

BEFORE THE APPELLATE BODY  
OF THE  
WORLD TRADE ORGANIZATION  
ON

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

AB–2005–3

**ORAL STATEMENT OF HONDURAS  
AT THE ORAL HEARING**

*Prepared with the cooperation  
of the Advisory Centre on WTO Law*

9 March 2005

Mr. Chairman and Members of the Appellate Body,

1. Honduras appreciates this opportunity to present its views. I will begin by presenting Honduras's arguments as an appellee on the tax stamp requirement and will then present our responses to Dominican Republic's arguments in its appellee submission on the bond requirement.

2. Turning first to the tax stamp requirement, Honduras wished to note at the outset that it is not questioning the right of a WTO Member to impose a tax stamp requirement on specific products. Many WTO Members have such a requirement which they impose in a WTO-consistent manner. What Honduras has challenged is the Dominican Republic's requirement that a tax stamp be affixed to all cigarette packets in its territory and under the supervision of its tax authorities. This requirement is to the advantage of domestic producers who can affix the stamp at their premises as part of their production process. Honduras argued that this discriminatory enforcement of the tax stamp requirement is in violation of Article III:4 and is not justified under Article XX(d) of the GATT 1994. The Panel agreed with Honduras. The Dominican Republic has not appealed the Panel's conclusion that the requirement at issue is inconsistent with Article III:4. Its appeal is only limited to the Panel's alleged error in finding that the discriminatory enforcement of the tax stamp requirement is not "necessary" and is therefore not justified under Article XX(d).

3. The Dominican Republic argues that (i) the Panel misinterpreted and misapplied the term "necessary" in Article XX(d) and that (ii) the Panel did not carefully examine whether alternative measures were "reasonably available." The Dominican Republic's arguments are without merit. The Panel cited and applied the appropriate weighing and balancing test as set out by the Appellate Body in order to determine whether the discriminatory enforcement of the tax stamp requirement was "necessary" within the meaning of Article XX(d). The EC agrees that all pertinent elements of the test had been considered and applied.

4. With respect to the "common interest" protected by the measure, the Dominican Republic is attempting to argue that its discriminatory enforcement of the tax stamp requirement contributes to the protection of the health of its citizens. The EC has observed that if the Dominican Republic really was concerned with public health it should have made an argument under Article XX(b) of the GATT. It did not. With respect to the trade impact

of the measure, Honduras notes that the Panel did not make a definitive finding, but merely made an assumption in order to proceed to the other elements of the test. The EC has correctly pointed out that one could assume that the increase of imports would have been even higher in the absence of, or "but for", the measure. With respect to the contribution of the measure to the ends pursued, the Panel correctly found the discriminatory enforcement of the stamp requirement does not lead to the elimination of forgery or smuggling or tax evasion.

5. In addition, the Dominican Republic has submitted that the Panel's methodological approach in examining whether alternative measures were "reasonably available" fall short of the requirements of Article XX(d). It submits that the Panel did not examine or weigh the proposed alternative measures 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 in *EC – Asbestos*. However, as the Dominican Republic has itself noted, the burden of proof is on the respondent to make a *prima facie* case that a less-restrictive alternative measure is not reasonably available.<sup>1</sup> The Dominican Republic failed to discharge its burden of proof. It cannot now blame the Panel for "methodological errors." Indeed, the Panel did not commit any methodological error with respect to the assessment of the alternative measures. The Panel could not make any findings about the alternative measure because the Dominican Republic had not discharged its burden to prove why the alternative measures would not contribute to the realisation of the ends pursued. Even though Honduras did not bear the burden of proof in this regard, it submitted arguments and evidence that demonstrated that there were reasonable alternatives available that were less trade-restrictive and which could contribute to achieving the same ends being pursued by the Dominican Republic. In considering the trade impact of the alternative measure as required by the *Korea – Beef* test, the Panel noted that Honduras had submitted that the pre-shipment inspection alternative would be "less trade-restrictive" than the challenged measure. It is important to note that the Panel never made a finding that the Dominican Republic was required to use pre-shipment inspection services. Thus, in our view, the Panel examined the appropriate factors to determine whether alternative measures were reasonably available to the Dominican Republic.

