

BEFORE THE APPELLATE BODY OF THE
WORLD TRADE ORGANIZATION

Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes

AB-2005-3

APPELLEE'S SUBMISSION OF HONDURAS

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<i>Australia – Salmon</i>	Appellate Body Report, <i>Australia – Measures Affecting Importation of Salmon</i> , WT/DS18/AB/R, adopted 6 November 1998.
<i>Canada – Wheat Exports and Grain Imports</i>	Appellate Body Report, <i>Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain</i> , WT/DS276/AB/R, adopted 27 September 2004. Panel Report, <i>Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain</i> , WT/DS276/R, adopted 27 September 2004, as upheld by the Appellate Body Report, WT/DS276/AB/R.
<i>Dominican Republic – Cigarettes</i>	Panel Report, <i>Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes</i> , WT/DS302/R (on appeal).
<i>EEC – Regulation on Imports of Parts and Components</i>	GATT Panel Report, <i>EEC – Parts and Components</i> , L/6657, adopted 16 May 1990, BISD 37S/132.
<i>EC – Asbestos</i>	Appellate Body Report, <i>European Communities – Measures Affecting Asbestos and Asbestos-Containing Products</i> , WT/DS135/AB/R, adopted 5 April 2001.
<i>EC – Hormones</i>	Appellate Body Report, <i>EC Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998.
<i>Japan – Agricultural Products II</i>	Appellate Body Report, <i>Japan – Measures Affecting Agricultural Products</i> , WT/DS76/AB/R, adopted 19 March 1999.
<i>Korea – Dairy</i>	Appellate Body Report, <i>Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products</i> , WT/DS98/AB/R, adopted 12 January 2000.
<i>Korea – Various Measures on Beef</i>	Appellate Body Report, <i>Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef</i> , WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001.
<i>US – Gasoline</i>	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996.
<i>US – Section 337</i>	GATT Panel Report, <i>United States Section 337 of the Tariff Act of 1930</i> , adopted 7 November 1989, BISD 36S/345.
<i>US – Shrimp</i>	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/R, adopted 6 November 1998.

I. INTRODUCTION

A. PROCEDURAL BACKGROUND

1. On 24 January 2005, pursuant to Articles 16.4 and 17.4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU") and Rule 20 of the Working Procedures for Appellate Review (the "Working Procedures"), the Dominican Republic notified its decision to appeal certain issues of law and legal interpretation in the Panel Report in *Dominican Republic – Cigarettes*, WT/DS302/R, (the "Panel Report").

2. On 31 January 2005, the Dominican Republic filed its Appellant's Submission. The present Submission constitutes Honduras's response to the Appellant's Submission of the Dominican Republic.

B. ISSUES RAISED IN THIS APPEAL

3. The measure at issue in this appeal is the discriminatory enforcement of a tax stamp requirement for cigarettes by the Dominican Republic. The Panel found that the Dominican Republic accords imported cigarettes treatment less favourable than that accorded to domestic cigarettes because it denies importers a significant economic advantage enjoyed by domestic producers, namely the advantage of combining in a single production process the packaging of cigarettes and the affixation of the tax stamps. The Panel concluded, therefore, that this discrimination is inconsistent with Article III:4 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"). The measure at issue in this appeal is thus not the requirement to affix tax stamps in the Dominican Republic as such, but rather the discriminatory enforcement of that requirement by the Dominican Republic. It is extremely rare that governments deny foreign producers to affix tax stamps at their premises while permitting domestic producers to do so. Even the Dominican Republic resorts to such discrimination only in respect of cigarettes, not in respect of other products attracting high taxes, such as alcoholic beverages.

4. The Dominican Republic invoked Article XX(d) of the GATT, claiming that it had to deny importers the economic advantage enjoyed by domestic producers because it could otherwise not secure compliance with its tax legislation. It argued that if it permitted also foreign producers to affix the stamps during the process of packaging the cigarettes, there would be a risk of tax evasion, smuggling and forgery of tax stamps.

5. The Panel, however, rejected this argument. It found that the Dominican Republic had not demonstrated that the discriminatory enforcement of the stamp tax requirement contributes to the reduction of the risk of forgery of tax stamps. The fact is that tax stamps can be forged irrespective of *where* the tax stamp is affixed. The Panel also found that the Dominican Republic had failed to demonstrate that the discriminatory enforcement could contribute to the reduction of the risk of smuggling and tax evasion. The fact is that

smuggling and tax evasion may occur irrespective of *where* the stamps are affixed to the cigarettes that enter the Dominican Republic legally.

6. The Dominican Republic accepts the finding of the Panel that the discriminatory enforcement of the stamp requirement violates Article III:4 of the GATT, but requests the Appellate Body to reverse the finding of the Panel that this measure is not justified by Article XX(d). Although all of the grounds for appeal advanced by the Dominican Republic are couched as claims of legal error, it presents in effect two types of arguments that need to be clearly distinguished: first, arguments related to the Panel's assessment of the evidence; and, second, arguments related to the Panel's application of Article XX(d).

7. Given that a re-assessment of the evidence submitted to a panel is a matter that falls in principle outside the purview of appellate review, Honduras will address these two types of arguments separately. Honduras will demonstrate that the Panel assessed the evidence before it consistently with Article 11 of the DSU, and that it interpreted and applied Article XX(d) consistently with the terms of that provision and the relevant Appellate Body jurisprudence. The Dominican Republic has introduced upon appeal new factual elements on the question of smuggling with respect to producer collusion. Honduras submits that these new factual allegations – that have not even been substantiated - cannot now be introduced at this stage with the intention of discrediting the Panel's assessment of the evidence and factual findings on Article XX(d) and must, in any case, be rejected as inadmissible in this appeal.

C. EXECUTIVE SUMMARY OF HONDURAS'S GROUNDS FOR OPPOSING THE APPEAL.

8. In this Submission, Honduras addresses the arguments raised by the Dominican Republic in its Appellant's Submission. First, Honduras considers that the Dominican Republic has erroneously characterised its appeal as one of the Panel's misinterpretation and misapplication of the "necessity" test of Article XX(d) of the GATT 1994. However, what the Dominican Republic claims are errors of legal interpretation are in fact requests that the Appellate Body reassess the evidence before the Panel in order to come to a different conclusion.

9. In addition, the Dominican Republic is introducing new factual elements to be considered on appeal for the reversal of certain panel findings. For example, the Dominican Republic is now claiming that as cigarette producers are involved in cigarette smuggling, it would not be appropriate to cede any control over the affixation of the tax stamp to the producers. However, the Dominican Republic never made such an argument before the Panel and cannot now introduce this factual information before the Appellate Body. In addition, the Dominican Republic faults the Panel for not taking into consideration the role that the discriminatory enforcement of the tax stamps contributed to the important interest of protecting the health of its citizens. It argues that that "it should be 'easier' to accept the tax

stamp requirement as a 'necessary' enforcement instrument because of the value and importance of the interests it protects."¹ While the protection of human health is an important interest to protect, the Dominican Republic never made arguments before the Panel that the discriminatory enforcement of its tax stamp requirement serves to protect the health of its citizens. Therefore, it has no grounds to find fault with the Panel's failure to consider this circumstance *i.e.*, protection of human health as part of the "weighing and balancing of the relevant factors".

10. The Dominican Republic also claims that the Panel did not properly weigh and balance the relevant factors to determine whether the tax stamp requirement was 'necessary' to secure compliance with its fiscal laws. However, the Panel correctly set out and applied the tests established by the Appellate Body in order to determine that the Dominican Republic had not demonstrated that the discriminatory enforcement of the tax stamp requirement was necessary to secure compliance with its laws and regulations. Furthermore, the Panel correctly set out and applied the test in order to determine whether there was less-trade restrictive measures that the Dominican Republic could reasonably be expected to employ. Honduras also argues that the Panel made an objective assessment of the facts before it with respect to the evidence concerning the tax stamp requirement. Honduras therefore requests the Appellate Body to dismiss the appeal of the Dominican Republic in its entirety.

II. LEGAL ARGUMENT

A. THE DOMINICAN REPUBLIC CHARACTERISES ITS APPEAL AS ONE OF THE LEGAL INTERPRETATION OF THE "NECESSITY" TEST BUT IT IS IN EFFECT SEEKING A REASSESSMENT OF THE FACTUAL FINDINGS OF THE PANEL.

11. Before the Panel, the Dominican Republic claimed that the "tax stamp secures compliance with the tax laws generally, and more specifically, with the provisions governing the Selective Consumption Tax."² For the purpose of examining the Dominican Republic's arguments under Article XX(d), the Panel "preliminarily assume[d] that the tax laws or regulations, which would be enforced through the tax stamp requirement, are not inconsistent with the provisions of the GATT."³ However, the Panel did not make a definitive finding in this regard. The Panel focused its analysis on "whether the tax stamp requirement is necessary to secure compliance with the Dominican Republic's tax laws and to prevent the smuggling of cigarettes."⁴

¹ Appellant's Submission of the Dominican Republic, para 40.

