

BEFORE THE APPELLATE BODY OF THE
WORLD TRADE ORGANIZATION

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

AB-2005-3

OTHER APPELLANT'S SUBMISSION OF HONDURAS

Prepared with the cooperation of the Advisory Centre on WTO Law

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<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>EC – Bananas III</i>	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997.
<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>EEC – Oilseeds</i>	GATT Panel Report, <i>European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-feed Proteins</i> , adopted 25 January 1990, BISD 37S/86; and DS28/R, 31 March 1992.
<i>India – Patents</i>	Appellate Body Report, <i>India – Patent Protection for Pharmaceutical and Agricultural Chemical Products</i> , WT/DS50/AB/R, adopted 16 January 1998.
<i>Japan – Alcoholic Beverages II</i>	Appellate Body Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.
<i>Korea – Alcoholic Beverages</i>	Appellate Body Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999.
<i>Korea – 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 – 1916 Act</i>	Appellate Body Report, <i>United States – Anti-Dumping Act of 1916</i> , WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000.
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<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 – FSC (Article 21.5)</i>	Appellate Body Report, <i>United States – Tax Treatment for "Foreign Sales Corporations"</i> , Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/AB/RW, adopted 29 January 2002.

Short Title	Full Case Title and Citation
<i>US – Hot-Rolled Steel</i>	Appellate Body Report, <i>United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan</i> , WT/DS184/AB/R, adopted 21 August 2001.
<i>US – Malt Beverages</i>	GATT Panel Report, <i>United States – Measures Affecting Alcoholic and Malt Beverages</i> , DS23/R, adopted 19 June 1992, BISD 39S/206.
<i>US – Section 211</i>	Appellate Body Report, <i>United States – Section 211 Omnibus Appropriations Act of 1998</i> , WT/DS176/AB/R, adopted 1 February 2002.
<i>US – Superfund</i>	GATT Panel Report, <i>United States – Taxes on Petroleum and Certain Imported Substances</i> , adopted 17 June 1987, BISD 34S/136

I. INTRODUCTION

1. On 24 January 2005, pursuant to Article 16.4 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 interpretations in the Panel Report in *Dominican Republic –Cigarettes*, WT/DS302/R, (the "Panel Report"). Honduras will respond to that appeal in its Appellee's submission, due on 18 February 2005.

2. On 7 February 2005, pursuant to Rule 23 of the Working Procedures, Honduras notified its decision to appeal to the Appellate Body certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel in that Report. This submission, filed in accordance with paragraph 2 of Rule 21 and paragraph 3 of Rule 23 of the Working Procedures, provides the legal arguments on which Honduras's appeal is based.

II. EXECUTIVE SUMMARY

3. There are four grounds of appeal set out in this submission. The first is that Panel did not make "an objective assessment of the matter before it" as required by Article 11 of the DSU. The matter referred to the Panel was the legislation establishing the bond requirement as such. The bond requirement had not been applied at the time of the establishment of the Panel. Indeed, it was only applied following the first meeting of the Panel with the Parties. However, the Panel did not examine the legislation as such but instead based its assessment of the WTO-consistency of the bond requirement on the basis of a letter provided by the Dominican Republic during the course of the panel proceedings that contradicted the clear terms of the legislation. The Panel's reliance on a letter submitted by a party during the course of the panel proceedings which contradicts the express terms of the legislation that is being challenged has systemic implications for the WTO dispute settlement system. Honduras respectfully requests the Appellate Body to find that the Panel did not make an objective assessment of the matter before it with respect to its reliance on the letter submitted by the Dominican Republic during the course of the proceedings.

4. The second ground of appeal is that the Panel erred in its examination of whether the bond requirement accords treatment less favourable to imported products under Article III:4 of the General Agreement on Tariffs and Trade 1994 (the "GATT"). The Panel's approach to its determination of what constitutes treatment less favourable is flawed. The Panel erred in its examination of the market situation in which the bond was applied rather than the conditions of competition. The Panel conducted an inadequate analysis to determine whether "treatment less favourable" was being accorded to imported products because the Panel never compared the fixed per-unit costs of complying with the bond for importers as compared with domestic producers. The Panel also erred in finding that a difference in costs for importers of

posting the bond does not create treatment less favourable for imported products as long as the conditions of competition were not adversely altered.

5. The third ground of appeal is that the bond requirement, though imposed equally on importers and domestic producers, inherently creates situations in which imported products are accorded conditions of competition less favourable than those accorded to domestic products. Honduras requests the Appellate Body to reverse the Panel's findings on the bond requirement and to find that the bond requirement is inconsistent with Article III.4 of the GATT 1994.

6. The fourth ground of appeal is that the Panel found that the timing of the payment of the Selective Consumption Tax in connection with the challenge to the bond requirement is a separate claim that was not within the terms of reference of the Panel. However, the timing of the payment of the Selective Consumption Tax was an argument in support of Honduras's main claim that the bond requirement was inconsistent with the obligations of the Dominican Republic under Article III.4. Honduras respectfully requests the Appellate Body to find that the timing of the payment of the Selective Consumption Tax was an argument in support of Honduras challenge of the bond requirement and not a separate claim in itself.

III. LEGAL ARGUMENT

A. INTRODUCTION

1. The requirements of Article III:4 of the GATT and the Panel's findings.

7. GATT Article III sets out the fundamental principle of national treatment. Article III:4 provides in relevant part as follows:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

8. The Panel correctly set out the test enunciated by the Appellate Body in *Korea – Beef* to establish a breach of Article III:4:

For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that

the imported products are accorded 'less favourable' treatment than that accorded to like domestic products ...¹

9. Of these three elements, the Panel found that the first two had been established. It agreed that the products at issue are "like products" and that the bond requirement was a "law, regulation or requirement affecting [the] internal sale" of these like products.² Neither the Dominican Republic nor Honduras appealed these findings. Therefore, based on Honduras's appeal, there remains only a single issue before the Appellate Body: whether the bond requirement accords to imported products treatment less favourable than that accorded to like domestic products.

