

## 2004 SIDLEY – HIEL WTO MOOT COURT COMPETITION

### PROBLEM

Revised as of January 8, 2004

The trade relations between the Governments of Brucia and Analand have become strained and marked by discord. The most recent in a series of unresolved trade disputes has left both countries entrenched in their respective positions with no real hope for a settlement.

Disagreements on non-trade issues have increased the growing tension between the two countries, which until recently had been long-time friends and allies. Mindful of their obligations under international law, both governments remain committed to resolve their trade disputes through the dispute settlement system of the World Trade Organization, in which both are Members.

Kryonics Inc. is a financially robust private company incorporated under the laws of Brucia, a developing country. Its main corporate activity is the manufacture of a Temperature Activated Cooling System apparatus (TACS) for the lucrative export market. Kryonics is an important political campaign contributor and employer of skilled labor in Brucia. Recent policy and regulatory changes in Analand—Kryonics' traditional market for TACS—has management enraged and clamoring for legal action by the Government of Brucia. Kryonics' prospects for 2004 are stark, with analysts predicting a loss of TACS market share in Analand. Ominous clouds loom over the stock price of Kryonics.

TACS are dual-use products. They are a sophisticated and technologically advanced apparatus. Few countries possess the technical expertise or the manufacturing capabilities to produce TACS. TACS originally were designed for use in the chemical industry, to prevent unintended chemical reactions triggered by high temperatures. Recently, however, TACS have been used by military organizations around the world. Although not originally intended for military use, militaries have found that TACS can be used in the production of chemical weapons and in the cooling of military equipment parts whose performance may be affected by the heat generated through continuous operation. Militaries have found that TACS are more dependable and efficient than traditional cooling systems. Use of TACS alone has contributed to an increase in

Analand’s chemical and conventional arsenals—indeed, to such a significant extent that it could alter the balance of power in Analand’s relations with other States.

There are differences between TACS intended for military use (“military TACS”) and commercial use (“commercial TACS”). Although these differences are relatively minor, they are physically noticeable. Commercial TACS must undergo an additional process in order for them to be suitable for military use, and are, therefore, less expensive to produce than TACS for military use. However, this additional process is not sufficient to constitute a substantial transformation, nor does it add significant value to the product.

Analand is a high-income developing country with a thriving chemical industry. In 1999, Analand introduced a new import and export control regime, as part of a broader reform program that reflects changes in its trade and foreign policies. These reforms include adoption of the National Defense Act of January 1, 1999 (the “Act”). Pursuant to the Act, the Ministry of National Defense issued on June 15, 1999, Rule No. 703(a)-NDA and Rule No. 703(b)-NDA. Rule No. 703(a)-NDA gives the Ministry of National Defense of Analand the authority to ascertain, through auditing and direct inspections (i) the amount of TACS available for use or sale in Analand and (ii) whether TACS sold or imported into Analand are intended for military or commercial use. According to the Preamble of Rule No. 703(a)-NDA, it is in the “national security interest of Analand to ensure that the supply of Temperature Activated Cooling System apparatus (otherwise known as ‘TACS’) is sufficient to meet the needs of the military in the production of weapons in preparation for or at a time of war.” Analand’s principal concern is that its military will be unable to defend its territorial integrity due to a lack of adequate equipment. Since military TACS improve weapons performance, a lack of available TACS is perceived as a threat to national security.

To that end, Rule No. 703(a)-NDA mandates that producers and importers cooperate with the authorities of Analand and obtain Certificate of Compliance 703-NDA from the Ministry of National Defense. This document certifies that the production or importation of TACS into Analand has been accounted and that these TACS comply with the requirements of Rule No. 703(a)-NDA. Since TACS are classified under the same HTS tariff heading, *i.e.*, 8485.00, regardless of use, the certificate is the mechanism through which Analand ascertains when its

military supply needs of TACS will not be met due to expanding purchases by its domestic chemical industry. Certificate of Compliance 703-NDA is a pre-condition for the sale of TACS in Analand.