² Panel Report, para.7.210.

³ Panel Report, para. 7.211.

⁴ Panel Report, para. 7.215.

12. The Panel noted that tax stamps may be a useful instrument to monitor tax collection on cigarettes and, conversely, to avoid tax evasion.⁵ The Panel then examined whether the requirement to affix the stamp in the territory of the Dominican Republic under the supervision of inspectors was justified. It noted that the Dominican Republic had argued that "allowing tax stamps to be shipped and affixed abroad would result in forgery of the stamps and the smuggling of the products in question".⁶

13. The Panel examined Exhibit DR-8, entitled "Evidence of forgery, smuggling and tax evasion resulting from allowing the affixation of Dominican Republic tax stamps abroad for alcoholic beverages." The Panel was not able to find on the basis of the evidence submitted in Exhibit DR-8 that the forgery of stamps actually took place. Although Exhibit DR-8 contains referrals to allegedly forged stamps, the letter from the Department of Alcohol and Tobacco of the Dominican Republic explicitly states that only the National Treasury would be in a position to confirm whether a set of stamps was forged. However, the Dominican Republic never submitted any evidence from the National Treasury regarding these confirmations.

14. The Panel then considered that even if, *arguendo*, Exhibit DR-8 had proven that tax stamps are forged, there was no evidence before the Panel to show that there is a causal link between allowing tax stamps to be affixed abroad and the fact that forgery of tax stamps may take place. The Panel noted that just because these two events occur simultaneously does not necessarily imply that those two events are correlated, much less that they are causally linked. Furthermore, in the view of the Panel, while tax stamps may be a useful instrument for the enforcement of tax laws and regulations, it does not necessarily follow that those stamps have to be affixed in the Dominican Republic and in front of an agent of the Dominican Republic. This is because the only purpose that the stamps can serve is to guarantee that those imported cigarettes that enter legally into the country and go through the proper customs procedures will carry authentic stamps as proof that the appropriate tax has been paid. The stamp requirement, in and of itself, would not prevent smuggling and tax evasion.⁷

15. Indeed, the Panel correctly found that the evidence submitted by the Dominican Republic – Exhibits DR-8 and DR-29 – indicated that smuggling and tax evasion may occur even in respect of products not subject to a stamp requirement, such as garlic. Therefore, the Panel questioned the contribution of the discriminatory enforcement of the tax stamp requirement to the prevention of smuggling.

16. The Dominican Republic also argued that it did not have any reasonable alternatives as it was necessary to have the stamp affixed in the presence of inspectors and it could not

⁵ Panel Report, para. 7.225.

⁶ Panel Report, paras. 4.68, 7.203 and 7.219.

⁷ Panel Report, para. 7.226.

afford to send its inspectors abroad to supervise foreign producers. Honduras argued that there were other less trade-restrictive alternatives available that would achieve the same ends, such as allowing pre-shipment inspections.

17. In its Appellant's Submission, the Dominican Republic claims that the Panel misinterpreted and misapplied the "necessity" test under Article XX(d) of the GATT 1994. Honduras notes that the Dominican Republic refers in its appeal to the same elements of the "necessity" test as those set out by the Panel in its Report. The Dominican Republic further asserts that "...the Panel improperly interpreted and applied the term "necessary" under Article XX(d) because it failed to examine fully all the factors relevant to determining whether a measure is "necessary" under Article XX(d), including weighing and balancing them as required by Article XX(d)."⁸ It appears, therefore, that the Dominican Republic's appeal is limited only to the alleged *misapplication* by the Panel of the "necessity" test.

18. Honduras submits that the Dominican Republic has not demonstrated that the Panel has misinterpreted or misapplied the "necessity" test under the GATT 1994. Moreover, Honduras submits that the Dominican Republic has not demonstrated that a "proper" legal analysis would have led the Panel to conclude that the requirement to affix a stamp in the territory of the Dominican Republic under the supervision of its inspectors is "necessary to secure compliance" with its laws and regulations. Honduras considers that the Dominican Republic has not demonstrated any legal errors in the Panel's findings and conclusions on Article XX(d). Rather, the Dominican Republic is seeking to re-argue the facts of the case and the conclusions that it considers should be drawn from the evidence it submitted to the Panel.

19. The Dominican Republic is claiming that the Panel made the following "legal errors":
- The Panel's analysis of alternative measures was in error because the Panel failed to analyse, weigh and balance the factors relevant to determine whether the alternative measures are reasonably available;⁹
 - The Panel erred in disregarding the other contributions the measure makes towards the prevention of tax evasion, forgery of tax stamps in cigarettes, and in particular reducing the volume of smuggled cigarettes and increasing the volume of cigarettes bearing authentic tax stamps;¹⁰
 - The Panel did not examine the contribution that the alternative measure would make to achieving the regulatory goals of the contested measure; nor did the Panel examine the consequences of implementation of the

⁸ Appellant's Submission of the Dominican Republic, para. 30.

⁹ Appellant's Submission of the Dominican Republic, para. 30.

¹⁰ Appellant's Submission of the Dominican Republic, para. 45.

measure for trade; nor did the Panel weigh these elements with its conclusion on the impugned measures;¹¹

- The Panel failed to examine whether it is "reasonable to expect" the Dominican Republic to cede control over the process of affixing tax stamps to foreign cigarette producers, possibly supervised by "reputable" private parties through pre-shipment inspection and certification in the place of the state's own officials;¹²
- The Panel failed to examine the contribution that the proposed alternative measure would make to achieving the elimination of the risk of smuggling through "zero tolerance";¹³
- The Panel erred in relying on the evidence of limited cigarette smuggling to conclude that the discriminatory aspects of the tax stamp requirement does not secure a zero tolerance of enforcement with regard to tax collection and the prevention of smuggling;¹⁴
- The Panel failed to consider the difficulties associated with implementation of the proposed alternative, *e.g.*, increase inspections of imports of cigarettes to attempt to prevent illicit supplies, with or without forged tax stamps;¹⁵ and,
- The Panel did not consider any possible trade impact of the alternative measure, or compare those impacts with the impact of the contested measure.¹⁶

20. Honduras submits to the Appellate Body that all the Dominican Republic's allegations cited above relate to the Panel's appreciation of facts or the weighing of the evidence. Although the Dominican Republic has alleged that the Panel's approach constitutes a legal error in its "interpretation" of the term "necessary" in Article XX(d), it is, in essence, asking the Appellate Body to make a re-examination of the features of the measure at issue or the alternative measures and to make factual findings thereon.

¹¹ Appellant's Submission of the Dominican Republic, para. 52.

¹² Appellant's Submission of the Dominican Republic, para. 54.

¹³ Appellant's Submission of the Dominican Republic, para. 55.

¹⁴ Appellant's Submission of the Dominican Republic, para. 62.

¹⁵ Appellant's Submission of the Dominican Republic, para. 65.

¹⁶ Appellant's Submission of the Dominican Republic, para. 67.

B. THE DOMINICAN REPUBLIC IS SEEKING TO INTRODUCE NEW FACTUAL ELEMENTS TO BE CONSIDERED ON APPEAL FOR THE REVERSAL OF CERTAIN PANEL FINDINGS.

1. The Dominican Republic is introducing the protection of human health as an objective to be secured by the discriminatory aspects of the tax stamp.

21. In its Appellant's Submission, the Dominican Republic asserts that "[b]y preventing tax evasion, smuggling, and forgery of tax stamps with respect to cigarettes, the Dominican Republic's tax stamp requirement *also has the consequence of protecting the health of its citizens, which is a vital interest for any Member*".¹⁷ In *EC – Asbestos* – a dispute actually argued under Article XX(b) – the Appellate Body stated that "the preservation of human life and health through the elimination, or reduction, of the well-known, and life-threatening, health risks posed by asbestos fibres" was a "value pursued [that] is both vital and important in the highest degree."¹⁸ The Dominican Republic quoted this dictum in its Appellant's Submission in support of its assertion that the tax stamp requirement has the effect of protecting human health. However, the Dominican Republic has not demonstrated *why* the discriminatory enforcement of its tax stamp requirement protects human health.

22. Acceptance of the Dominican Republic's arguments regarding the role played by tax stamps in the protection of human health requires several leaps of logic, for which no credible factual support can be found in the Panel record or in the Panel Report. It should be noted that the Dominican Republic has not invoked Article XX(b) at the Panel stage. For these reasons, the Panel made *no* factual findings on whether the discriminatory enforcement of the tax stamp requirement protects the health of the citizens of the Dominican Republic. Therefore, the Appellate Body has no factual basis on which to make a finding with respect to the protection of human health alleged by the Dominican Republic. In this regard, it is not clear if the Dominican Republic is seeking to make a claim under *Article XX(b)* – which of course, it would obviously not be able to do at this stage. In the light of the foregoing, the Appellate Body should give no credence to the Dominican Republic's belated and tenuous arguments related to the protection of human health, and disregard its submissions thereto for its appeal under Article XX(d).