2. Honduras challenged the bond requirement as provided in the Dominican Republic's legislation *as such*.

10. As stated in the Panel Request, and consistently maintained by Honduras throughout the panel proceedings, Honduras challenged the bond requirement provided for in the Dominican Republic's legislation as such.

11. The right of a Member to challenge the measures of another Member *as such* is well-established under the jurisprudence of the WTO. As the Appellate Body articulated in *US - 1916 Act*:

Prior to the entry into force of the *WTO Agreement*, it was firmly established that Article XXIII:1(a) of the GATT 1947 allowed a Contracting Party to challenge legislation as such, *independently from the application of that legislation in specific instances*.³ (emphasis added).

12. The Appellate Body added that:

... the GATT and WTO case law firmly establishes that dispute settlement proceedings may be brought based on the alleged inconsistency of a Member's legislation as such with that Member's obligations.⁴

13. In *US – Corrosion-Resistant Steel Sunset Review*, the Appellate Body reaffirmed this principle, stating that:

... instruments of a Member containing rules or norms could constitute a "measure", irrespective of how or whether those rules or norms are applied in a particular instance. This is so

¹ Appellate Body Report, *Korea – Beef*, para. 133, as quoted in the Panel Report, para. 7.272.

² Panel Report, para. 7.272.

³ Appellate Body Report, *US – 1916 Act*, para. 60.

⁴ Appellate Body Report, *US – 1916 Act*, para. 75.

because the disciplines of the GATT and the WTO, as well as the dispute settlement system, are intended to protect not only existing trade but also the security and predictability needed to conduct future trade. This objective would be frustrated if instruments setting out rules or norms inconsistent with a Member's obligations could not be brought before a panel once they have been adopted and irrespective of any particular instance of application of such rules or norms.* It would also lead to a multiplicity of litigation if instruments embodying rules or norms could not be challenged as such, but only in the instances of their application. Thus, allowing claims against measures, as such, serves the purpose of preventing future disputes by allowing the root of WTO-inconsistent behaviour to be eliminated.⁵ (* footnote omitted.)

14. In this case, Honduras invoked its right to challenge the bond requirement *as such*, "independently from the application of that legislation in specific instances." The objective of the WTO described by the Appellate Body would have been frustrated for Honduras if it could not have challenged the bond requirement *as such* but only after it had been actually applied. *Indeed, at the time of the establishment of the Panel, the bond requirement had never been applied.* It was only during the course of the panel proceedings – after the first meeting of the Panel with the Parties – that the Dominican Republic decided to apply the bond requirement to the Honduras importer. The Dominican Republic requested the posting of the bond in a letter to the Honduran importer dated 13 May 2004.⁶ Although Honduras referred during the proceedings to this application of the bond requirement by the Dominican Republic, the nature of Honduras's challenge remained as stated at the time of the establishment of the Panel; namely that the bond requirement *as such* is inconsistent with Article III:4 of the GATT.

B. THE PANEL FAILED TO MAKE AN ASSESSMENT OF THE MEASURE CLAIMED BY HONDURAS TO BE INCONSISTENT WITH ARTICLE III:4 OF THE GATT AND THEREFORE VIOLATED ARTICLE 11 OF THE DSU.

1. The requirements of Article 11 of the DSU

15. Article 11 of the DSU provides, in part, as follows:

The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the

⁵ Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 82.

⁶ Exhibit HOND-36.

recommendations or in giving the rulings provided for in the covered agreements.

16. As noted by the Appellate Body in *United States – Hot-Rolled Steel*:

Article 11 of the DSU imposes upon panels a comprehensive obligation to make an "objective assessment of the matter", an obligation which embraces all aspects of a panel's examination of the "matter", both factual and legal. Thus, panels make an "objective assessment of the facts", of the "applicability" of the covered agreements, and of the "conformity" of the measure at stake with those covered agreements.⁷

17. Under Article 11 of the DSU, a panel enjoys discretion in its assessment of the evidence. However, as the Appellate Body stressed in *Korea – Alcoholic Beverages*, a "panel's discretion as trier of facts is not, of course, unlimited. *That discretion is always subject to, and circumscribed by, among other things, the panel's duty to render an objective assessment of the matter before it.*"⁸ In *Chile - Price Band*, the Appellate Body added that:

... the obligations under Article 11 of the DSU go beyond a panel's appreciation of the evidence before it. Article 11 obliges panels not only to make 'an objective assessment of the facts of the case', but also 'an objective assessment of the matter before it.' ... As with our finding in *US – Certain EC Products*, the second sentence of Article II:1(b) was not the subject of a claim before the Panel. Because it made a finding on a provision that was not before it, the Panel, therefore, did not make an objective assessment of the matter before it, as required by Article 11. Rather the Panel made a finding on a matter that was not before it. In doing so, the Panel acted *ultra petita* and inconsistently with Article 11 of the DSU.⁹

2. The Panel did not make an objective assessment of the "matter" before it, namely Honduras's challenge to the bond requirement *as such*.

18. Under Article 7.1 of the DSU, the Panel was required to examine the "matter" referred to the DSB in Honduras's Panel Request. This included the challenge to the bond requirement as set out in the Dominican Republic's legislation.

19. In assessing the WTO-consistency of the bond requirement, the Panel was thus required to determine whether this measure, *as such*, was consistent with Article III:4.

⁷ Appellate Body Report, *United States – Hot-Rolled Steel*, para. 54.

⁸ Appellate Body Report, *Korea – Alcoholic Beverages*, para. 162, (emphasis added.).

⁹ Appellate Body Report, *Chile – Price Band*, para. 172 – 173.

3. The Panel did not examine the legislation as such but instead based its assessment of the WTO-consistency of the bond requirement on the basis of a letter provided by the Dominican Republic in the course of the Panel proceedings that contradicted the clear terms of the legislation.