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<sup>1</sup> Appellant's Submission of the Dominican Republic, para. 51.

6. The Dominican Republic has argued vigorously that it cannot adopt the alternative measure of providing the tax stamps to producers to be affixed abroad because that "would fail to recognize the right of the Dominican Republic to enforce its own laws through State action; would increase the risk of producer driven smuggling; would be less likely to secure the goals of the contested measure; and would not eliminate the measure's already minimal effects on trade." Indeed, the Dominican Republic went so far as to say that "it has established, on a *prima facie* basis, that the alternative measure is not one it could reasonably be expected to employ."<sup>2</sup>

7. Honduras is surprised that the Dominican Republic is taking this position. In October 2004, it enacted Decree No. 1360 – 04 to modify Article 37 of the Decree 79-03 in order to allow importers to affix the tax stamp abroad at the time of production.<sup>3</sup> Pursuant to this Regulation, Honduras exported a cigarette shipment two weeks ago with the tax stamps affixed at the point of production.<sup>4</sup> Honduras assumes that the Dominican Republic still maintains its interest of maintaining tax collection and preventing smuggling and forgery. Therefore, by allowing the tax stamps to be affixed abroad, the Dominican Republic has acknowledged that this alternative measure is reasonably available and can contribute to the ends pursued. Indeed, as the EC has noted, the sale of tax stamps abroad to an authorised manufacturer is a very commonly used practice in order to secure that imported cigarettes fulfil the necessary tax requirements, as the risk of forgery is minimal.<sup>5</sup> It is important to note that the Dominican Republic's new regulation merely allows the exporter to affix the stamps abroad. It does not require that the exporter employ the services of a pre-shipment inspection company. Honduras notes that it is the importer itself which has engaged the services of a pre-inspection company and has paid for its services. A company can, of course, take on extra costs for its imported products, if it so wishes. WTO law only prevents governments from imposing additional costs on imported products.

8. Even though the Dominican Republic has passed a law allowing this reasonable alternative to be employed and has, in fact, allowed the importer to affix the tax stamp abroad, it is possible that the Dominican Republic could change its laws again. Therefore, in order to

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<sup>2</sup> Appellant's Submission of the Dominican Republic, para. 76.

<sup>3</sup> Annex 1. Decree No. 1360 – 04.

<sup>4</sup> Annex 2. Certificate of the affixation of the stamp abroad.

<sup>5</sup> Third Participant Submission by the European Communities, paras. 29-30.

secure a positive solution to this dispute, Honduras requests the Appellate Body to uphold the Panel's findings that the discriminatory enforcement of the stamp requirement is in violation of Article III:4 and is not "necessary" within the meaning of Article XX(d).

9. Honduras notes that the United States has made certain points with respect to the interpretation of Article XX(d). First, it states that it "considers incorrect the notion that Article XX(d) requires a Member to select a less-GATT inconsistent alternative, where no GATT-consistent alternative is available." However, Honduras submits that the Panel's reference to a "less-GATT" consistent option is merely a reflection of many rulings – starting with *US - Section 337* – which have interpreted the term "necessary" in Article XX(d). In cases where the only reasonably available alternative measures are WTO-inconsistent, a Member is bound to use the measure that entails the least degree of inconsistency with WTO obligations.

10. The United States has stated "[m]easures are either consistent or inconsistent with the GATT 1994; it is logically impossible to discern degrees of GATT-inconsistency..."<sup>6</sup> However, Honduras submits that the degree of GATT-inconsistency does not apply to the analysis of one measure in and of itself, but rather to the comparison between different measures. Therefore, if one alternative measure is inconsistent with Article III and Article I and another measure is inconsistent with Article III only, then a Member would be bound to choose the latter measure. Second, the United States has stated that "it is error for the Panel to attempt to retrofit this concept [less trade-restrictive] into Article XX(d) particularly since it is clear that these concepts are separate and distinct from the concept of necessary".<sup>7</sup> However, Honduras notes that in *EC – Asbestos*, the Appellate Body stated in its analysis of "necessary" under Article XX(b), that the "remaining question ... is whether there is an alternative measure that would achieve the same end and that is less restrictive of trade than a prohibition."<sup>8</sup> Therefore, the analysis of the trade impact of the alternative measure (as required by the test set out in *Korea – Beef* combined with the test in *US –Section 337*) may require the assessment of whether that measure is less trade- restrictive than the original measure.