2. The Dominican Republic is introducing new factual elements with respect to the alleged collusion of cigarette producers in smuggling operations.

23. In its Appellant's Submission, the Dominican Republic points to the supposed "active collusion" of cigarette producers in smuggling.¹⁹ This is the first time that the Dominican Republic has made this allegation as a basis for its argument that it cannot avail itself of the alternative of providing tax stamps to importers to allow them to affix the stamps at the point of production abroad. It makes the allegation of producer collusion in smuggling in

¹⁷ Appellant's Submission of the Dominican Republic, para. 39. (Emphasis added.)

¹⁸ Appellate Body Report, *EC – Asbestos*, para. 172.

¹⁹ Appellant's Submission of the Dominican Republic, para. 43.

paragraphs 3, 4, 9 14 and 56 of its Appellant's Submission. However, it never made such allegations in any of its submissions or replies to questions before the Panel. For the purposes of WTO dispute settlement, the Panel made no factual findings regarding alleged collusive criminal behaviour by BAT, or any other importer.

24. As a threshold matter, in order for the Appellate Body to accept the Dominican Republic's argument that it cannot provide the tax stamps to importers for this reason, it would have to acknowledge that cigarette producers, including British American Tobacco ("BAT"), "collaborate in smuggling". The Appellate Body cannot reach such a factual determination on its own, as there is no undisputed record on which it could rely in doing so.

25. The Dominican Republic's assertion of the alleged collusion by BAT is an extremely serious accusation. Essentially, the Dominican Republic has accused BAT – a reputable international corporation – of engaging in criminal behaviour. The Dominican Republic expands on this accusation later in the submission, when it claims that BAT was "heavily involved in orchestrating, managing, and controlling cigarette smuggling" as part of a "conspiracy".²⁰ To the knowledge of Honduras, this marks the first time in a WTO dispute settlement proceeding that a WTO Member has accused a specific, named company of criminal behaviour.

26. Indeed, the sole "evidence" that the Dominican Republic offers for this very serious and unsubstantiated claim is a supplementary memorandum submitted by ASH (Action on Smoking and Health), "a campaigning public health charity working for a comprehensive societal response to tobacco aimed at achieving a sharp reduction and eventual elimination of the health problems caused by tobacco,"²¹ to a Select Committee on Health of the House of Commons of the UK Parliament. The Dominican Republic states that "[a] United Kingdom House of Commons Select Committee concluded that, among other producers, BAT – the primary exporter of cigarette [*sic*] to the Dominican Republic in Honduras – has actively participated and colluded in smuggling cigarettes in Asia and Latin America".²²

27. Honduras has several comments to make on this serious and unsubstantiated allegation by the Dominican Republic. First, Exhibit DR-15 does not appear to indicate anywhere that the Select Committee of the United Kingdom Parliament made *any* conclusions that BAT has engaged in collusive smuggling behaviour. The Exhibit contains only a supplementary memorandum submitted *by ASH to the Select Committee* which was then included in the Minutes of Evidence. The Exhibit does not contain any conclusions by the Select Committee. Second, even if one were to accept the report by the public health charity at face value – *quod non* – the report makes no specific mention of any supposed

²⁰ Appellant's Submission of the Dominican Republic, para. 56.

²¹ <http://www.ash.org.uk>, last visited 14 February 2005.

²² Appellant's Submission of the Dominican Republic, para. 56.

smuggling by BAT in the Dominican Republic. In its Submission, the Dominican Republic merely extrapolates from the memorandum submitted by ASH, the public health charity, concerning unsubstantiated allegations of BAT executive involvement in smuggling in other countries such as Colombia and Singapore to draw the conclusion that BAT is involved in smuggling in the Dominican Republic.

28. Therefore, the main basis for the Dominican Republic's assertion that it cannot provide the tax stamps to BAT to affix abroad at the point of production is based on the incorrect conclusions it draws from the Supplementary Memorandum submitted by ASH, the public health charity to the Select Committee of the U.K. House of Commons, namely that BAT is involved in cigarette smuggling itself. As its basis for making such an assertion is unfounded, then the Dominican Republic does not have any legitimate grounds to refuse to provide the tax stamps to the Honduran importer so that the tax stamps may be affixed abroad. As the Panel noted, such an alternative had been proposed by Honduras in conjunction with the use of the services of a pre-shipment inspection company.

29. Therefore, in the light of the foregoing, the Appellate Body should disregard all of the Dominican Republic's statements about alleged criminal behaviour by BAT.

C. THE PANEL APPLIED THE CORRECT TESTS TO DETERMINE WHETHER THE DISCRIMINATORY ENFORCEMENT OF THE TAX STAMP REQUIREMENT IS "NECESSARY" WITHIN THE MEANING OF ARTICLE XX(D) OF THE GATT 1994.

1. The Panel's test to determine whether the discriminatory enforcement of the tax stamp is "necessary"

30. In *Korea – Various Measures on Beef*, the Appellate Body made clear the requirements that must be met for the successful invocation of Article XX(d):

For a measure, otherwise inconsistent with GATT 1994, to be justified provisionally under paragraph (d) of Article XX, two elements must be shown. First, the measure must be one designed to "secure compliance" with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994. Second, the measure must be "necessary" to secure such compliance. A Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met.²³

31. In the light of this Appellate Body's statement, the Panel therefore recognised that the party invoking Article XX(d), the Dominican Republic bore the burden of proof of demonstrating both (i) that the requirement to affix stamps on cigarettes in the territory of the Dominican Republic under the supervision of its inspectors "secures compliance" with its

²³ Appellate Body Report, *Korea – Various Measures on Beef*, para. 157.

WTO-consistent laws or regulations, and (ii) that the stamp tax is "necessary" to secure such compliance.

32. The Dominican Republic claimed that the "tax stamp secures compliance with the tax laws generally, and more specifically with the provisions governing the Selective Consumption Tax".²⁴ As noted above, the Panel "preliminarily assume[d] that the tax laws or regulations, which would be enforced through the tax stamp requirement, are not inconsistent with the provisions of the GATT".²⁵ However, the Panel did not make a definitive finding in this regard. The Panel focussed its analysis on "whether the tax stamp requirement is necessary to secure compliance with the Dominican Republic's tax laws and to prevent the smuggling of cigarettes."²⁶

33. The Panel cited the Appellate Body's statements in *Korea – Various Measures on Beef* setting out the test to be applied in examining whether a measure is "necessary" within the meaning of Article XX(d) and stated that:

"We believe that, as used in the context of Article XX(d), the reach of the word 'necessary' is not limited to that which is 'indispensable' or 'of absolute necessity' or 'inevitable'. Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfil the requirements of Article XX(d). But other measures, too, may fall within the ambit of this exception. As used in Article XX(d), the term "necessary" refers, in our view, to a range of degrees of necessity. At one end of this continuum lies "necessary" understood as "indispensable"; at the other end, is "necessary" taken to mean as "making a contribution to". We consider that a "necessary" measure is, in this continuum, located significantly closer to the pole of "indispensable" than to the opposite pole of simply "making a contribution to".*²⁷ (*footnote omitted.)

34. The Panel therefore even-handedly referred to the two poles set out by the Appellate Body. The Panel stated, "[o]n the one hand, the Appellate Body has clarified that in order to be considered as "necessary" to secure compliance, a measure does not need to be "indispensable". On the other hand, it should not just be simply "making a contribution to".²⁸ In its Appellant's Submission, however, the Dominican Republic has only referred to the Panel's reference to the pole of "indispensable" as if that were the Panel's entire position.

²⁴ Panel Report, para.7.210.

²⁵ Panel Report, para. 7.211.

²⁶ Panel Report, para. 7.215.

²⁷ Panel Report, para. 7.213 citing, Appellate Body Report, *Korea – Various Measures on Beef*, para. 161. (Emphasis added.)

²⁸ Panel Report, para. 7.213.