20. Instead of determining the WTO-consistency of the bond requirement as such, the Panel relied on a letter prepared by the authorities of the Dominican Republic to assess the WTO-consistency of the bond requirement under Article III:4. In the present case, the Panel made a finding on the coverage of tax liabilities secured by the bond requirement based on the letter produced by the Dominican Republic in the course of the panel proceedings, and not on the legislation establishing the bond requirement.

21. The bond requirement for importers is imposed under Decree 79-03, approving the Regulations for the Application of Section VI of the Dominican Republic's Tax Code. It is important to stress that *Section IV of the Tax Code refers to the Selective Consumption Tax as the tax obligation to be secured by the bond*. The Preamble of Decree 79-03 refers to the adoption of adequate rules for the administration and collection of the Selective Consumption Tax. Article 14 of Decree 79-03 refers to Article 376 of the Dominican Republic's Tax Code which is part of Chapter VI on Special Rules for the Alcohol and Tobacco Products under Section IV on the Selective Consumption Tax.

22. Thus, as such, the bond requirement stated unambiguously that the tax obligation secured by the bond was the Selective Consumption Tax, and nothing more. At the time of the establishment of the Panel, the bond requirement had never been applied. Therefore, Honduras's challenge of the bond requirement was as it existed in the Dominican Republic's legislation at the time of the establishment of the Panel. The Panel should have properly examined only the terms of the legislation and not have relied on the unsubstantiated views of one officer of an agency of the Dominican Republic.

23. However, the Panel did not undertake an analysis of the legislation alone. Instead, as the Panel stated:

...[t]he Dominican Republic further argues that its tax authority treats the bond as a guarantee of compliance with internal tax obligations other than the Selective Consumption Tax, such as the tax on the transfer of goods and services ("ITBIS") and the income tax. *The Dominican Republic acknowledges that there is no explicit provision in its legislation that authorizes the use of the bond as a guarantee of compliance for internal tax obligations other than the Selective Consumption Tax*. Nevertheless, it declares that, in practice, and in exercise of its broad powers to ensure the proper and effective enforcement of the tax laws, *the Dominican Republic tax authorities regard the bond as a guarantee of compliance for internal tax obligations other than the Selective Consumption Tax*. In support of its

argument, the Dominican Republic has presented a copy of a written declaration to that effect from its Director General of Internal Taxes.¹⁰ (emphasis added)

24. Thus, the Dominican Republic conceded that "there is no explicit provision in its legislation that authorizes the use of the bond as a guarantee of compliance for internal tax obligations other than the Selective Consumption Tax."¹¹ In other words, *the bond requirement, on its face, provided that it guaranteed compliance for the Selective Consumption Tax only.* Nevertheless, the Panel chose to rely on a letter provided by the Dominican Republic's authorities in the course of the panel's proceedings which – although plainly contradicted by the legislation establishing the bond requirement – broadened the coverage of the tax liabilities the bond was intended to secure.

25. Thus, instead of determining whether the bond requirement was consistent with the Article III:4 *as such*, the Panel chose to rely on these inconsistent – and unsubstantiated – assertions by the Dominican Republic with respect to coverage of the tax liabilities that the bond is intended to secure. The Panel failed to make "an objective assessment of the matter" before it as it was required to do under Article 11 of the DSU.

26. The Panel's reliance on a letter contradicting the actual terms of the challenged legislation opens the door to potentially serious abuse in WTO dispute settlement proceedings. The Panel's approach, if allowed to stand, would mean that legislation challenged as such could be "saved" by a letter from a respondent, dated and produced during the course of the proceedings, to the effect that the clear terms of the legislation must be overridden by the unsubstantiated views of one officer of an agency of the respondent.

27. In *India – Patents*, the Appellate Body addressed a similar situation and stated:

...We agree with the Panel that these provisions of the Patents Act are mandatory. And, like the Panel, we are not persuaded that India's "administrative instructions" would prevail over the contradictory mandatory provisions of the Patents Act. We note also that, in issuing these "administrative instructions", the Government of India did not avail itself of the provisions of section 159 of the Patents Act, which allows the Central Government to "make rules for carrying out the provisions of [the] Act, or section 160 of the Patents Act, which requires that such rules be laid before each House of the Indian Parliament. We are told by India that such rulemaking was not required for the "administrative instructions" at issue here. But this, too,

¹⁰ Panel Report, para. 7.291.

¹¹ Panel Report, para. 7.293.

seems to be inconsistent with the mandatory provisions of the Patents Act.

We are not persuaded by India's explanation of these seeming contradictions. Accordingly, we are not persuaded that India's "administrative instructions" would survive a legal challenge under the Patents Act. And, consequently, we are not persuaded that India's "administrative instructions" provide a sound legal basis to preserve novelty of inventions and priority of applications as of the relevant filing and priority dates.¹²

28. In this case, the Dominican Republic submitted a letter in the course of the proceedings that contradicted the terms of the legislation establishing the bond requirement. It may be correct that a government would have a general power of reassessment of all tax liabilities, as the Panel found. Honduras does not submit that this general right of reassessment must be spelled out in every provision in a government's Tax Code. However, if the Dominican Republic wishes to use the bond requirement to secure tax liabilities other than the Selective Consumption Tax, this would have to be clearly indicated in its legislation and not based upon a letter produced by the respondent. Therefore, if the Dominican Republic were indeed using the bond requirement to secure tax liabilities other than the Selective Consumption Tax, it is not clear that such linkage, would, in the words of the Appellate Body in *India - Patents*, would "survive a legal challenge." The basis for Honduras's challenge is that the content of the letter contradicts the actual terms of the legislation, which makes no reference to the bond securing liabilities other than the Selective Consumption Tax. For that reason, the letter should not have been relied upon by the Panel.

