393. Neither does the chapeau say "third countries" as did, *e.g.*, bilateral trade agreements negotiated by the United States under the 1934 *Reciprocal Trade Agreements Act*; *e.g.* the *Trade Agreement between the United States of America and Canada*, 15 November 1935, 168 L.N.T.S. 356 (1936). These earlier treaties are here noted, not as pertaining to the *travaux préparatoires* of the *General Agreement*, but simply to show how in comparable treaties, a particular intent was expressed with words not found in printer's ink in the *General Agreement*.

kinds of considerations pertinent in deciding whether the application of a particular measure amounts to "arbitrary or unjustifiable discrimination", may also be taken into account in determining the presence of a "disguised restriction" on international trade. The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.

There was more than one alternative course of action available to the United States in promulgating regulations implementing the CAA. These included the imposition of statutory baselines without differentiation as between domestic and imported gasoline. This approach, if properly implemented, could have avoided any discrimination at all. Among the other options open to the United States was to make available individual baselines to foreign refiners as well as domestic refiners. The United States has put forward a series of reasons why either of these courses was not, in its view, realistically open to it and why, instead, it had to devise and apply the baseline establishment rules contained in the Gasoline Rule.

In explaining why individual baselines for foreign refiners had not been put in place, the United States laid heavy stress upon the difficulties which the EPA would have had to face. These difficulties related to anticipated administrative problems that individual baselines for foreign refiners would have generated. This argument was made succinctly by the United States in the following terms:

Verification on foreign soil of foreign baselines, and subsequent enforcement actions, present substantial difficulties relating to problems arising whenever a country exercises enforcement jurisdiction over foreign persons. In addition, even if individual baselines were established for several foreign refiners, the importer would be tempted to claim the refinery of origin that presented the most benefits in terms of baseline restrictions, and tracking the refinery or origin would be very difficult because gasoline is a fungible commodity. The United States should not have to prove that it cannot verify information and enforce its regulations in every instance in order to show that the same enforcement conditions do not prevail in the United States and other countries ... The impracticability of verification and enforcement of foreign refiner baselines in this instance shows that the "discrimination" is based on serious, not arbitrary or unjustifiable, concerns stemming from different conditions between enforcement of its laws in the United States and abroad.²⁷[27]

²⁷[27] Para. 55 of the Appellant's Submission, dated 4 March 1996. The United States was in effect making the same point when, at pages 11 and 12 of its Post-Hearing Memorandum, it argued that the

conditions were not the same as between the United States, on the one hand, and Venezuela and Brazil on the other.

Thus, according to the United States, imported gasoline was relegated to the more exacting statutory baseline requirement because of these difficulties of verification and enforcement. The United States stated that verification and enforcement of the Gasoline Rule's requirements for imported gasoline are "much easier when the statutory baseline is used" and that there would be a "dramatic difference" in the burden of administering requirements for imported gasoline if individual baselines were allowed.²⁸[28]

While the anticipated difficulties concerning verification and subsequent enforcement are doubtless real to some degree, the Panel viewed them as insufficient to justify the denial to foreign refiners of individual baselines permitted to domestic refiners. The Panel said:

While the Panel agreed that it would be necessary under such a system to ascertain the origin of gasoline, the Panel could not conclude that the United States had shown that this could not be achieved by other measures reasonably available to it and consistent or less inconsistent with the General Agreement. Indeed, the Panel noted that a determination of origin would often be feasible. The Panel examined, for instance, the case of a direct shipment to the United States. It considered that there was no reason to believe that, given the usual measures available in international trade for determination of origin and tracking of goods (including documentary evidence and third party verification) there was any particular difficulty sufficient to warrant the demands of the baseline establishment methods applied by the United States.²⁹[29]

...