35. The Panel further noted that the Appellate Body in *Korea – Various Measures on Beef* had set out additional elements to be considered in determining whether a measure is "necessary" under Article XX(d):

"In appraising the 'necessity' of a measure ..., it is useful to bear in mind the context in which "necessary" is found in Article XX(d). The measure at stake has to be "necessary to ensure compliance with laws and regulations ... , *including* those relating to customs enforcement, the enforcement of [lawful] monopolies ... , the protection of patents, trade marks and copyrights, and the prevention of deceptive practices". (emphasis added) Clearly, Article XX(d) is susceptible of application in respect of a wide variety of "laws and regulations" to be enforced. It seems to us that a treaty interpreter assessing a measure claimed to be necessary to secure compliance of a WTO-consistent law or regulation may, in appropriate cases, take into account the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect. The more vital or important those common interests or values are, the easier it would be to accept as "necessary" a measure designed as an enforcement instrument. ... There are other aspects of the enforcement measure to be considered in evaluating that measure as 'necessary'. One is the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue. The greater the contribution, the more easily a measure might be considered to be 'necessary'. Another aspect is the extent to which the compliance measure produces restrictive effects on international commerce, that is, in respect of a measure inconsistent with Article III:4, restrictive effects on imported goods. A measure with a relatively slight impact upon imported products might more easily be considered as 'necessary' than a measure with intense or broader restrictive effects ...²⁹

36. In accordance with the Appellate Body's statements in *Korea – Various Measures on Beef*, the Panel considered three relevant factors in determining whether the discriminatory enforcement of the tax stamp requirement (namely, to affix it on cigarettes in the territory of the Dominican Republic under the supervision of its inspectors) is "necessary" to secure compliance with a WTO-consistent law or regulation within the meaning of Article XX(d), namely:

²⁹ Panel Report, para. 7.214, citing Appellate Body Report, *Korea – Various Measures on Beef*, paras. 162-164.

- the relative importance of the common interests or values that the underlying law or regulation to be enforced is intended to protect;
- the extent to which the stamp tax requirement contributes to securing compliance with the underlying law or regulation at issue; and
- the extent to which the stamp tax requirement produces restrictive effects on international commerce, *i.e.*, restrictive effects on imported goods.

37. In its Appellant's Submission, the Dominican Republic asserts that "the Panel improperly interpreted and applied the term 'necessary' because it failed to examine fully all the factors relevant to determining whether a measure is 'necessary' under Article XX:(d)..."³⁰ However, as will be shown below, it is clear that the Panel properly set out and applied the appropriate factors in its assessment of the measure under Article XX(d).

2. The Panel examined the relative importance of the interest served by the measure at issue.

38. The Panel found "...no reason to question the Dominican Republic's assertions in the sense that the collection of tax revenue (and, conversely, the prevention of tax evasion) is a most important interest for any country and particularly for a developing country such as the Dominican Republic."³¹ Thus the Panel conducted an appropriate examination of this factor and agreed with the Dominican Republic that tax collection was an important interest to protect.

39. However, even though the Panel agreed with the Dominican Republic's contention on this point, the Dominican Republic now argues that:

...its tax stamp requirement not only ensures the collection of tax revenue by preventing the deceptive practices of tax evasion, smuggling, and forgery of tax stamps related to cigarettes but also helps ensure the health and well-being of its citizens, both of which are interests of fundamental and critical importance. Consequently, in the overall weighing and balancing, it is "easier" to accept the tax stamp requirement as a "necessary" enforcement instrument because of the value and importance of the interests it protects. The Panel, however, did not properly consider this circumstance as part of the weighing and balancing of all of the relevant factors."³²

40. The Dominican Republic is therefore now criticising the Panel for not taking into consideration the health and well-being of its citizens, which are interests of fundamental and

³⁰ Appellant's Submission of the Dominican Republic, para. 30.

³¹ Panel Report, para. 7.215.

³² Appellant's Submission of the Dominican Republic, para. 40.

critical importance. However, the Dominican Republic never made *any* arguments before the Panel that the discriminatory enforcement of the tax stamp requirement was intended to protect the health of its citizens. It provided Exhibit DR-14 by the World Conference on Tobacco or Health to demonstrate that "[s]mugglers tend to thrive in countries that tolerate smuggling where enforcement is lax and corruption is widespread."³³ The Dominican Republic provided Exhibit DR-15 in order to demonstrate that "Caribbean countries such as Aruba, have been used as illegal distribution channels for cigarettes"³⁴...whereas the Dominican Republic has chosen a level of enforcement that ensures its tax authorities can adequately monitor the affixation of stamps to prevent tax evasion and minimise the risk that the Dominican Republic will be used as an illegal distribution channel for cigarettes, as has been the case in other Caribbean countries."³⁵ The thrust of the Dominican Republic's arguments was that the discriminatory enforcement of the tax stamp requirement was necessary to prevent tax evasion and smuggling.

41. While Honduras agrees that the collection of taxes is an important objective for any country, and especially a developing country, it submits that it is not on par with, for example, the protection of human life and health. Therefore, this objective, which is essentially fiscal in nature, needs to be kept in perspective. As the Panel stated in *Canada – Wheat Exports and Grain Imports*:

With respect to the importance of the interests or values that the statutory and other provisions with which, according to Canada, Section 57(c) secures compliance are intended to protect, Canada has indicated that those objectives are to ensure the quality of Canadian grain, maintain the integrity of the Canadian grading system, protect consumers against misrepresentation and preserve and enforce the CWB monopoly. ... It is clear that these interests, which appear to be essentially commercial in nature, are important. It seems equally clear, however, that these interests are not as important as, for instance, the protection of human life and health against a life threatening health risk, an interest which the Appellate Body in *EC – Asbestos* characterized as "vital and important in the highest degree."³⁶

42. Accordingly, to paraphrase the jurisprudence, human life and health are not at issue in the present dispute, and it should be more difficult to accept as "necessary" a measure – the stamp tax – which is designed as an enforcement instrument only for the collection of tax revenue.

³³ First Written Submission of the Dominican Republic, para. 105.

³⁴ First Written Submission of the Dominican Republic, para. 105.

³⁵ First Written Submission of the Dominican Republic, para. 117.

³⁶ Panel Report, *Canada – Wheat Exports and Grain Imports*, para. 6.224.

43. As the Dominican Republic has introduced the element of the importance of protection of human health only at the Appellate stage, it does not have any grounds to fault the Panel for not taking into account the fundamental importance of this "vital and important interest."

44. It appears that the Dominican Republic is assessing the tax stamp requirement not only in terms of the laws and regulations with which it secures compliance with, but also with the "objectives" of those laws and regulations. This approach is in contrast with the approach set out by the GATT Panel in *EEC – Parts and Components*, which examined the scope of the terms "to secure compliance" and found that:

[Article XX(d)] does not refer to objectives of laws or regulations but only to laws or regulations. This suggests that Article XX(d) merely covers measures to secure compliance with laws and regulations as such and not with their objectives.

...

The Panel then examined the alternative interpretations in the light of the purpose of Article XX(d) and found the following. If the qualification "to secure compliance with laws and regulations" is interpreted to mean "to enforce obligations under laws and regulations", the main function of Article XX(d) would be to permit contracting parties to act inconsistently with the General Agreement whenever such inconsistency is necessary to ensure that the obligations which the contracting parties may impose consistently with the General Agreement under their laws or regulations are effectively enforced. If the qualification "to secure compliance with laws and regulations" is interpreted to mean "to ensure the attainment of the objectives of the laws and regulations", the function of Article XX(d) would be substantially broader. Whenever the objective of a law consistent with the General Agreement cannot be attained by enforcing the obligations under that law, the imposition of further obligations inconsistent with the General Agreement could then be justified under Article XX(d) on the grounds that this secures compliance with the objectives of that law. This cannot, in the view of the Panel, be the purpose of Article XX(d): ...³⁷

45. Therefore, in the light of the foregoing test, the Dominican Republic appears to argue that the requirement to affix the stamp on cigarettes in its territory and in the presence of its inspectors is necessary because it furthers the objectives of its laws. In Honduras's view, however, what must be demonstrated is that the measure is necessary for compliance with the laws themselves.

³⁷ GATT Panel Report, *EEC – Parts and Components*, paras. 5.16-5.17.

3. The Panel examined the extent to which the tax stamp requirement contributes to securing compliance with the tax laws and regulations.

46. The Panel found that the Dominican Republic had not proven that the discriminatory enforcement of the stamp requirement facilitates the prevention of tax forgery or smuggling and tax evasion. Even with discriminatory enforcement, the Dominican Republic has still experienced the smuggling of cigarettes.

47. Furthermore, Honduras notes that the Dominican Republic did not provide the text of any laws against smuggling with which the discriminatory enforcement of the tax stamp requirement would secure compliance. The prevention of smuggling is an "objective" of the tax laws, not a law cited by the Dominican Republic in and of itself. As the Panel in *United States – Section 337* made clear, the measure at issue must be "necessary" to secure compliance with its laws and regulations as such, and not "to ensure the attainment of the objectives" of those laws and regulations.³⁸ It appears that the Dominican Republic is seeking to use its tax stamp requirement to achieve the attainment of the objective of eradicating smuggling when in fact the only purpose of this requirement is to secure the collection of taxes.