29. It is important to note that in the present case, Honduras's argument that the bond requirement is inconsistent with Article III:4 of the GATT is not dependent upon whether the bond requirement secures only the Selective Consumption Tax or whether the bond secures tax liabilities in addition to the Selective Consumption Tax. In either case scenario, the bond requirement is inconsistent with the Dominican Republic's obligations under Article III:4 for the reasons set out in Section C. Thus, the Appellate Body's findings on the Article 11 claim should not affect the Appellate Body's conclusions on the substantive issues discussed below.

C. THE PANEL ERRED IN ITS EXAMINATION OF WHETHER THE BOND REQUIREMENT ACCORDS "LESS FAVOURABLE TREATMENT" UNDER ARTICLE III:4 OF GATT 1994.

1. The Panel erred in examining the market situation in which the bond requirement was applied, rather than the conditions of competition established by the legislation.

30. In its assessment of Honduras's claim under Article III:4, the Panel took into account the market performance of importers in the past years as the decisive element, rather than the

¹² Appellate Body Report, *India - Patents*, paras. 69-70.

bond requirement itself. This was an error of law in its interpretation of the requirements to examine an inconsistency with Article III:4 of the GATT.

31. In its examination of the consistency of the bond requirement with the Dominican Republic's obligations under Article III:4 of the GATT, the Panel found as follows:

The Panel notes that, under the domestic regulations, the required bond must be issued by an insurance company or banking institution accredited in the Dominican Republic. The effective cost that the bond has on domestic producers and importers is thus the fee charged by the financial institution that issues the bond. According to the evidence provided by Honduras, in the specific case of the importer of cigarettes from that country, the annual fee charged by the insurance company that issued the bond was RD\$84,000 (approximately US\$1,873*). When divided by the annual imports of cigarettes made by that same company, the cost of the bond would be equivalent to RD\$0.9 (or approximately 2 cents of a US dollar) per thousand cigarettes. That annual value is equivalent to 0.2 per cent of the value of cigarette imports made by the importer in the year 2003.* The Panel also notes that the cost of complying with the bond requirement has been diminishing for the importing company in the recent years, since its imports have increased while the bond amount has remained the same. Had the importer posted a bond in the years 2001 and 2002 for the same cost, the cost of that bond would have represented 0.64 per cent and 0.41 per cent, respectively, of the value of cigarette imports made by the importer in those two years (*footnotes omitted).¹³

32. The Panel determined that the "effective cost that the bond has on domestic producers and importers is thus the fee charged by the financial institution that issues the bond." The Panel then divided the annual fee for the bond by the annual imports and found that the cost per unit of a thousand cigarettes was RD\$ 0.9. It noted that as imports had increased from 2001 to 2003 and "the bond has remained the same", the per-unit cost of the bond fee for the importer "has been diminishing".

33. In other words, in examining what was unmistakably an *as such* claim, the Panel examined the *current costs paid by one specific importer* in the light of its volumes of imports for 2001-2003 in order to determine the consistency of the bond requirement with Article III:4. In effect, the Panel implicitly stated that if imports were low, then the per-unit cost of the bond fee would be higher for importers. Conversely, if imports were high, then the per-unit cost would be lower.

¹³ Panel Report, para. 7.299.

34. The Panel should not have looked at the actual level of trade flows in order to examine whether the bond requirement accorded treatment less favourable to importers. Instead, the Panel should have determined whether the bond requirement was consistent with the obligations of the Dominican Republic under Article III:4. In making that legal determination, the economic performance of the actors in the market is simply irrelevant. The Panel's approach, if allowed to stand, 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.

35. The "market reaction" approach of the Panel is also at odds with the unambiguous obligation of all Members under Article XVI:4 of the WTO Agreement that each Member "shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreement." This fundamental obligation required all Members not only to bring their measures into force as of 1 January 1995, but also to ensure that all *new measures, upon adoption, are consistent with their WTO obligations*. The Panel's approach would render Article XVI:4 a nullity, in that the WTO-consistency of a new measure would only be apparent once the market had reacted to it.

36. The Panel's approach is also inconsistent with well-established GATT/WTO jurisprudence. For example, in *US – Section 337*, the panel referred to:

... [the] previous practice of the CONTRACTING PARTIES in applying Article III, which has been to *base their decisions on the distinctions made by the laws, regulation or requirements themselves and on their potential impact rather than on the actual consequences for specific imported products*¹⁴ (emphasis added, footnotes omitted).

37. In the Panel in *US – FSC (Article 21.5)*, quoting from the Panel in *Canada – Autos*, summarized the applicable jurisprudence under Article III:4:

We recall the essence of the Article III:4 obligation...as follows:

The "no less favourable treatment obligation" in Article III:4 has been consistently interpreted as a requirement to ensure effective equality of opportunities between imported products and domestic products. In this respect, it has been held that, since a fundamental objective of Article III is the protection of expectations on the competitive relationship between imported and domestic products, a measure can be found to be inconsistent with Article III:4 because of its potential discriminatory impact on imported products.⁸⁴² *The*

¹⁴ GATT Panel Report, *United States – Section 337*, para.5.13.

*requirement of Article III:4 is addressed to "relative competitive opportunities created by the government in the market, not to the actual choices made by enterprises in that market".*⁸⁴³ Both in relation to Article III:2 and Article III:4 it has been established that the actual trade effects of a disputed measure are not a decisive criterion in determining whether the requirements of these provisions are met in a given case⁸⁴⁴ (emphasis added).¹⁵

⁸⁴² Panel Report on *US – Section 337*, *supra* note 280, paras. 5.11 and 5.13.

⁸⁴³ Panel Report on *US – Malt Beverages*, *supra* note 427, para. 5.31.

⁸⁴⁴ See, e.g., Appellate Body Report on *Japan – Alcoholic Beverages*, *supra* note 271, p. 16; Panel Report on *EC – Bananas III (ECU)*, *supra* note 269, para. 7.179.

