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MEMORANDUM

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Re: **WTO Rules Against United States on Revised Country of Origin Labeling**

In a recently issued decision, a World Trade Organization (WTO) compliance Panel ruled in favor of Canada and Mexico in a dispute over the United States' country of origin labeling (COOL) requirements as they apply to cattle and hog muscle cuts.1/ Although it found that the United States has a right to require country of origin labels for meat products, the compliance Panel concluded that the U.S. Department of Agriculture's (USDA's) revised COOL regulations failed to bring the United States into compliance with earlier Panel and Appellate Body findings that the COOL requirements treat Canadian and Mexican livestock less favorably than domestic livestock in violation of WTO rules.

The United States may appeal the WTO decision. Canada and Mexico are poised to enact retaliatory trade sanctions, however, if the United States loses the appeal, as seems very likely, or if it opts not to appeal the decision and it becomes final. It has been estimated the sanctions could affect $2 billion in U.S. exports to Canada and Mexico. USDA could also try to revise the rule again, although it appears unlikely that USDA would be willing to revise the rule in a way the WTO would find acceptable.

Background

The WTO first ruled on the U.S. COOL regulations in November 2011 after Canada and Mexico challenged the requirements. The USDA regulations limited U.S. origin labels to meat from animals born, raised, and slaughtered exclusively in the United States and required origin labeling for products of foreign origin. The WTO ruled that the regulations violated Articles 2.1 and 2.2 of the Technical Barriers to Trade (TBT) Agreement and that a policy that Secretary of Agriculture Vilsack announced in a letter violated the General Agreement on Tariffs and Trade (GATT). The WTO Appellate Body upheld the decision in July 2012, requiring the United States to bring its regulations into compliance.

The USDA responded by amending the regulations in May 2013 to require the labels of muscle cuts of beef, lamb, chicken, goat, and pork to specify the country or countries where the animal was born,

1/ World Trade Organization, United States – Certain Country of Origin Labeling (COOL) Requirements, Reports of the Panel, WT/DS384/RW, WT/DS386/RW (Oct. 20, 2014) (WTO Report). The WTO Report is available on the WTO website at http://bit.ly/1zgvTHK.

raised, and slaughtered, instead of addressing these steps collectively through a general origin statement, in effect doubling down on its original rule by making it even more restrictive.2/ The rule prohibits "commingling" livestock, or processing livestock from Canada, Mexico, and the United States during the same processing day and then labeling those products with a "mixed-origin" label. Canada and Mexico challenged the revised regulations, arguing they are even more detrimental to competition among domestic and foreign products than the original regulations.

The WTO Decision

In its most recent decision, the WTO's compliance Panel evaluated whether the revised 2013 regulation complies with the WTO's earlier ruling, finding that the regulations continue to treat Canadian and Mexican livestock less favorably than U.S. livestock, as was widely anticipated. In fact, according to the Panel, the amended regulations increase the original COOL measure's detrimental impact on the ability of livestock imported in the U.S. market to compete because it "necessitates increased segregation of meat and livestock according to origin; entails a higher recordkeeping burden; and increases the original COOL measure's incentive to choose domestic over imported livestock."3/ The WTO found that the regulations violate two of its governing provisions, but opted not to evaluate a third alleged violation.

Article 2.1 of the TBT Agreement

The Panel found that the revised regulations violate Article 2.1 of the TBT Agreement, which requires that members' technical regulations not discriminate against imported products. In prior cases, the WTO established a two-part test for analyzing potential Article 2.1 violations: (1) a determination of whether a measure has a detrimental impact on imports; and (2) if so, whether the impact stems from "legitimate regulatory distinctions" between like products.4/ In the instant case, the Panel found that the 2013 revised regulations negatively impact conditions of competition for Canadian and Mexican cattle and hogs, and that these detrimental impacts did not stem from legitimate regulatory distinctions.

As it did in its 2012 analysis, the Panel concluded that the regulation's recordkeeping requirements were disproportionate to the amount of information that consumers received, created a *de facto* incentive to use domestic livestock, and adversely affected conditions of competition in violation of TBT Article 2.1. It also found that the United States arbitrarily applied the measure because it exempts processed meat and restaurants in many situations. The Panel determined that the 2013 rule's more detailed and specific labeling requirements, restrictions against commingling, and elimination of previous flexibilities regarding the order of countries listed on meat labels caused an even greater detrimental impact on Canadian and Mexican producers than the original regulation.