48. In addition, according to the evidence submitted by the Dominican Republic in Exhibit DR-29 and taken into consideration by the Panel, smuggling of products for which a tax stamp is not required at all also occurs. This was the case of the 120 bags of garlic that were smuggled in July 2002. In the light of this evidence submitted by the Dominican Republic, the Panel found that:

- smuggling occurs of products for which the tax stamp must be affixed in the territory of the Dominican Republic, such as cigarettes;
- smuggling occurs of products for which the tax stamp can be affixed outside of the territory of the Dominican Republic, such as alcoholic beverages; and
- smuggling occurs of products for which there is no requirement for a tax stamp, such as garlic.

49. Therefore, in the light of the fact that smuggling occurs in all situations – whether a tax stamp is required for that product or not, or whether the tax stamp must be affixed within the territory of the Dominican Republic or not – the Panel correctly considered that the Dominican Republic had not made demonstrate that the discriminatory enforcement of the tax stamp requirement makes a contribution to the prevention of smuggling.

³⁸ GATT Panel Report, *EEC – Parts and Components*, para. 5.17.

4. The Panel examined whether the tax stamp requirement has had restrictive effects on international commerce.

50. The Dominican Republic refers to the Appellate Body's statement that the "[a] measure with a relatively slight impact upon imported products might more easily be considered as necessary than a measure with intense or broader restrictive effects"³⁹ and concludes that the Dominican Republic's tax stamp requirement has had "little to no impact on Honduras's ability to export cigarettes to the Dominican Republic" as "imports by BAT into the Dominican Republic have substantially increased over the past year."⁴⁰

51. The Panel stated that:

although it has already found that the tax stamp requirement modifies the conditions of competition in the marketplace to the detriment of imported cigarettes, Honduras has still been able to export cigarettes to the Dominican Republic and, in fact, its exports have increased quite significantly over the last few years. So the Panel *may assume* that the measure has not had any intense restrictive effects on trade.⁴¹

52. The Panel did not make a specific finding on this point. However, the very fact that the Panel went on to examine whether there were "less-trade restrictive" options available to the Dominican Republic implies the Panel did consider the stamp tax requirement to be trade restrictive.

53. Honduras notes that the Dominican Republic's approach to what constitutes "restrictive effects on international commerce" is flawed. This phrase cannot be used as a test to assess whether levels of imports have increased despite the imposition of the compliance measure. As Honduras has explained in its Other Appellant's Submission, such a "market reaction" approach would result in the unprecedented consequence that "the consistency of a challenged measure would depend on the market's reaction to it and consequently on factors that normally escape the control of WTO Members rather than the features of the measure itself".⁴² The "restrictive effects" referred to by the Appellate Body in *Korea – Various Measures on Beef* must be viewed as meaning the effects on the conditions of competition of the imported product, rather than the restrictive effects on the trade flows of imported products. This interpretation is supported by the following sentence: "[a] measure with a relatively slight impact upon imported products might more easily be considered as 'necessary' than a measure with intense or broader restrictive effects."⁴³ Therefore, the wording used to describe the effects on imported products in terms of *intense*

³⁹ Appellate Body Report, *Korea – Various Measures on Beef*, para. 163.

⁴⁰ Appellant's Submission of the Dominican Republic, paras. 34 and 35.

⁴¹ Panel Report, para. 7.215. (Emphasis added.)

⁴² Other Appellant's Submission of Honduras, para. 34.

⁴³ Appellate Body Report, *Korea – Various Measures on Beef*, para. 163.

or *broader* – rather than greater or lesser - restrictive effects on imported products suggests that a "qualitative" rather than a mere quantitative approach must be employed. A quantitative approach to this assessment of restrictive effects would undermine the basic principles of the WTO dispute settlement system, namely that the WTO-consistency of a measure cannot depend on the demonstration of the adverse trade effects that flow from that measure.

54. Therefore, the figures cited by the Dominican Republic with respect to the 4800% increase in imports (with which Honduras does not agree) are irrelevant to the issue of the WTO-consistency of the tax stamp requirement.

5. The Panel conducted an appropriate weighing and balancing of the relevant factors to ascertain their merits

55. The Dominican Republic argues that "[t]he panel, therefore, in the overall analysis must take into account the relative importance of each factor in light of the strengths or weaknesses of the others."⁴⁴ However, the Panel did conduct a "weighing and balancing" of the relative importance of the three relevant factors. This "weighing and balancing" is demonstrated by the fact that the Panel found in favour of the Dominican Republic with respect to both the common interest of the tax collection and the "minimal" trade restrictive effects that the measure had, but found in favour of the Honduras's argument that the tax stamp requirement did not contribute to the prevention of smuggling and tax evasion and forgery of tax stamps. Given the fact that the Panel found different elements to be in favour of different parties, it clearly conducted a weighing and balancing of these factors to arrive at its final conclusion.

56. The Dominican Republic has not presented any credible arguments to demonstrate how the Panel did not correctly weigh and balance the relevant factors.

6. The Panel correctly identified alternative, less-trade restrictive measures that would secure compliance with the laws and regulations of the Dominican Republic.

57. The Appellate Body in *Korea – Various Measures on Beef* cited the GATT Panel in *US – Section 337* as describing the applicable standard for the evaluation of a measure under Article XX(d):

It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as "necessary" in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is

⁴⁴ Appellant's Submission of the Dominican Republic, para. 32.

not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions.⁴⁵

58. The Appellate Body added that "the weighing and balancing process we have outlined is comprehended in the determination of whether a WTO-consistent alternative measure which the Member concerned could 'reasonably be expected to employ' is available, or whether a less WTO-inconsistent measure is 'reasonably available'".⁴⁶

59. The Dominican Republic alleges that the Panel did not "examine or weigh the proposed alternative measure in terms of the relevant factors set forth by the panel in *Canada – Wheat Exports and Grain Imports* and by the Appellate Body in *Korea – Beef and EC – Asbestos*."⁴⁷ However, the Panel made it clear that it employed the test set out in *US – Section 337* in order to assess whether the Dominican Republic could use an alternative measure, which is less trade-restrictive but nevertheless achieves the same level of enforcement:

Even assuming that the Dominican Republic has chosen to pursue a zero tolerance level of enforcement with regard to tax collection and cigarette smuggling, it is the Panel's opinion that the Dominican Republic, as the party raising this particular defence, has not discharged its duty to prove why other, reasonably-available, less-GATT inconsistent, measures would not be able to achieve that same level of enforcement. More specifically, the Dominican Republic has not proved why, for example, providing secure tax stamps to foreign exporters, so that those tax stamps can be affixed on cigarette packets in the course of their own production process and prior to importation into the Dominican Republic, would not be equivalent to the current tax stamp requirement in terms of allowing it to secure the same high level of enforcement with regard to tax collection and the prevention of cigarette smuggling.⁴⁸

60. In its Appellant's Submission, the Dominican Republic points to two factors that, in its view, supports its position that the requirement to affix the stamp on cigarettes in its territory under the supervision of inspectors cannot be replaced with alternative measures because these alternative measures would not achieve the same level of securing compliance with its laws. First, it points to the supposed "active collusion" of cigarette producers in

⁴⁵Appellate Body Report, *Korea – Various Measures on Beef*, para. 165, citing GATT Panel Report, *US – Section 337*, para. 5.26.

⁴⁶Appellate Body Report, *Korea – Various Measures on Beef*, paras. 166.

⁴⁷Appellant's Submission of the Dominican Republic, para. 52.

⁴⁸Panel Report, para. 7.228.

smuggling.⁴⁹ Second, it asserts that there is "a much larger prevalence of tax evasion, smuggling and forgery of tax stamps with respect to alcohol than with respect to cigarettes [which must indicate] that the Dominican Republic's tax stamp requirement for cigarettes contributes significantly to the eradication of these deceptive practices."⁵⁰ Both these factors are unsubstantiated assertions, on which the Panel made no factual findings.

61. As discussed above, the first assertion, the alleged collusion by BAT, is an extremely serious accusation that is not substantiated by the evidence submitted by the Dominican Republic. The Dominican Republic never introduced this argument before the Panel. However, its sole argument for now claiming that it cannot employ the less-trade restrictive alternative of giving the stamps to the producers to affix abroad is that the cigarette producers are involved in the smuggling. This is a *ex-post facto* argument that cannot be taken into consideration by the Appellate Body.

62. In addition, and more to the point for the purposes of WTO dispute settlement, the Panel made no factual findings regarding collusive criminal behaviour by BAT, or any other importer. Nor can the Appellate Body reach such a factual determination on its own, as there is no undisputed record on which it could rely in doing so.