38. This principle was also applied by the Appellate Body in *Korea – Beef*, where it stated that: "[w]hat is addressed by Article III:4 is merely the *governmental* intervention that affects the conditions under which goods, domestic and imported, compete within a Member' territory."¹⁶ (original emphasis.)

39. Given these Appellate Body rulings, the Panel should have examined the legislation establishing the bond requirement and its potential discriminatory impact on imported products rather than the "actual choices made by enterprises in that market" in order to ascertain its WTO-consistency.

40. Another difficulty with the Panel's "market reaction" approach is that it is based on a static view of the market. However, as *EEC – Oilseeds* made clear, the purpose of Article III is "to protect expectations of the contracting parties as to the competitive relationship between their products and those of other contracting parties. Both articles [Articles III and XI] are *not only to protect current trade but also create the predictability needed to plan future trade*"¹⁷ (emphasis added). Similarly, the Appellate Body ruled in *Japan – Alcoholic Beverages II* that "Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products..."¹⁸

41. It is therefore irrelevant that, in the current market conditions, the per-unit cost of the bond is low for one particular importer. The Panel also examined the trends of cigarette

¹⁵ Panel Report, *United States- FSC (21.5)* para. 8.128, citing Panel Report, *Canada – Autos*, para. 10.78.

¹⁶ Appellate Body Report, *Korea – Beef*, para. 149.

¹⁷ GATT Panel Report, *EEC – Oilseeds*, para. 150, citing GATT Panel Report, *US – Superfund*.

¹⁸ Appellate Body Report, *Japan –Alcoholic Beverages II*, page 13.

imports in the Dominican Republic market and concluded that as imports had increased, the per-unit cost of the bond fee had progressively decreased for the importer. It is equally irrelevant whether in the light of the trend of increasing imports for that particular importer, the per-unit cost of the bond has decreased.

42. Other than the diminishing fixed unit costs for importers from 2001 to 2003, the Panel did not cite any other basis to dismiss Honduras's claim that the bond requirement is inconsistent with Article III:4 because the fixed amount of the bond with respect to importers and domestic producers with differing tax liabilities provides less favourable treatment to imported products.

2. The Panel compounded its error by making baseless assumptions and failing to compare the per-unit cost of posting the bond for like domestic products.

43. As argued above, the "market reaction" approach of the panel constituted a flawed interpretation of the obligations of Article III:4. Furthermore, even assuming that the "market-reaction" analysis is appropriate, the Panel's analysis does not support its conclusion.

44. First, the per-unit cost determined by the Panel was incorrect because it was based on the volume of imports in the years 2001 to 2002, during which the bond was not even required by the Dominican Republic legislation, and was based on the cost charged by financial institutions for a bond fee in 2004. Honduras recalls that the bond requirement was not introduced in the legislation until 10 March 2003.

45. Second, the Panel did not determine the per-unit cost for domestic producers. As the Panel did not determine the per-unit cost for domestic producers, it was unable to make a comparison between the per-unit costs between imported products and domestic like products. In order to determine whether 'less favourable treatment' was being accorded to imports, the Panel needed to make a comparison between the treatment accorded to imported products and that accorded to like domestic products. The Panel did not make such a comparison, and therefore, it did not have any basis upon which to conclude that there was no less favourable treatment being accorded to imports.

46. Instead of examining whether there was a difference in the treatment accorded to imported products compared with domestic like products, the Panel fundamentally erred by *examining exclusively the situation of imports alone*. The Panel examined the past performance levels of imports and concluded that "had the importer posted a bond in the years 2001 and 2002" in the light of its imports at that time, its cost of that bond would have been RD\$ 0.64 per cent and RD\$ 0.41, respectively. It added that in the light of its imports in 2003, its cost of the bond was RD\$ 0.9.¹⁹

¹⁹ Panel Report, para. 7.299.

47. The test under Article III:4 is *not* whether the treatment accorded to imported products somehow "improved", but rather *whether the treatment accorded to imported products is less favourable than that accorded to domestic products*. The Panel asked itself the wrong question, and provided the wrong answer. Therefore, the Panel's finding that imports were not being accorded 'less favourable' treatment had no basis under Article III:4.

3. The Panel erred in its finding that a difference in costs for importers of posting the bond does not create less favourable treatment for imported products.

48. In the Panel's view, a fixed amount of a bond for importers and domestic producers that have differing tax liabilities did not necessarily lead to less favourable treatment to imported products. The Panel found that:

By definition, any expense that is fixed (i.e. not related to volumes of production) may lead to different costs per unit among supplier firms. As long as the difference in costs does not alter the conditions of competition in the relevant market to the detriment of imported products, that fact in itself should not be enough to conclude that the expense creates a less favourable treatment for imported products.²⁰

49. As noted above, the Panel recognised that the fixed amount of the bond may lead to different per-unit cost among suppliers, including domestic producers and importers. However, the Panel went on to say that these "different" (which must be assumed to mean higher and lower) costs did not create less favourable treatment for imported product *as long as the conditions of competition were not adversely altered*.

50. The Panel did not provide any explanation as to why it considered that additional expenses would not alter conditions of competition among suppliers and therefore, would not constitute less favourable treatment. The Panel, therefore, overlooked the basic requirement of Article 12.7 of the DSU requiring panels to state the basic rationale for their findings.

51. The Panel assumed, without any explanation or analysis, that the additional expense for importers does not alter the conditions of competition in the Dominican Republic's market essentially because the volumes of imports increased from 2001 to 2003, and therefore, the importer has been able to compete efficiently in the market. The Panel contented itself with the conclusion that as the level of imports had increased, and the "treatment" accorded to imports had improved, Article III:4 could not have been violated. Once again, the Panel focused on the situation of imports *qua* imports, and not on the situation of imports *as compared with* like domestic products.

²⁰ Panel Report, para.7.300.