In the view of the Panel, the United States had reasonably available to it data for, and measures of, verification and assessment which were consistent or less inconsistent with Article III:4. For instance, although foreign data may be formally less subject to complete control by US authorities, this did not amount to establishing that foreign data could not in any circumstances be sufficiently reliable to serve U.S. purposes. This, however, was the practical effect of the application of the Gasoline Rule. In the Panel's view, the United States had not demonstrated that data available from foreign refiners was inherently less susceptible to established techniques of checking, verification, assessment and

²⁸[28] Supplementary responses by the United States to certain questions of the Appellate Body, dated 1 April 1996.

²⁹[29] Panel Report, para. 6.26.

enforcement than data for other trade in goods subject to US regulation. The nature of the data in this case was similar to data relied upon by the United States in other contexts, including, for example, under the application of antidumping laws. In an antidumping case, only when the information was not supplied or deemed unverifiable did the United States turn to other information. If a similar practice were to be applied in the case of the Gasoline Rule, then importers could, for instance, be permitted to use the individual baselines of foreign refiners for imported gasoline from those refiners, with the statutory baseline being applied only when the source of imported gasoline could not be determined or a baseline could not be established because of an absence of data.³⁰[30]

We agree with the finding above made in the Panel Report. There are, as the Panel Report found, established techniques for checking, verification, assessment and enforcement of data relating to imported goods, techniques which in many contexts are accepted as adequate to permit international trade - trade between territorial sovereigns - to go on and grow. The United States must have been aware that for these established techniques and procedures to work, cooperative arrangements with both foreign refiners and the foreign governments concerned would have been necessary and appropriate. At the oral hearing, in the course of responding to an enquiry as to whether the EPA could have adapted, for purposes of establishing individual refinery baselines for foreign refiners, procedures for verification of information found in U.S. antidumping laws, the United States said that "in the absence of refinery cooperation and the possible absence of foreign government cooperation as well", it was unlikely that the EPA auditors would be able to conduct the on-site audit reviews necessary to establish even the overall quality of refineries' 1990 gasoline.³¹[31] From this statement, there arises a strong implication, it appears to the Appellate Body, that the United States had not pursued the possibility of entering into cooperative arrangements with the governments of Venezuela and Brazil or, if it had, not to the point where it encountered governments that were unwilling to cooperate. The record of this case sets out the detailed justifications put forward by the United States. But it does not reveal what, if any, efforts had been taken by the United States to enter into appropriate procedures in cooperation with the governments of Venezuela and Brazil so as to mitigate the administrative problems pleaded by the United States.³²[32] The fact that the United States Congress might have intervened, as it did

³⁰[30] Panel Report, para. 6.28.

³¹[31] Supplementary responses to the United States to certain questions of the Appellate Body, dated 1 April 1996.

³²[32] While it is not for the Appellate Body to speculate where the limits of effective international cooperation are to be found, reference may be made to a number of precedents that the United States (and other countries) have considered it prudent to use to help overcome problems confronting enforcement agencies by virtue of the fact that the relevant law and the authority of the enforcement of the agency does not hold sway beyond national borders. During the course of the oral hearing, attention was drawn to the fact that in addition to the antidumping law referred to by the Panel in the passage cited above, there were other US regulatory laws of this kind, *e.g.*, in the field of anti-trust law, securities exchange law and tax law. There are cooperative agreements entered into by the US and other governments to help enforce regulatory laws of the kind mentioned and to obtain data from abroad. There are such agreements, *inter alia*, in the anti-trust and tax areas. There are also, within the

later intervene, in the process by denying funding, is beside the point: the United States, of course, carries responsibility for actions of both the executive and legislative departments of government.

In its submissions, the United States also explained why the statutory baseline requirement was not imposed on domestic refiners as well. Here, the United States stressed the problems that domestic refineries would have faced had they been required to comply with the statutory baseline. The Panel Report summarized the United States' argument in the following terms:

The United States concluded that, contrary to Venezuela's and Brazil's claim, Article XX did not require adoption of the statutory baseline as a national standard even if the difficulties associated with the establishment of individual baselines for importers were insurmountable. Application of the statutory baseline to domestic producers of reformulated and conventional gasoline in 1995 would have been *physically and financially impossible because of the magnitude of the changes required in almost all US refineries; it thus would have caused a substantial delay in the programme*. Weighing the feasibility of policy options in economic or technical terms in order to meet an environmental objective was a legitimate consideration, and did not, in itself, constitute protectionism, as alleged by Venezuela and Brazil. Article XX did not require a government to choose the most expensive possible way to regulate its environment.^{33[33]} (emphasis added)

Clearly, the United States did not feel it feasible to require its domestic refiners to incur the physical and financial costs and burdens entailed by immediate compliance with a statutory baseline. The United States wished to give domestic refiners time to restructure their operations and adjust to the requirements in the Gasoline Rule. This may very well have constituted sound domestic policy from the viewpoint of the EPA and U.S. refiners. At the same time we are bound to note that, while the United States counted the costs for its domestic refiners of statutory baselines, there is nothing in the record to

framework of the WTO, the *Agreement on the Implementation of Article VI of GATT 1994*, (the "Antidumping Agreement"), the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement") and the *Agreement on Pre-shipment Inspection*, all of which constitute recognition of the frequency and significance of international cooperation of this sort.

^{33[33]} Panel Report, para. 3.52.

indicate that it did other than disregard that kind of consideration when it came to foreign refiners.

We have above located two omissions on the part of the United States: to explore adequately means, including in particular cooperation with the governments of Venezuela and Brazil, of mitigating the administrative problems relied on as justification by the United States for rejecting individual baselines for foreign refiners; and to count the costs for foreign refiners that would result from the imposition of statutory baselines. In our view, these two omissions go well beyond what was necessary for the Panel to determine that a violation of Article III:4 had occurred in the first place. The resulting discrimination must have been foreseen, and was not merely inadvertent or unavoidable. In the light of the foregoing, our conclusion is that the baseline establishment rules in the Gasoline Rule, in their application, constitute "unjustifiable discrimination" and a "disguised restriction on international trade." We hold, in sum, that the baseline establishment rules, although within the terms of Article XX(g), are not entitled to the justifying protection afforded by Article XX as a whole.

V. FINDINGS AND CONCLUSIONS

For the reasons set out in the preceding sections of this report, the Appellate Body has reached the following conclusions:

(a) the Panel erred in law in its conclusion that the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations did not fall within the terms of Article XX(g) of the *General Agreement*;

(b) the Panel accordingly also erred in law in failing to decide whether the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations fell within the ambit of the chapeau of Article XX of the *General Agreement*;

(c) the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations fail to meet the requirements of the chapeau of Article XX of the

General Agreement, and accordingly are not justified under Article XX of the *General Agreement*.

The foregoing legal conclusions modify the conclusions of the Panel as set out in paragraph 8.1 of its Report. The Appellate Body's conclusions leave intact the conclusions of the Panel that were not the subject of appeal.

The Appellate Body *recommends* that the Dispute Settlement Body request the United States to bring the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations into conformity with its obligations under the *General Agreement*.

It is of some importance that the Appellate Body point out what this does *not* mean. It does not mean, or imply, that the ability of any WTO Member to take measures to control air pollution or, more generally, to protect the environment, is at issue. That would be to ignore the fact that Article XX of the *General Agreement* contains provisions designed to permit important state interests - including the protection of human health, as well as the conservation of exhaustible natural resources - to find expression. The provisions of Article XX were not changed as a result of the Uruguay Round of Multilateral Trade Negotiations. Indeed, in the preamble to the *WTO Agreement* and in the *Decision on Trade and Environment*,^{34[34]} there is specific acknowledgement to be found about the importance of coordinating policies on trade and the environment. WTO Members have a large measure of autonomy to determine their own policies on the environment (including its relationship with trade), their environmental objectives and the environmental legislation they enact and implement. So far as concerns the WTO, that autonomy is circumscribed only by the need to respect the requirements of the *General Agreement* and the other covered agreements.

...

^{34[34]} Adopted by Ministers at the Meeting of the Trade Negotiations Committee in Marrakesh on 14 April 1994.