Rule No. 703(b) of the National Defense Act provides that when the Ministry of National Defense determines that military TACS are in short supply, the Ministry has the discretion to prohibit the sale of commercial TACS. The Ministry enforces this prohibition by refusing to issue the required Certificate of Compliance. The measure's rationale is that a prohibition on the import and sale of commercial TACS in Analand will lead manufacturers to shift from commercial to military TACS production, thus alleviating any shortage in supply.

Pursuant to Rule No. 703(a)-NDA, TACS manufactured abroad must be inspected upon importation into Analand and are subject to the following procedures:

- (a) Importer must make formal declaration indicating intended use of TACS (Customs Declaration Form 703-NDA).
- (b) TACS are subject to inspection within the territory of Analand to determine compliance with Rule No. 703(a)-NDA.
- (c) The Ministry of Defense has granted customs agents special authority to carry out the inspection required by Rule No. 703(a)-NDA and to apply Rule No. 704(b)-NDA. Customs agents may either issue a Certificate of Compliance 703-NDA-2 or withhold the Certificate pursuant to Rule No. 703(b)-NDA.
- (d) Pending inspection, TACS are stored in secured warehouses pre-sanctioned by the National Customs Office.

Kryonics complained bitterly to high-level officials of the Ministry of Foreign Trade of Brucia that Rules No. 703(a)-NDA and 703(b)-NDA place its exports of TACS to Analand at a disadvantage vis-à-vis imports of TACS from Claudonia and domestic production in Analand.

It is no secret that the strengthening of political and commercial ties between Analand and Claudonia coincides with a deterioration of relations between Analand and Brucia. Claudonia, a developing country not yet a Member of the WTO, is the main competitor of Brucia in the production of TACS. Unlike Brucia, Claudonia produces mainly military TACS, whereas 90% of Brucia's production is commercial. Claudonia recently lent its support to Analand in a long-standing territorial dispute against Nieland that has brought Analand and Nieland to the brink of

a full-scale war. Brucia has refused to get involved in the conflict. Brucia sits in the Security Council with Analand but does not support the war against Nieland. In fact, Brucia has threatened to veto a Security Council resolution proposed by Analand. The proposed resolution declares Nieland in breach of international law and seeks recognition of a “state of war,” thus enabling deployment of United Nations peacekeeping forces along the border.

Shortly after Claudonia declared its support for Analand in its war against Nieland, Analand and Claudonia entered into an Economic and Strategic Cooperation Agreement. The Preamble of the Agreement notes that Analand is entering into the Agreement in consideration of “common strategic and commercial interests” of both countries. The Agreement specifically states that it neither establishes nor lays the foundation for the formation of a free-trade area or customs union. The Agreement is self-executing under the laws of Analand.

The Economic and Strategic Cooperation Agreement, which entered into force on January 18, 2000, contains an “*in situ* Certification Procedure” under which Claudonia may request that Analand send inspectors from the Foreign Affairs Office of the Ministry of National Defense to manufacturing plants in Claudonia to inspect TACS intended for export to Analand. Upon inspection, the officer of the Ministry of National Defense issues Certificate of Compliance 703-NDA-1, which certifies compliance with Rule No. 703(a)-NDA *in situ*. TACS thus certified are not subject to inspection by the National Customs Office upon importation. Imports of TACS from Claudonia unaccompanied by Certificate of Compliance 703-NDA-1 are subject to the normal inspection and certification procedure in Analand, pursuant to Rule No. 703(a)-NDA.

In late February 2000, Kryonics began to lobby high-level officials in the Ministry of National Defense and the Ministry of Commerce, Industry and Economy of Analand to request that TACS manufactured in Brucia receive Certificates of Compliance prior to importation. The Ministry of National Defense was sympathetic and responsive to Kryonics’ request. On March 27, 2000, the Vice-Minister sent an official response to the President of Kryonics on letterhead bearing the official golden stamp of the State of Analand. He stated that Analand was willing to accede to Kryonics’ request. However, the laws of Analand required acceptance and ratification of an Economic and Strategic Cooperation Agreement between Analand and Brucia before Certificate of Compliance 703-NDA-1 could be issued for products manufactured in Brucia. Breaking from

protocol, the Vice-Minister invited Kryonics to lobby the Government of Brucia to enter into negotiations for an Economic and Strategic Cooperation Agreement with Analand.