52. Therefore, in the view of the Panel, if the importer is still competing efficiently in the market, there could not be a violation of Article III:4. Such an approach ignores the fact that as the Appellate Body has made clear in *Japan – Alcoholic Beverages II*, any less favourable treatment accorded to imported products will violate Article III:4 *per se*, regardless of the trade effects:

Even the smallest amount of "excess" is too much. "The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard."²¹

53. Although this statement was made in the context of an Article III:2 claim, it applies equally under Article III:4. The fact that the additional expense to importers is small does not negate the fact that less favourable treatment is being accorded to imported products.

54. As Honduras has explained above, the WTO-consistency of a measure cannot be determined by examining the actual market conditions in which that measure is applied. The Panel erred in finding that there could be no less favourable treatment if imported products are competing efficiently in the market. This is a fundamentally flawed interpretation of Article III:4 contrary to consistent GATT/WTO jurisprudence.

D. THE BOND REQUIREMENT AS SUCH IS INCONSISTENT WITH ARTICLE III:4 OF GATT.

1. The bond requirement imposes an "extra burden" on imported products compared with domestic products.

55. The Panel found that:

..., the Panel finds that the evidence available does not support Honduras's assertion that there is no liability that the bond requirement would serve to secure. While the importers may pay in full at the moment of importation their obligations under the Selective Consumption Tax and other applicable taxes, the Dominican Republic has demonstrated that its tax authorities have the legal powers to reassess and eventually readjust the applicable tax liabilities for a period of up to three years. If a readjustment occurs as a result of a reassessment, then the importer may be asked to make a new payment. The bond would serve to guarantee this payment, if the importer does not pay in time. Even assuming *arguendo* the validity of Honduras's argument that there have been no reassessments for the payment of the Selective Consumption Tax on imports of cigarettes, that does not mean that those reassessments could not occur. A bond is a guarantee to avoid some of the damage that may result in the event that a particular situation may

²¹ Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 23, citing GATT Panel Report, *US – Malt Beverages*, para. 5.6.

occur. The fact that a bond is not used, does not necessarily mean that a bond requirement is unjustified.²²

56. As stated in Section B, Honduras is appealing separately the Panel's objective assessment of the matter before it by relying on a letter produced by the Dominican Republic that broadened the scope of the tax liabilities and contradicted the terms of the legislation that established that the bond secured only the Selective Consumption Tax. However, it is Honduras's position that regardless of whether the bond secures only the Selective Consumption Tax or the Selective Consumption Tax and other tax liabilities, the bond requirement is an "extra hurdle" or "extra burden" imposed on imported products.

57. WTO jurisprudence establishes that an "extra hurdle" imposed on imported products will always be inconsistent with Article III:4 of the GATT. As the Appellate Body stated in *United States – Section 211*:

The United States may be right that the likelihood of having to overcome the hurdles of [the U.S. measures in question]... may, echoing the panel in *US – Section 337*, be *small*. But, again echoing that panel [Section 337], even the *possibility* that non-United States successors-in-interest face two hurdles is *inherently less favourable* than the undisputed fact that United States successors-in-interest face only one.²³ [Original emphasis]

58. Although *United States – Section 211* was a case under the TRIPS Agreement, the concept applies equally under GATT Article III:4. Indeed, as the *Canada – Wheat Exports and Grain Imports* Panel explained:

The Appellate Body concluded in... its Report in *United States – Section 211 Omnibus Appropriations Act of 1998* ("*US – Section 211 Appropriations Act*")...that the provision in question imposed an additional obstacle on foreign successors-in-interest that was not faced by US successors-in-interest...We recognize that this reasoning was based on the national treatment obligation contained in the *TRIPS Agreement*. However, we consider that the Appellate Body's logic is equally applicable when applied in the context of the provisions of Article III:4 of the GATT 1994. Indeed, we note that the panel in *US – Malt Beverages* followed a very similar logic when it found that it was inconsistent with the United States' obligations under Article III:4 for the United States to require that only imported beer use an "additional level of

²² Panel Report, para. 7.292.

²³ Appellate Body, *United States – Section 211*, para. 265.

distribution", namely, the wholesale level. More specifically, the panel found that "the requirement that beer imported into the United States be distributed through in-state wholesalers or other middlemen, when no such obligation to distribute through wholesalers exists with respect to in-state like domestic products, results in treatment ... less favourable than that accorded to like domestic products' from domestic producers, inconsistent with Article III:4".²⁴

59. Thus, as the consistent jurisprudence of the GATT and the WTO demonstrates, *any possibility* of additional "hurdles" or "obstacles" faced by imported products, no matter how small, is "inherently less favourable", and violates GATT Article III:4.

60. Honduras submits that the Panel in this case erred in not finding that the bond requirement is an "extra burden" imposed on imported products. Honduras's argument is that the bond requirement secures only the payment of the Selective Consumption Tax as set out in the legislation. As noted above, the bond requirement for importers is imposed under Decree 79-03, approving the Regulations for the Application of Section VI of the Dominican Republic's Tax Code. It is important to stress that *Section IV of the Tax Code refers to the Selective Consumption Tax as the tax obligation to be secured by the bond*. The Preamble of Decree 79-03 refers to the adoption of adequate rules for the administration and collection of the Selective Consumption Tax. Article 14 of Decree 79-03 refers to Article 376 of the Dominican Republic's Tax Code which is part of Chapter VI on Special Rules for the Alcohol and Tobacco Products under Section IV on the Selective Consumption Tax.

61. Thus, on its face, the legislation establishing the bond requirement states unambiguously that the tax obligation secured by the bond was the Selective Consumption Tax, and nothing more.

62. It is undisputed between the parties that importers pay the full amount of the Selective Consumption Tax upon importation. However, even though an importer pays the full amount of the Selective Consumption Tax upon importation, he still has to post the bond to guarantee the payment of the Selective Consumption Tax. On the other hand, domestic producers have to post the bond and then have an additional 50 day period within which they have to pay the Selective Consumption Tax. Therefore, for domestic producers, the bond serves as a guarantee for the eventual payment of the Selective Consumption Tax. However, for importers, the bond does not serve as a guarantee for the payment of the Selective Consumption Tax because that amount is paid upon importation.