63. The second assertion put forward by the Dominican Republic to support its requirement that the tax stamp be affixed on cigarettes in its territory and under the supervision of its inspectors is the allegedly higher rate of smuggling for alcohol products, which are permitted to have tax stamps affixed abroad at the point of production. The Dominican Republic argues that:

... in the case of alcoholic beverages, there is evidence that tax evasion, smuggling and forgery of tax stamps is prevalent while in the case of cigarettes, there is little or no evidence of these deceptive practices ... As all else is equal between the Dominican Republic's tax stamp regime for cigarettes and alcoholic beverages, the mere fact that there is a much larger prevalence of tax evasion, smuggling and forgery of tax stamps with respect to alcohol than with respect to cigarettes, indicates that the Dominican Republic's tax stamp requirement for cigarettes contributes significantly to the eradication of these deceptive practices.⁵¹

64. The Dominican Republic has no factual basis to draw the conclusion that the tax stamp requirement contributes significantly to the eradication of these deceptive practices. First, the Dominican Republic has cited only two examples of smuggling of alcohol in Exhibit DR-8 (19 July 2001) and in Exhibit DR-29 (12-14 March 2002) as compared to one

⁴⁹ Appellant's Submission of the Dominican Republic, para. 43.

⁵⁰ Appellant's Submission of the Dominican Republic, para. 44.

⁵¹ Appellant's Submission of the Dominican Republic, para. 44.

example of smuggling of cigarettes (Exhibit DR-16). This hardly constitutes "a much larger prevalence of smuggling" for alcoholic beverages. The Dominican Republic has only asserted, but has not demonstrated, that the "tax stamp requirement contributes importantly to reducing the volume of smuggled cigarettes".⁵² It is not at all clear that it is the affixation of the stamp on cigarettes in the territory of the Dominican Republic that "causes" the fewer incidents of cigarette smuggling. The Panel was therefore correct when it asserted that there is "no supporting evidence in Exhibits DR-8 and DR-29 to the Dominican Republic's assertion that there is a causal link between allowing stamps to be affixed abroad and the forgery of tax stamps".

65. Contrary to the Dominican Republic's allegations, the Panel did examine the relevant factors in its assessment of whether there were less trade restrictive alternative measures that the Dominican Republic could have employed.

(a) *The Panel correctly found that allowing importers to affix the stamp abroad at the point of production would achieve the same level of enforcement as the existing measure.*

66. The Panel noted that:

the Dominican Republic has not proved why, for example, providing secure tax stamps to foreign exporters, so that those tax stamps can be affixed on cigarette packets in the course of their own production process and prior to importation into the Dominican Republic, would not be equivalent to the current tax stamp requirement in terms of allowing it to secure the same high level of enforcement with regard to tax collection and the prevention of cigarette smuggling.⁵³

67. Therefore, the Panel did examine whether the alternative measure would achieve the same level of enforcement sought by the Dominican Republic.

(b) *The Panel correctly found that allowing importers to affix the stamp abroad at the point of production under supervision of a pre-shipment company would present little difficulty to the Dominican Republic.*

68. The Panel also examined the difficulty of the implementation of the alternative measure and noted that, for example, a [reasonable] alternative would include ensuring that the tax stamps are duly affixed to cigarettes in the exporting country through the services of a reputable pre-shipment company, at the expense of the importer. Contrary to the allegations of the Dominican Republic, this alternative does not "impose" on the Dominican Republic the

⁵² Appellant's Submission of the Dominican Republic, para. 45.

⁵³ Panel Report, para.7.228.

obligation to employ the services of a pre-shipment company itself, as all costs would be borne by the importer. The Panel stated:

...Honduras proposed that the Dominican Republic could resort to pre-shipment inspection and certification, through a reputable company, at the expense of the importer, in order to ensure that the tax stamps of the Dominican Republic are duly affixed to cigarettes in the exporting country. Honduras has presented as Exhibit HOND-29 a letter of 26 April 2004 from the representative of an international inspection and certification company which refers to the availability of those services.⁵⁴

(c) *The Panel correctly found that allowing importers to affix the stamp abroad at the point of production would be less trade-restrictive than the current measure.*

69. The Panel also examined whether the alternative measure would be less trade-restrictive. It noted that:

The Panel recalls that, *as part of an alternative which would be less trade-restrictive*, Honduras proposed that the Dominican Republic could resort to pre-shipment inspection and certification, through a reputable company, at the expense of the importer, in order to ensure that the tax stamps of the Dominican Republic are duly affixed to cigarettes in the exporting country.⁵⁵ (Emphasis added.)

70. To allow the importers to affix the stamp abroad would mean that the cigarette packages would be visually more attractive as they would have the stamp affixed under the cellophane. In addition, the importers would not have to undergo additional steps to affix the stamp in the territory of the Dominican Republic.

71. The Dominican Republic has not demonstrated that the Panel erred in its application of the necessity test under Article XX(d), and therefore, the Appellate Body should uphold the analysis of the Panel.

III. IF THE APPELLATE BODY WERE TO REVERSE THE PANEL, THE APPELLATE BODY WOULD HAVE, IN ANY EVENT, TO FIND THAT THE DOMINICAN REPUBLIC DID NOT DEMONSTRATE THAT THE MEASURE AT ISSUE MEETS THE REQUIREMENTS OF THE CHAPEAU OF ARTICLE XX.

72. The Panel concluded that it did not need to assess the application of the stamp requirement under the *chapeau* of Article XX:

⁵⁴ Panel Report, para.7.228.

⁵⁵ Panel Report, para.7.228.

[i]n light of the preceding considerations, and since the tax stamp requirement has not been found to be a "necessary" measure to secure compliance with the Dominican Republic's tax laws and regulations, the Panel does not need to analyze the elements contained in the *chapeau* of Article XX of the GATT 1994, i.e. whether the different treatment constitutes a means of "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", or a "disguised restriction on international trade".⁵⁶

73. If the Appellate Body were to reverse the Panel and find that the Dominican Republic's tax stamp requirement were "necessary" to secure compliance with its tax laws and regulations, and therefore was provisionally justified under Article XX(d), it would then need to carry out an examination of the requirements contained in the *chapeau*.

74. According to the Appellate Body, an examination of the *chapeau* requires an analysis of the following standards:

There are three standards contained in the *chapeau*: first, arbitrary discrimination between countries where the same conditions prevail; second, unjustifiable discrimination between countries where the same conditions prevail; and third, a disguised restriction on international trade.⁵⁷

75. It must be recalled that Article XX of the GATT requires that the examination of a measure under the *chapeau* must assess the *application* of the measure and not the measure *as such*. The Appellate Body has confirmed this interpretation in *US – Gasoline*, where it stated the following:

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. ...⁵⁸

76. Therefore, an Appellate Body's examination of whether the Dominican Republic's stamp requirement meets the standards provided for under the Article XX *chapeau* would have to be based on the stamp requirement *as applied* by the Dominican Republic's authorities and not on whether the requirement *as such* meets those standards.

77. The burden of proof is on the Dominican Republic to demonstrate that its tax stamp requirement does not, in its application, constitute abuse of the exception under the *chapeau*. In *US – Gasoline*, the Appellate Body made it clear that:

⁵⁶ Panel Report, para. 7.231.

⁵⁷ Panel Report, *US – Shrimp*, para. 150.

⁵⁸ Appellate Body Report, *US – Gasoline*, p. 22.

[t]he 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. ...⁵⁹

78. The Dominican Republic did not discharge this burden of proof at the Panel level nor has it done so before the Appellate Body. The Dominican Republic merely asserted in its First Written Submission before the Panel that the stamp requirement " ... is not applied in a manner that constitutes either arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade".⁶⁰ It repeated this assertion in its Second Written Submission stating that:

... there is no evidence that the Dominican Republic applies its stamp requirement to Honduras any differently than to other countries where the same conditions prevail – *i.e.*, the Dominican Republic is consistent in its application of the stamp requirement across all countries. Therefore, there is no discrimination of any kind for the purposes of the chapeau of Article XX, let alone arbitrary or unjustifiable discrimination, or disguised restrictions on international trade.⁶¹

79. In contrast, Honduras consistently argued throughout the panel proceedings that these assertions were unsubstantiated.

80. Therefore, Honduras is of the view that even if the stamp requirement were to be provisionally justified by the Panel, the Dominican Republic, as the party invoking Article XX(d), still bore the burden of proving that the application of that requirement complied with the provisions of the *chapeau*. In the view of Honduras, given the fact that the Dominican Republic did not submit any evidence to discharge its burden and the fact that the Panel found that the measure at issue was not provisionally justified under Article XX(d), the Panel did not make any factual findings – not even *arguendo* – on whether the application of the tax stamp requirement constituted unjustifiable or arbitrary discrimination or a disguised restriction on international trade.