Kryonics' largest client in Analand is Algortech Inc. Algortech, incorporated as a private company under the laws of Analand, is a publicly traded company and the largest defense contractor in Analand. The Government of Analand is a majority shareholder in Algortech. The Ministry of National Defense is one of Algortech's most important and loyal clients.

Algortech's "corporate policy" is to buy TACS that bear Certificate of Compliance 703-NDA-1, since this certificate relieves Algortech from the responsibility of subjecting imports of TACS to inspection by the Customs authorities within the territory of Analand. Algortech buys TACS bearing other types of certificates of compliance only if imports from Claudonia are not sufficient to meet its demand, which invariably has been the case since Rule No. 703(a)-NDA entered into force.

In fact, since Algortech started buying military TACS, imports of TACS, either from Claudonia or Brucia, have not been sufficient to meet demand. As a result, Algortech invested US\$33 million to develop capacity to produce limited quantities of military or commercial TACS domestically to make up the difference between supply and demand. Nevertheless, Brucia and Claudonia have an incontrovertible competitive advantage over Algortech in the production of TACS. With average total costs of production of TACS by Algortech exceeding those of Brucia and Claudonia by 45% and 35% respectively, it makes economic sense for Algortech to produce TACS for domestic consumption only if it cannot import them from Brucia and Claudonia. Algortech thus produces TACS—either military or commercial—only when it cannot buy them from Brucia and Claudonia.

The TACS produced in Analand are also subject to Rule No. 703(a)-NDA and Rule No. 703(b)-NDA. However, inspection by the Ministry of National Defense is not required under Rule No. 703(a)-NDA prior to the issuance of Certificates of Compliance for TACS produced domestically. Instead, the Ministry of National Defense issues Certificate of Compliance 703-NDA-3 on the basis of an affidavit issued by the manufacturer, declaring the quantities of TACS intended, respectively, for commercial and military use. As an additional safeguard, Rule No. 703(a)-NDA grants the Ministry discretion to conduct unannounced, on-site inspections of

Algortech's manufacturing plants and warehouses to verify the accuracy of the sworn declaration.

On April 18, 2001, under intense pressure from Kryonics, the Government of Brucia formally challenged Rule No. 703(a)-NDA and the certification requirement imposed by the Government of Analand in a WTO dispute settlement proceeding (WT/DS540). In that dispute, Brucia challenged the consistency of the “*in situ* Certification Procedure” of the Economic and Strategic Cooperation Agreement between Analand and Claudonia with Article 5.1.1 of the TBT Agreement. Specifically, Brucia claimed that the measure at issue violated the National Treatment (NT) and Most Favored Nation (MFN) obligations under that provision. The Panel agreed, finding the measure inconsistent with Article 5.1.1 and recommending, pursuant to Article 19 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (“DSU”), that Analand bring the measure into conformity with the covered agreement. Analand appealed the Panel's findings and conclusions. The Appellate Body (AB) reversed the Panel's findings and found, instead, that Rule No. 703(a)-NDA was not a technical regulation and thus was not subject to Article 5.1.1 of the TBT Agreement. Based on its finding that the measure at issue was not a technical regulation, the AB found it unnecessary to determine whether Analand had adopted and applied “conformity assessment procedures” to products originating in Brucia under “conditions no less favourable than those accorded to suppliers of like products of national origin or originating in any other country.” On October 17, 2002, the Dispute Settlement Body adopted the Panel report, as amended by the AB report.