63. In other words, an importer has to pay the amount due for the Selective Consumption Tax prior to importation and has to post a bond to secure a tax liability that has already been

²⁴ Panel Report, *Canada – Wheat Exports and Grain Imports*, footnote 275.

discharged. By contrast, the domestic producer has up to 20 days following the month in which the transaction was made to pay the Selective Consumption Tax. For the domestic producers, therefore, the bond serves a legitimate purpose to secure a tax liability that has not been discharged. For importers, however, the bond serves no purpose. It is this lack of symmetry between the liabilities that bond secures - as between domestic producers and importers – that constitutes an "extra hurdle" or "extra burden" for imported products.

64. In the present case, therefore, the bond requirement imposed on importers to secure payment of the Selective Consumption Tax is superfluous because there are no outstanding liabilities *with respect to the Selective Consumption Tax* for the bond to secure. The Dominican Republic does not dispute this and the Panel has impliedly recognised this.

65. Even under the scenario presented by the Dominican Republic, namely that the bond requirement secures tax liabilities in addition to the Selective Consumption Tax (*quod non*) – such as reassessment of the Selective Consumption Tax – it *still* presents a greater burden for importers – for the reasons set out above. In this scenario, for importers, the bond serves to secure the reassessment of the Selective Consumption Tax and other tax liabilities. The bond cannot serve to secure the payment of the original amount of the Selective Consumption Tax because this amount has already been paid. For domestic producers, however, the bond serves to secure the payment of the Selective Consumption Tax, the reassessment of the Selective Consumption Tax, and other tax liabilities. Thus, even under the scenario presented by the Dominican Republic, the asymmetry remains.

66. Honduras considers that the Panel failed to recognise this essential point. The Panel erred in finding that the "evidence available does not support Honduras's assertion that there is no liability that the bond requirement would serve to secure. While importers may pay in full at the moment of importation their obligations under the Selective Consumption Tax and other applicable taxes, the Dominican Republic has demonstrated that its tax authorities have the legal powers to reassess and eventually readjust the applicable tax liabilities for a period of up to three years."²⁵

67. The Panel therefore reasoned that the bond did secure tax liabilities for importers because it considered that the bond secured the amounts that could be owed *as a result of the reassessment*. However, while the Panel recognised that the possibility of reassessment of the Selective Consumption Tax applied equally to imported and domestic products, it did not make a finding with respect to the asymmetry concerning the principal tax obligation – the Selective Consumption Tax – that the bond secured. Even though the Panel recognised that the importers may pay the full amount of the Selective Consumption Tax at the border as well post a bond, and it is undisputed between the parties that the Selective Consumption Tax on

²⁵ Panel Report, para. 7.292.

domestic products may be paid on the 20th day following the month in which the sale was transacted²⁶ – the Panel failed to make a legal finding that this unequal situation with respect to the liability secured by the bond leads to treatment less favourable for imported cigarettes as compared to like domestic cigarettes, contrary to Article III:4 of the GATT.

68. This extra hurdle or additional burden for imported products – a hurdle not faced by domestic like products – results in the bond requirement providing treatment less favourable to imported products compared to the treatment being accorded to like domestic products in violation of Article III:4 of the GATT.

2. The bond requirement, though imposed equally on importers and domestic producers, inherently creates situations in which imported products are accorded conditions of competition less favourable than those accorded to domestic products.

69. It is undisputed that the amount of the bond is fixed at RD\$5 million both for importers and for domestic producers. It is also undisputed that the tax liability for importers and domestic producers is variable. In its Replies to the Questions by the Panel, the Dominican Republic stated that: "The nature of the tax obligations is the same for domestic producers and importers. The absolute tax liability for each importer and domestic producer of cigarettes is not specific or static. The liability will depend on the volume of sales and the value of the merchandise in question."²⁷

70. In Exhibit DR-44, the Dominican Republic submitted information indicating that in 2003, the amount of Selective Consumption Tax imposed on domestic cigarettes (RD\$118.2 million) was about *three times higher* than the amount imposed on imported cigarettes (RD\$35.4 million). In 2003, the per-unit cost of the bond requirement for imported cigarettes was thus three times higher than for domestic products. If the cigarettes had been imported by more than one importer, the difference would have been even greater. If a new importer had intended to import a small amount of cigarettes to test the market, the per-unit costs of the bond requirement could have been so high as to discourage the entry of a new product into the market.

71. These considerations illustrate that the bond requirement, though imposed equally on *importers* and *domestic producers*, inherently creates situations in which *imported products* are accorded conditions of competition less favourable than those accorded to *domestic products*. It is, of course, conceivable that a situation may arise in the future in which in which the bond requirement creates more favourable conditions of competition for imported products. However, that is legally irrelevant. Article III:4 requires that no less favourable treatment be accorded to *all* imported products, not only those imported under certain market

²⁶ Panel Report, paras. 7.302 to 7.305.

²⁷ Dominican Republic's Answer to Question 5 from the Panel, 27 May 2004, page 37.

conditions. This fundamental principle was already recognised under the GATT 1947 by the panel on *US – Section 337*, which ruled:

The Panel further found that the "no less favourable" treatment requirement of Article III:4 has to be understood as applicable to each individual case of imported products. The Panel rejected any notion of balancing more favourable treatment of some imported products against less favourable treatment of other imported products. If this notion were accepted, it would entitle a contracting party to derogate from the no less favourable treatment obligation in one case, or indeed in respect of one contracting party, on the ground that it accords more favourable treatment in some other case, or to another contracting party. Such an interpretation would lead to great uncertainty about the conditions of competition between imported and domestic products and thus defeat the purposes of Article III.²⁸

72. As quoted above from *US – Section 211*, the Appellate Body has also noted, *any possibility* of additional "hurdles" or "obstacles" faced by imported products, no matter how small, is "inherently less favourable", and violates GATT Article III:4.