81. In this context, Honduras recalls the Appellate Body's statements in *EC – Asbestos* with respect to the task of completing the analysis:

... In previous appeals, we have, on occasion, completed the legal analysis with a view to facilitating the prompt settlement of the dispute, pursuant to Article 3.3 of the DSU.* However, we have insisted that we can do so only if the factual findings

⁵⁹ Appellate Body Report, *US – Gasoline*, p. 22.

⁶⁰ First Written Submission of the Dominican Republic, para. 140.

⁶¹ Second Written Submission of the Dominican Republic, para. 64.

of the panel and the undisputed facts in the panel record provide us with a sufficient basis for our own analysis. If that has not been the case, we have not completed the analysis.*⁶²
(* footnotes omitted.)

82. In accordance with this approach, in *Korea – Dairy Safeguard*, the Appellate Body refused to complete the analysis because of the lack of factual support in the panel findings or in the panel record:

In the absence of any factual findings by the Panel or undisputed facts in the Panel record relating to whether the alleged increase in imports was, indeed, "a result of unforeseen developments and of the effect of the obligations incurred by a Member under this Agreement, including tariff concessions ...", we are not in a position, within the scope of our mandate set forth in Article 17 of the DSU, to complete the analysis and make a determination as to whether Korea acted inconsistently with its obligations under Article XIX:1(a). Accordingly, we are unable to come to a conclusion on whether or not Korea violated its obligations under Article XIX:1(a) of the GATT 1994.⁶³

83. In this case, even if the Dominican Republic's stamp requirement were provisionally justified under Article XX(d) of the GATT, given the failure of the Dominican Republic to discharge its burden of proof, the lack of factual findings by the panel regarding the application of the stamp requirement, and, as will be shown below, the disputed facts between the parties as to whether the measure at issue was applied in an unjustifiably or arbitrarily discriminatory manner, Honduras considers that the completion of the analysis under the *chapeau*, as requested by the Dominican Republic, is not legally possible.

IV. IF THE APPELLATE BODY WERE NEVERTHELESS TO COMPLETE THE ANALYSIS UNDER THE CHAPEAU, IT SHOULD FIND THAT STAMP TAX REQUIREMENT IS APPLIED IN A MANNER THAT CONSTITUTES UNJUSTIFIABLE OR ARBITRARY DISCRIMINATION BETWEEN COUNTRIES WHERE THE SAME CONDITIONS PREVAIL.

84. As noted above, the Dominican Republic did not demonstrate before the Panel that the stamp requirement is not applied in a manner that constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail. In its Appellant's Submission, the Dominican Republic cites the legislation establishing the tax stamp requirement and states: "Article 37 of Decree No. 79-03 and Articles 1 and 2 of Decree 130-02 clearly stipulate the manner in which the tax stamp requirement is to be applied. However, there is no evidence that the DGII has ever applied the tax stamp in a manner

⁶² Appellate Body Report, *EC – Asbestos*, paras. 78.

⁶³ Appellate Body Report, *Korea – Dairy Safeguard*, para. 92.

contrary to the prescriptions of these Decrees." ⁶⁴ To the contrary, even though Honduras did not bear the burden of proof on this matter, based on the evidence submitted by the Dominican Republic in Exhibit DR-3, Honduras presented arguments demonstrating that the stamp tax requirement *is applied* in a manner inconsistently with the chapeau.⁶⁵

85. Honduras submitted that the stamp requirement is applied in a manner constituting arbitrary and unjustifiable discrimination because domestic producers, such as the company listed in Exhibit DR-3 (Grupo León Jiménez), are *in practice* allowed to pay the cost of the tax stamp as an advance payment of the Selective Consumption Tax.⁶⁶ In contrast, importers are subjected to the strict application of Paragraph III of Article 37 of the Regulations for the Application of Title IV of the Tax Code and therefore have to pay the cost of the tax stamp in addition to the payment of the Selective Consumption Tax.⁶⁷

86. As submitted to the Panel⁶⁸, the receipt indicated in item 9 of Exhibit DR-3 (RP-01) indicates that the amount paid for the stamps by the domestic producer concerned is credited as payment for the "[Impuesto] selectivo cigarillos que conte...".

87. In addition, the note to item 8 of Exhibit DR-3, states:

Al momento del pago se debe procurar que el concepto del RP-01 (Recibo de pago de impuesto) sea el # 30-BIS "Avance Selectivo Tabaco y Cigarillo". No puede ser # 99 "Pago Estampillas de Alcohol"

88. Furthermore, the note to item 11 of Exhibit DR-3, states:

El *Monto avance* del ISC por cada estampilla ... (Italics supplied).

89. On the other hand, when an importer pays for tax stamps the receipt issued indicates:

[Impuesto] adicional sobre cigarillos. (Exhibit HOND – 32)

90. To summarise, for domestic cigarettes, the effective cost of tax stamps is zero because it is credited as part of the payment for the Selective Consumption Tax. For imported cigarettes, however, the cost of the stamps must be paid in addition to the Selective Consumption Tax.

⁶⁴ Appellant's Submission of the Dominican Republic, para. 110.

⁶⁵ Second Written Submission of Honduras, paras. 62-72.

⁶⁶ Exhibit DR-3.

⁶⁷ Exhibit HOND-4 and Exhibit HOND-32.

⁶⁸ Second Written Submission of Honduras, paras. 63-66.

91. In its First Written Submission before the Panel, the Dominican Republic defined "arbitrary" as "dependent on will or pleasure; dependent on the decision of a legally recognized authority; discretionary" or "based on mere opinion or preference as opposed to the real nature of things; capricious, unpredictable, inconsistent".⁶⁹ As submitted before the Panel,⁷⁰ Honduras notes that there is no provision either in the Tax Code or in the Regulations for the Application of Title IV of the Tax Code which would authorise domestic producers to deduct the cost of the "measure to secure compliance with" the Selective Consumption from the Selective Consumption Tax. Thus, Honduras submits that such discriminatory treatment in the application of the stamp requirement *depends on the will* of the Dominican Republic's tax authorities, and therefore, it is "arbitrary" according to the Dominican Republic's own definition submitted to the Panel.

92. This discriminatory application of the tax stamp is also "unjustifiable" as there is no valid reason for such less favourable treatment to be accorded to imported cigarettes.

93. The Dominican Republic suggested that in WTO jurisprudence, "unjustifiable discrimination means discrimination that is not unavoidable or discrimination that is coercive." It added that:

... in *Argentina – Hides and Leather*, in particular, the Panel equated the *question of whether discrimination is justifiable with the question of whether it is unavoidable*. The Panel in that case found the application of the measures in question was not justifiable because the *extra tax burden imposed on importers as a result of those measures was not unavoidable* (emphasis added.)⁷¹

94. In this case, applying the Dominican Republic's own definition of "unjustifiable discrimination", by allowing domestic producers to deduct the cost of the stamps from their payment of the Selective Consumption Tax, and not allowing this option to importers, the Dominican Republic imposes an extra tax burden on importers. This extra tax burden would be avoidable if either domestic producers were not allowed to deduct the cost of the stamp or if importers were given the option to so deduct.

95. Therefore, the manner in which the measure at issue is applied by the Dominican Republic constitutes a means of arbitrary or unjustifiable discrimination.

⁶⁹ First Written Submission of the Dominican Republic, para. 126.

⁷⁰ Second Written Submission of Honduras, para. 78.

⁷¹ First Written Submission of the Dominican Republic para. 32 citing Panel Report, *Argentina – Hides and Leather*, paras. 11.324-11.325, 11.330.

V. THE PANEL MADE AN OBJECTIVE ASSESSEMENT OF THE EVIDENCE SUBMITTED CONCERNING THE TAX STAMP REQUIREMENT IN ACCORDANCE WITH ARTICLE 11 OF THE DSU.

96. The Dominican Republic is alleging that the Panel "exceeded the bounds of its discretion in its appreciation of the evidence submitted by the Dominican Republic related to tax evasion, smuggling and forgery of tax stamps with respect to alcohol products." The Appellate Body has made it clear that "disregard" of the evidence:

...impl[ies] not simply an error of judgment in the appreciation of evidence but rather an egregious error that calls into question the good faith of a panel.⁷²

97. Therefore, it is a high hurdle to prove that a panel has committed an 'egregious error' in the appreciation of the evidence or that a panel has exceeded the bounds of its discretion, as the trier of facts, in its appreciation of the evidence. In *Canada – Wheat Exports and Grain Imports*, the Appellate Body therefore rejected the U.S. assertion that the panel did not make an objective assessment of the facts of the case as required by Article 11 of the DSU.⁷³

98. In *EC – Hormones*, the Appellate Body made it clear that the Article 11 duty includes "an obligation to consider the evidence presented to a panel and to make factual findings on the basis of that evidence." In that case, it found that while the Panel sometimes misinterpreted some of the evidence before it, these mistakes did not rise to the level of "deliberate disregard" or "wilful distortion" of the evidence, and therefore there was no violation of Article 11.⁷⁴

99. The Dominican Republic argues that the Panel "exceeded the bounds of its discretion in its appreciation of the evidence submitted by the Dominican Republic related to tax evasion, smuggling, and forgery of tax stamps with respect to alcohol products".⁷⁵ According to the Dominican Republic, the Panel did not make an objective assessment of the facts with respect to two items of evidence, namely Exhibit DR-8 and Exhibit DR-29.