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<sup>6</sup> Third Participant Submission of the United States, para. 5.

<sup>7</sup> Third Participant Submission of the United States, para. 7.

<sup>8</sup> *European Communities, -Measures Affecting Asbestos and Asbestos-containing Products*, WT7DS135/AB/R, para. 173.

Mr. Chairman and Members of the Appellate Body,

11. I will now turn to the bond requirement. As Honduras has noted in its Other Appellant's Submission, given the Panel's findings on this measure, there remains only one issue before the Appellate Body: does the bond requirement accord treatment less favourable to imported products than to like domestic products? In Honduras's view, the answer to this question is clearly yes. Honduras has submitted that the bond requirement constitutes an "extra hurdle" or "burden" for imported products.<sup>9</sup> The reason that imported products bear an extra burden is because of the lack of symmetry between the tax liabilities the bond secures for imported and domestic products. The fact remains that, for imported products, the bond must be posted to secure the payment of the Selective Consumption Tax which has already been paid at the border. The Dominican Republic has not addressed the "extra hurdle" argument in its Appellee's Submission, and therefore, has not rebutted this argument.

12. Honduras notes that that the issue with respect to the bond requirement is not the annual cost of the fee. It is the total amount of the bond of RD \$5 million pesos which could be called upon at any time to secure a variety of tax liabilities. An importer accounting for 2% of the market would have to post a bond for RD\$5 million pesos and a domestic producer accounting for 88% of the market would have to post the bond in the same amount. Such disproportionality between the amount of the bond and the liabilities to be secured between a small importer and a large domestic producer adversely affects the conditions of competition for an importer with a small market share. The law of the Dominican Republic inevitably leads to less favourable treatment in all such situations. Article III:4 requires the Dominican Republic to ensure that its laws accord no less favourable treatment to imported products in all situations.

13. The EC has stated that identical amount of the bond would have the same effect on a small importer who wished to test the market as on a small domestic producer that wished to test the market.<sup>10</sup> However, this is not correct. The possibility that an importer in certain circumstances may be accorded more favourable treatment than a domestic producer is not

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<sup>9</sup>Other Appellant's Submission of Honduras, paras. 55-68.

<sup>10</sup>Third Participant Submission of the European Communities, para. 51.

germane. As *US – Section 337* made clear, the notion of balancing more favourable treatment for some imported products with less favourable treatment for other imported products must be rejected.

Mr. Chairman and Members of the Appellate Body,

14. Honduras has made a claim under Article 11 of the DSU to the effect that the Panel erred in relying on a Letter, rather than on the legislation, in order to determine the scope of the liabilities the bond is intended to secure. The Dominican Republic has argued that the legislation need not specify the "uses" to which the bond may be put. By the same token, the legislation does not provide authority for the DGII to change the scope of the law so as to broaden the liabilities that are secured by the bond requirement. Honduras notes that, in the interests of transparency, predictability and certainty, information on the regulatory conditions under which traders operate has to be made publicly available so as to enable them to become acquainted with those regulatory conditions. It is in this context that Honduras takes issue with the Panel's reliance on the Letter in Exhibit DR-12 (written by one high-ranking official to another high-ranking official) indicating the "uses" the bond is intended to secure includes the ITBIS, income tax and withholding taxes.