According to the compliance Panel, the USDA's revised rule only increased the incentives for meat processors to refrain from using imported livestock. In effect, the only way to comply with the revised rule is to segregate domestic and imported livestock and track them more closely along the production line, which would increase costs for companies that purchase imported livestock compared to those that purchase only domestic livestock. The Panel reasoned that the prohibition harmed imports by increasing "the practical necessity for private actors to choose domestic over

2/ Final Rule, Mandatory Country of Origin Labeling of Beef, Pork, Lamb, Chicken, Goat Meat, Wild and Farm-Raised Fish and Shellfish, Perishable Agricultural Commodities, Peanuts, Pecans, Ginseng, and Macadamia Nuts, 78 Fed. Reg. 31367 (May 24, 2013) (to be codified at 7 C.F.R. pts. 60 and 65).

3/ United States – Certain Country of Origin Labeling (COOL) Requirements, World Trade Organization, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds384_e.htm#bkmk384rw.

4/ WTO Report ¶ 7.61.

imported livestock."5/ In its arguments, the United States conceded that its goal with the revised rule was to make the labeling required more proportionate with the information it gathered, rather than to address the detrimental impact the Appellate Body identified with its prior decision. It maintained, however, that the USDA's revised rule did not increase the detrimental impact on imports.

When analyzing whether the United States had presented a "legitimate regulatory distinction" that could justify the disparate impact of the rule, the compliance Panel emphasized that the labels could be inaccurate in some situations because the rule allows for flexibility in describing where the animal was raised. Under the rule, if an animal spent 15 days in the United States prior to slaughter, companies could label it "raised" in the United States. The United States argued that this flexibility was necessary to save space on the label and to recognize that any animal born outside the United States would also spend some time in the United States before slaughter. The compliance Panel disagreed, arguing that the flexibility "takes no account of the substantial amount of time that traded livestock typically spend outside the United States."6/ In addition, the revised rule failed to address the extensive exceptions for restaurants and processed foods, undercutting the rule's purported goal of ensuring that consumers have accurate origin information.7/

Article 2.2 of the TBT Agreement

In a minor victory for the United States, the Panel did not find that the regulations violate Article 2.2 of the TBT agreement, which requires technical measures to be no more trade restrictive than necessary to fulfill a legitimate objective. The Panel adopted a holistic approach of "weighing and balancing"8/ a series of factors in determining whether the revised USDA rule complied with Article 2.2, including (1) the rule's degree of contribution to a legitimate objective, (2) the rule's trade restrictiveness, (3) the nature of the risks at issue, (4) whether the proposed alternatives are less trade-restrictive, (5) whether the proposed alternatives would make an equivalent contribution to achieving the rule's policy goals, and (6) whether the proposed alternative is "reasonably available." 9/

As it did in the 2012 decision, the WTO Panel held that providing consumers with information on a product's origin is a legitimate objective. The Panel also considered the risks if the United States did not fulfill the goals of its regulation, which it assessed in terms of "consumer interest in, and willingness to pay for, different types of country of origin information."10/ However, the Panel was unable to ascertain the "gravity of consequences" if these objectives were not met because of USDA's inability to quantify the consumer benefits.11/ In addition, Canada and Mexico proposed four alternative measures they argued could accomplish the United States' goals without restricting competition as much as the COOL regulations. After examining the proposed alternatives, the Panel held that neither Canada nor Mexico established *prima facie* arguments for how the four proposed alternative measures would make an equivalent contribution to the legitimate objective of providing consumers with origin information, would cause less harm to trade than the United States' COOL regulation, or were reasonably available in terms of feasibility.

5/ *Id*. ¶ 7.167.
6/ *Id.* ¶ 7.243.
7/ *Id.* ¶ 7.272.
8/ The approach closely resembles and was drawn from the Appellate Body's approach to weighing "necessity" in GATT Article XX. *See, e.g.,* AB Report, *Brazil – Tyres*, WT/DS322/AB/R, ¶¶ 142-212 (3 Dec. 2007).
9/ *Id.* ¶ 7.303.
10/ *Id.* ¶ 7.375.
11/ *Id.* ¶¶ 7.422-7.433.