100. With respect to Exhibit DR-8, the Dominican Republic claims the following:

Exhibit DR-8 was offered as evidence of (a) smuggling and, separately, (b) forgery of tax stamps of a product in respect of which the Dominican Republic allows tax stamps to be affixed outside its territory. The Dominican Republic established through that evidence that there is forgery of tax stamps and smuggling of products, in respect of which tax stamps can be affixed abroad. The Panel, however, incorrectly focused on the

⁷² Appellate Body Report, *EC – Hormones*, para. 133.

⁷³ Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, paras. 195-196.

⁷⁴ Appellate Body Report, *EC – Hormones*, paras. 131-145.

⁷⁵ Appellant's Submission of the Dominican Republic, para. 79.

relationship between smuggling and forgery, which was not the main focus of either Exhibit DR-8 or DR-29. As the title of Exhibit DR-8 makes clear, it was offered as "[e]vidence of forgery, smuggling, and tax evasion resulting from allowing the affixation of Dominican Republic tax stamps abroad for alcoholic beverages" (footnote omitted).⁷⁶

101. The Dominican Republic blames the Panel for " ... incorrectly focus[sing] on the relationship between smuggling and forgery, which was not the main focus of ... Exhibit DR-8." However, when the Dominican Republic presented Exhibit DR-8 in its First Submission, it argued that:

... the Dominican Republic allowed stamps to be affixed on alcoholic beverages abroad, expecting that smuggling of alcohol would be more difficult and less likely than smuggling of cigarettes. As set out in Exhibit DR-8, it quickly became clear that affixing stamps abroad resulted in smuggling and tax evasion, *as well as* in forgery of tax stamps (emphasis added).⁷⁷

102. Furthermore, the Dominican Republic named Exhibit DR-8 as "Evidence of forgery, smuggling, *and* tax evasion resulting from allowing the affixation of Dominican Republic tax stamps abroad for alcoholic beverages" (emphasis added).

103. Honduras considers that any trier of facts may have reasonably construed the Dominican Republic's evidence as the Panel did; *i.e.*, as referring to a single case in which alcohol products with forged stamps were smuggled into the Dominican Republic. Therefore, Honduras does not consider that the Panel "exceeded the bounds of its discretion in its appreciation of the evidence submitted by the Dominican Republic."

104. Furthermore, the Panel correctly found, based on the evidence before it, that the smuggling referred to in Exhibit DR-8 was completely unrelated to any problem of forgery.⁷⁸ Indeed, Exhibit DR-8 shows that along with the alcohol products smuggled, tax stamps were also seized. However, the Dominican Republic did not raise doubts concerning the authenticity of the tax stamps seized. As the Dominican Republic did not allege that the tax stamps were forged, the Panel was correct in finding that there was no evidence demonstrating a relationship between forgery of tax stamps and smuggling of alcohol products.

105. The Dominican Republic submitted Memo DAT-No. 46 in Exhibit DR-8 to prove the occurrence of forgery of stamps. The Panel correctly found that " ... the Department of Alcohol and Tobacco of the DGII explicitly states that only the National Treasury would be

⁷⁶ Appellant's Submission of the Dominican Republic, para. 88.

⁷⁷ First Written Submission of the Dominican Republic, para. 61.

⁷⁸ Panel Report, para. 7.223.

in a position to confirm whether a set of tax stamps were forged."⁷⁹ However, the Dominican Republic never presented any evidence from the National Treasury indicating that those tax stamps were forged. Consequently, Honduras considers that there was no basis for the Panel to accept Memo DAT-No. 46 as conclusive evidence that stamps can be forged when they are not affixed within the territory of the Dominican Republic. Therefore, Honduras also considers that there are no grounds to conclude that the Panel "exceeded the bound of its discretion" in assessing the evidence in Exhibit DR-8.

106. The Dominican Republic also alleges that the Panel erred in characterising properly the forgery of ½ cents and RD\$0.50 stamps. Honduras recalls the Appellate Body's statement in *EC – Hormones* to the effect that:

... when may a panel be regarded as having failed to discharge its duty under Article 11 of the DSU to make an objective assessment of the facts before it? Clearly, not every error in the appreciation of the evidence (although it may give rise to a question of law) may be characterized as a failure to make an objective assessment of the facts. ...⁸⁰

107. In any event, Honduras does not consider that an inconsequential mistake that the Panel may have made concerning the appreciation of the ½ cents or RD\$0.50 cents tax stamps would make any difference in the panel's assessment of the evidence. The Panel found that the evidence submitted by the Dominican Republic in Exhibit DR-8 does not prove that the tax stamp requirement avoids smuggling or the forgery of tax stamps. Even if the Panel made an inconsequential mistake in its appreciation of the evidence between the ½ cent and the RD\$0.50 cent stamps, this does not be considered as a "failure to make an objective assessment of the facts." It does not constitute an egregious error by the Panel which would warrant a finding under Article 11 of the DSU.

108. With respect to Exhibit DR-29, the Dominican Republic claims the following:

... the Panel simply disregarded the evidence therein. It did so, apparently, because it mistakenly believed that the exhibit was offered only as evidence of forgery of tax stamps.

...

⁷⁹ Panel Report, para. 223.

⁸⁰ Appellate Body Report, *EC – Hormones*, para. 133. In the same manner, the Appellate Body stated in *Japan – Agricultural Products II*, para. 141:

... not every failure by the Panel in the appreciation of the evidence before it can be characterized as failure to make an objective assessment of the facts as required by Article 11 of the DSU. Only egregious errors constitute a failure to make an objective assessment of the facts as required by Article 11 of the DSU.

The evidence in that exhibit ... was offered to further demonstrate that alcoholic beverages are being smuggled into the Dominican Republic. It succeeds in doing that. The Panel did not – and could not – contest that fact. The evidence documents the seizure of alcoholic beverages smuggled into the territory of the Dominican Republic. Forgery of tax stamps was not what the Dominican Republic intended to establish with the evidence in Exhibit DR-29. As noted above, its title explains that it was offered as "[f]urther evidence of smuggling of alcoholic beverages into the Dominican Republic". The fact that garlic does not carry tax stamps is completely beside the point. There is no serious problem of tax evasion and health risk associated with garlic, as there is with respect to cigarettes and alcoholic beverages – quite the contrary, garlic is good for human health!

109. First, the Appellate Body has made clear that panels have a broad discretion with respect to the evidence it may rely upon. In *EC – Hormones*, the Appellate Body stated:

... it is generally within the discretion of the Panel to decide which evidence it chooses to utilize in making findings. ...⁸¹

110. The Dominican Republic may have intended to rely on Exhibit DR-29 to show that smuggling occurs in alcohol products. However, the evidence submitted in that Exhibit also demonstrated that smuggling occurs in products for which the stamp is required (such as alcohol) but also on products for which the stamp is not required (such as garlic). In the light of this evidence, the Panel found that the forgery of the tax stamps did not itself play a role in the smuggling of products. The Panel was well within its bounds of discretion to rely on the evidence before it to make these findings.

111. The Dominican Republic finally claims that the Panel erred in concluding that Exhibits DR-8 and DR-29 do not establish a causal link between allowing stamps to be affixed abroad and forgery of tax stamps.⁸² The Dominican Republic states that what it submitted to the Panel was "at very least, a clear indicia that there is a correlation between smuggling and forgery of tax stamps (as two independent, albeit related situations), on the one hand, and the affixation of tax stamps outside the territory of the Dominican Republic, on the other hand."⁸³ The Panel did not draw such a causal link and was well within its exercise of its discretion in so doing. As the Appellate Body has made clear in *Australia – Salmon*:

⁸¹ Appellate Body Report, *EC – Hormones*, para. 135.

⁸² Appellant's Submission of the Dominican Republic, para. 91.

⁸³ Appellant's Submission of the Dominican Republic, para. 92.

Panels ... are not required to accord to factual evidence of the parties the same meaning and weight as do the parties.⁸⁴

112. Therefore, even though the Panel did not draw the same conclusion as the Dominican Republic wanted it to draw, it does not mean that the Panel erred in its conclusions on the evidence before it.

VI. CONCLUSION

113. In light of the considerations set out above, Honduras respectfully requests the Appellate Body to dismiss the appeal of the Dominican Republic in its entirety.

⁸⁴ Appellate Body Report, *Australia – Salmon*, para. 267.