73. In the light of the foregoing arguments, Honduras respectfully requests the Appellate Body to reverse the Panel's finding and to conclude that the bond requirement does not provide "less favourable treatment to importers."

74. The Appellate Body stated in *Canada – Autos*:

In *Australia – Salmon*, we stated that where we have reversed a finding of a panel, we should attempt to complete a panel's legal analysis "to the extent possible on the basis of the factual findings of the Panel and/or of undisputed facts in the Panel record".²⁹

75. As Honduras has demonstrated above, there are sufficient undisputed facts and factual findings in the Panel record to enable the Appellate Body to make a finding that the bond requirement is inconsistent with the Dominican Republic's obligations under Article III:4 of the GATT 1994.

²⁸ GATT Panel Report, *US – Section 337*, para. 5.14.

²⁹ Appellate Body Report, *Canada – Autos*, para. 133.

E. THE PANEL ERRED IN ITS DETERMINATION THAT THE TIMING OF THE PAYMENT OF THE SELECTIVE CONSUMPTION TAX WAS A SEPARATE CLAIM THAT WAS NOT WITHIN THE TERMS OF REFERENCE OF THE PANEL.

1. The Panel found that the timing of the payment of the Selective Consumption Tax was a separate claim that was not within the terms of reference of the Panel.

76. The Panel found that:

The claim on the bond requirement is part of the terms of reference of the Panel. There is, however, nothing in the request for establishment of the Panel that would lead to the conclusion that the Panel would be asked to make any finding regarding the difference in timing of the payment of the Selective Consumption Tax between domestic producers and importers. The Panel therefore concludes that Honduras's claim regarding the different costs for domestic producers and importers arising from the time of payment of the Selective Consumption Tax is not directly related with the bond requirement and it is not within the Panel's terms of reference.³⁰

2. The difference in the timing of the payment of the Selective Consumption Tax between importers and domestic producers is an argument in support of Honduras' claim that the bond requirement is inconsistent with Article III:4, and not a separate claim.

77. In *EC – Bananas III*, the Appellate Body drew a clear distinction between claims and arguments. It held that:

We accept the Panel's view that it was sufficient for the Complaining Parties to list the provisions of the specific agreements alleged to have been violated without setting out detailed arguments as to which specific aspects of the measures at issue relate to which specific provisions of those agreements. In our view, there is a significant difference between the claims identified in the request for the establishment of a panel, which establish the panel's terms of reference under Article 7 of the DSU, and the arguments supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal submissions and the first and second panel meetings with the parties.³¹

78. In its Panel Request, Honduras identified its claim that the bond requirement is inconsistent with Article III:4 of the GATT.³² The argument to support this claim was that importers were legally required to post the bond *and* had to pay the Selective Consumption

³⁰ Panel Report, para. 7.308.

³¹ Appellate Body Report, *EC – Bananas III*, para. 141.

³² Request for the Establishment of a Panel by Honduras, WT/DS302/5.

Tax in full upon importation, whereas domestic producers only had to post the bond and were allowed an additional period within which to pay the Selective Consumption Tax. The issue of the timing of the payment of the Selective Consumption Tax was therefore not a claim, in and of itself, as the Panel erroneously found, but was rather one argument, among others, in support of Honduras' claim that the bond requirement resulted in treatment less favourable for importers.

79. As the Dominican Republic stated in its response to Question 88 from the Panel, [a]rticle 376 of the Dominican Republic Tax Code explicitly provides that the bond shall secure the Selective Consumption Tax." It is obvious that the Selective Consumption Tax has to be paid by domestic producers and importers at a certain time. The timing for the payment of the Selective Consumption Tax is established for importers and domestic producers in Articles 368 and 369 of the Tax Code of the Dominican Republic. Therefore, the timing of the payment of the Selective Consumption Tax is an issue related to the requirement that the bond is to secure the payment of the Selective Consumption Tax.

80. Following the line of reasoning set out by the Appellate Body in *EC – Hormones*, Honduras is of the view that the Panel's finding that the timing of the payment of the Selective Consumption Tax is outside its terms of reference overlooks the distinction between legal claims made by a complainant and arguments used by that complainant to sustain its legal claims. A panel would be prevented from addressing a legal claim that fell outside its terms of reference. That is not the case here. A panel is, however, not prevented from using an argument submitted by a party to support its findings.³³ In this case, the Panel erred in not recognising that the issue of the timing of the payment of the Selective Consumption Tax was not a claim, in and of itself, but rather an argument in support of the claim that the bond requirement was inconsistent with Article III:4.

81. Honduras respectfully requests that the Appellate Body reverse the Panel's finding that the timing of the payment of the Selective Consumption Tax was a claim that was not within its terms of reference. Based on the undisputed facts on the record, Honduras requests that the Appellate Body find that the issue of the timing of the payment of the Selective Consumption Tax was an argument in support of Honduras's claim that the bond requirement is in violation of Article III:4 of the GATT.

IV. CONCLUSION

82. In light of the considerations set out above, Honduras respectfully requests the Appellate Body to:

³³ Appellate Body Report, *EC – Hormones*, para. 156.

- § find that the Panel failed to make an assessment of the measure claimed by Honduras to be inconsistent with Article III:4 of the GATT and therefore violated Article 11 of the DSU;
- § find that the Panel erred in its interpretation of the terms "treatment less favourable" in Article III:4 of the GATT;
- § find that the bond requirement is inconsistent with Article III:4 of the GATT; and
- § find that the Panel erred in its finding that the timing of the payment of the Selective Consumption Tax was not within the terms of reference of the Panel.

83. Honduras also respectfully requests the Appellate Body to recommend in accordance with Article 19 of the DSU to request the Dispute Settlement Body to request the Dominican Republic to bring its bond requirement into conformity with the GATT.