Article III:4 of GATT

The Panel found that the regulation also violates Article III:4 of GATT, which prohibits members from favoring domestic products over imported products. 12/ The Panel based this finding on its conclusion that the amended COOL measure increased the original rule's detrimental effect on the competitiveness of imported livestock compared to U.S. products. In reaching this conclusion, it relied on the same considerations that informed its finding of a detrimental impact under Article 2.1 of the TBT Agreement. Unlike its analysis of the Article 2.1 violation, however, it was not necessary for the Panel to determine whether the detrimental impact stemmed exclusively from legitimate regulatory distinctions in order to find a violation under Article III:4.

Implications of the Decision

The United States has 60 days to appeal the Panel's ruling, and the Appellate Body would then issue a final decision within 90 days. In a recent interview, Secretary Vilsack said the U.S. Trade Representative is considering an appeal.13/ He added, however, that WTO has asked the United States not to appeal the decision until January 2015 to allow it to handle its current backlog of appeals.

Meanwhile, Canada and Mexico have already begun threatening to impose retaliatory tariffs if the United States loses an appeal or opts not to challenge the decision. Those retaliatory tariffs would likely become effective within a year. Canada released in June 2013 a list of 38 products it plans to target with retaliatory measures, including live bovine and swine, bovine and swine meat, offal, cheese, apples, cherries, corn, maple syrup, chocolate, pasta, cereals, bread and pastries, frozen orange juice, ketchup, and wine.14/ Mexico has not released a list of planned retaliatory measures, but it is similarly expected to target agricultural products. Reports estimate the retaliatory tariffs may cost as much as $2 billion.15/

In light of the potential detrimental economic impact of these potential tariffs, as well as other concerns, leaders of both the House and Senate agriculture committees are encouraging the administration to reach a settlement instead of continuing to argue the dispute before the WTO. House Agriculture Chairman Frank Lucas (R-OK) said in a statement that it is "time for the Administration to put this case behind us by exercising leadership in order to achieve a lasting compromise that is satisfactory for our producers, processors, retailers, consumers and our trading partners."16/ Similarly, Senate Agriculture Chairwoman Debbie Stabenow (D-MI) issued a press release commenting that the United States "can spend decades litigating the issue at the WTO, or we can work together to find a solution that encourages international trade and gives consumers what they need to make choices for their families."17/ Secretary Vilsack said he has asked USDA staff to evaluate whether they can revise the labeling requirement in a way that satisfies the

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12/ *See id*. ¶ 7.643.
13/ Chris Clayton, *COOL Appeal Likely in 2015: Backlog at WTO May Mean a U.S. Appeal Won't Come Until January*, The Progressive Farmer (Oct. 27, 2014, 3:28 PM), http://bit.ly/1zLHf7S.
14/ Statement by Ministers Fast and Ritz on U.S. Country of Origin Labelling, Government of Canada (June 7, 2013), http://bit.ly/1tkgAsP.
15/ *Canada threatens tariffs on American wine, orange juice and ketchup in meat labelling dispute*, Financial Post (Oct. 20, 2014, 9:48 AM), http://bit.ly/1yIDQCy.
16/ Chris Clayton, *Views in Congress Vary on COOL*, The Progressive Farmer (Oct. 20, 2014), http://bit.ly/1tj5RjI.
17/ *Id.*

agency's congressional mandate to provide specific labeling without running afoul of WTO rules.18/ In the meantime, the COOL regulations will remain in effect.19/

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We will continue to monitor developments with this dispute and other labeling and international trade issues. Please do not hesitate to contact us if you have any questions.

18/ *See* Clayton, *supra* note 13.

19/ Despite fervent support in some corners of USDA, the White House, and populist farm groups for COOL, the agency is running out of options, as any fresh effort to maintain the rule is likely to require confronting the exceptions for restaurants and processed foods, which were specifically cited by the Panel. This would likely lead to a serious political backlash from large and small restaurant owners and food companies alike, who would join meat processors and mainstream farm groups in opposition. It would also have the practical effects of making restaurant menus and food labels much longer and virtually unreadable, as well as further driving up food costs for American households.