On July 24, 2003, Brucia again requested consultations with Analand pursuant to Article 4 of the DSU and Article XXII:1 of the GATT regarding Rule No. 703(a)-NDA of the Act and the “*in situ* Certification Procedure” of the Economic and Strategic Cooperation Agreement between Analand and Claudonia. Consultations were held in Geneva on August 19-20, 2003.

Having failed to settle the matter in consultations, Brucia requested the establishment of a panel pursuant to Articles 4.7 and 6 of the DSU and Article XXIII:2 of the GATT on October 3, 2003.

In its request for the establishment of a panel, Brucia asked that the panel thus established find nullification or impairment of benefits accruing to Brucia as a result of the violation by Analand of Articles I, III, and XI of GATT 1994. Brucia indicated in its request for the establishment of

the panel that the specific measures at issue in the dispute were Rules No. 703(a)-NDA and 703(b)-NDA of the Act, including the conditions for the issuance of Certificates of Compliance 703-NDA-1, 703-NDA-2, and 703-NDA-3; and the implementation by Analand of the “*in situ* Certification Procedure” of the Economic and Strategic Cooperation Agreement between Analand and Claudonia.

A panel was established on November 5, 2003, with standard terms of reference. The Panel was composed on November 24, 2003. According to the Panel’s timetable for the proceedings, the first written submission of the parties is due on January 12, 2004. The Panel will hold its first substantive meeting with the parties on January 29 and 30, 2004.

In response to Brucia’s claims, Analand will argue, *inter alia*, that:

- (a) the same claims had been resolved in an earlier case (WT/DS540) and that, based on the principle of *res judicata*, the Panel should not issue the recommendations requested by Brucia;
- (b) the measures at issue are in conformity with Articles I, III and XI of GATT 1994; and
- (c) the measures at issue are justified under the Security Exceptions of Article XXI of GATT 1994.

#### Clarifications of January 8, 2004

The Steering Committee received two separate requests for clarification from the team representative of one of the participating schools: the first on Monday, January 5, 2004 (10:42 p.m.); the second on Thursday, January 08, 2004 (8:36 a.m.). In accordance with Official Rule 5, the Steering Committee hereby makes the request and the clarification available to all teams:

1. *Would you be able to clarify whether prior to receiving imports from Claudonia, Analand, through the Algortech plant or the military, converted commercial TACS into military TACS?*

The Competition Problem contains no facts that indicate that the Algortech plant or the Analand military converted commercial TACS into military TACS, either prior to or after receiving imports from Claudonia.

2. *Does the Algortech plant have the capacity to convert commercial TACS into military TACS or only to produce the military TACS from scratch?*

There is no mention in the Competition Problem of whether the additional production process that differentiates military from commercial TACS can be undertaken separately - by Algortech or any other manufacturer - or whether it must invariably be part of one integrated and uninterrupted production process.

3. *May we assume that since the conversion of commercial TACS into military TACS "does not add significant value to the product," that the transformation procedure is not costly and easy to do?*

The Steering Committee is not in a position to confirm factual assumptions made by Teams.

4. *Is the transformation of a commercial TACS into a military TACS irreversible? That is to say, can military TACS, as they are or through a reverse transformation, be used for commercial purposes?*

The Competition Problem contains no facts that indicate that the transformation of a commercial TACS into a military TACS is reversible. Likewise, there are no facts that suggest that military TACS, "as they are or through a reverse transformation," can be used for commercial purposes.

5. *How long do TACS sit in the warehouse before being examined? (During the normal course of importation -- not when 703(b) has been invoked to stop commercial TACS from being certified.)*

The time-period is unspecified.

6. *The facts state that the customs people "may" issue a certification at the border. Is there any more about their procedure that could be enlightened? In which cases could they refuse to issue a certification (again, not when 703(b) has been invoked to stop commercial TACS from being certified.)*

Customs agents can withhold the Certificate of Compliance 703-NDA-2 when: (a) compliance with Rule No. 703(a)-NDA cannot be certified; or (b) Rule No. 703(b)-NDA is applied.