15. Honduras submits that the Panel did commit an egregious error in its appreciation of this evidence. There were two letters from the same high-ranking official submitted to the Panel - in Exhibit DR-12 and Exhibit HOND-36. The Dominican Republic has described this official as "the person [best] qualified to make representations on behalf of the Dominican Republic regarding the permissible uses of the law as a matter of municipal law." Exhibit DR-12 is a letter from this official to the President of the Commission established on an *ad-hoc basis* for the settlement of this dispute. There is no indication that the information in this letter was made more widely available so as to allow traders to become acquainted with its contents. Second, Exhibit HOND-36 is a letter dated 13 May 2004 to the importer requesting the posting of the bond pursuant to the provisions regulating the Selective Consumption Tax, namely Article 376 of the Tax Code and Article 14 of the Regulations.<sup>11</sup> These two letters signed by the same official describe different liabilities that the bond secures. The Panel, however, ignored the information in Exhibit HOND-36 which was consistent with the text of the legislation in favour of the information provided in Exhibit DR-12 which was not in

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<sup>11</sup> Exhibit HOND-36.

accordance with the text of the legislation. In the light of the foregoing, therefore, Honduras does not consider that, as claimed by the Dominican Republic, the Panel followed the approach of previous panels and the Appellate Body, and objectively assessed *all of the pertinent evidence before it*, with respect to the municipal law at issue.<sup>12</sup>

16. Turning to our arguments with respect to the Panel's consideration of the "conditions of competition", Honduras disagrees that its arguments are contrary to the Appellate Body's interpretations of Article III:4. Honduras challenged the bond requirement as such. Indeed, at the time the Panel was established, the bond requirement had never been applied. In examining whether the Dominican Republic's bond requirement is in violation of Article III:4 of the GATT 1994, Honduras is not suggesting that the Panel could not have examined the conditions of competition established by the Dominican Republic. Honduras, however, submits that in its examination of whether the conditions of competition had been impaired, the Panel should have looked at the regulatory consequences of the measure for imported cigarettes, rather than the economic performance of an importer that happened to be in that market at a given point in time. It is in this context that the Panel erred.

17. Honduras believes that the Panel focused on irrelevant factors in its assessment of the consistency of the bond requirement with obligations under Article III:4. It examined the increase of imports from Honduras (from 0 to less than 2% of the market) combined with the fixed cost of the bond to demonstrate a decline in the per-unit cost of the bond for importers and to conclude that there was no impairment in the conditions of competition. The Panel disregarded the most important factor; namely, that the identical amount of the bond in the light of the different tax liabilities between 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 this potential for asymmetry between imported products and domestic products that leads to less favourable treatment for imported products. The Dominican Republic could, in the future, increase the fixed amount of the bond requirement to, say, RD\$ 50 million. This would be a fixed amount that would apply equally to importers and domestic producers. It would, however, bear no relation to the tax liabilities to be secured for importers, but may have a relationship to the tax liabilities to be secured for domestic producers. Therefore, an identical requirement could have different

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<sup>12</sup> Appellee's Submission of the Dominican Republic, para. 30.

consequences in their application that could affect the conditions of competition between imported and domestic products.

18. The Dominican Republic has argued that even if the bond requirement is in violation of Article III:4, it is nevertheless justified under Article XX(d) because it secures compliance with the SCT, the ITBIS and income tax – which, incidentally, are the same liabilities the Dominican Republic has argued that discriminatory enforcement of the tax stamp secures. The Dominican Republic has argued that the bond requirement is "indispensable" or "necessary" under Article XX(d). Even if the bond is necessary, *arguendo* to guarantee collection of these taxes, then why is it only required for alcohol and cigarettes products and not for *all* products that must pay the SCT, the ITBIS and income tax. For those other products, therefore, the Dominican Republic must have in place an alternative measure that is reasonably available to secure compliance with its tax laws.

19. In Honduras's view, just as the Panel found that the Dominican Republic had not proven that the discriminatory enforcement of the tax stamp requirement was "necessary" under Article XX(d), the Appellate Body should find that the Dominican Republic has not proven that its bond requirement is "necessary" under Article XX(d).

20. Thank you for your attention. We stand ready to answer any questions you may have.