

**Mexico – Tax Measures on Soft Drinks and Other Beverages  
(WT/DS308)**

**March 22, 2005**

**Comments of the United States on  
Mexico’s Answers to Questions of the Panel in Relation  
to the Second Substantive Meeting with the Parties**

**1. For both parties**

**52. The Panel recalls that, in its response to Panel questions Nos. 45 and 50, Mexico stated that “as of 1 January 2005, imported soft drinks, syrups and concentrates for preparing soft drinks will be exempt from payment of the IEPS, as long as they are sweetened only with cane sugar.” Could parties please provide more information in this regard?**

**The Panel further notes that, in its rebuttal submission, the United States has said that “The January 1, 2005 amendment to the HFCS soft drink tax is outside the Panel’s terms of reference.” Do parties have any additional comments on the matter? Could they please explain how the new amendment works and how it has changed the previous relevant provisions of the law.**

1. Mexico’s response misinterprets Article 11 of the DSU. Contrary to Mexico’s assertion and its incorrect reading of the panel report in *India – Autos*,<sup>1</sup> Article 11 of the DSU does not require panels to take into account amendments to measures that occur after the date of the panel request.

2. Rather, Article 11 of the DSU requires panels to 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....” The “matter before” a panel is the matter (which consists of the measures at issue and the claims made with respect to those measure) identified in the panel request. Accordingly, the matter before this Panel is the consistency of the tax measures identified in the U.S. panel request with Mexico’s obligations under Article III of the GATT 1994. The tax measures identified in the U.S. panel request are:

Law on the Special Tax on Production and Services (*Ley del  
Impuesto Especial sobre Producción y Servicios* or “IEPS”)

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<sup>1</sup> It is evident from the quotation included in Mexico’s response that the *India – Autos* panel’s citation to Article 11 of the DSU was made in connection with “the appropriateness of making a recommendation under Article 19.1 of the DSU.” It was not made in connection with whether the panel should make findings on the measures at issue inclusive of subsequent amendments. Panel Report, *India – Measures Affecting the Automotive Sector*, WT/DS146/R, WT/DS175/R, adopted on April 5, 2002, para. 8.26; *see also infra*.

published on January 1, 2002 and its subsequent amendments published on December 30, 2002 and December 31, 2003; and

any related or implementing measures, including the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* published on May 15, 1990, the *Resolucion Miscelanea Fiscal Para 2004* (Title 6) published on April 30, 2004, and the *Resolucion Miscelanea Fiscal Para 2003* (Title 6) published on March 31, 2003 which identify, *inter alia*, details on the scope, calculation, payment and bookkeeping and recording requirements of the IEPS.<sup>2</sup>

Because the U.S. panel request does not include the January 1, 2005 amendment, it is not within the Panel’s terms of reference and, accordingly, is not part of the “matter” of which Article 11 of the DSU requires the Panel to make an objective assessment. In fact, because the January 1, 2005 amendment is not within the Panel’s terms of reference, it is not a measure for which this Panel is authorized to issue findings, either alone or in connection with the IEPS as it existed on the date of the U.S. panel request.

3. While Mexico refers to *India – Autos* in support of its assertion that panels are required to take into account amendments to a measure after a panel request, the panel in that report did not find this.<sup>3</sup> To the contrary, it made findings on the measures as they existed on the date of panel establishment.<sup>4</sup> The context in which the panel examined India’s amended measure was to determine whether to make the recommendation called for under DSU Article 19.1.<sup>5</sup> In this regard, it is worth noting that none of the parties, including India and the United States, considered that the panel had the authority to undertake this examination.<sup>6</sup>

4. Furthermore, the United States did not consider that the *India – Autos* panel’s concerns regarding its obligations under DSU Article 11 supported the panel’s approach. The United States noted that the panel had expressed a concern that it would not be carrying out its function of assisting the Dispute Settlement Body (“DSB”) unless it revisited the Indian measures as

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<sup>2</sup> WT/DS308/4.

<sup>3</sup> In fact, the panel specifically rejected the proposition that events occurring subsequent to the panel’s establishment prevented it from examining the measures as they existed at the time of the panel’s establishment. Panel Report, *India – Autos*, para. 7.29-7.30.

<sup>4</sup> *Id.* paras. 7.29-7.30, 8.2-8.3.

<sup>5</sup> *Id.*, para. 8.20 (“The issue is limited solely to the question of whether, as argued by the respondent, certain events subsequent to the Panel’s establishment are such as to affect the continued relevance of the Panel’s initial findings with regard to measures clearly within its terms of reference. This raises the issue of whether they should be considered, in this light, before the Panel can make appropriate recommendations as to the need for India to bring its measures into conformity with the GATT 1994”); *see also id.*, paras. 8.00- 8.30, 8.32, 8.58.

<sup>6</sup> *Dispute Settlement Body: Minutes of the Meeting Held on 5 April 2002*, WT/DSB/M/171, paras. 12, 15-18.

amended during the course of the proceedings. The United States disagreed with the panel on this point and noted that the panel’s report – even without the additional analysis of the amended measure – would provide the DSB with assistance by establishing the rulings and recommendations with which India would have to comply. As the *Indonesia Autos* panel had noted, a revocation (or other elimination or amendment) of a challenged measure would be particularly relevant at the implementation stage of dispute settlement.<sup>7</sup>

5. Finally, we note that even under its own terms, the analysis of the *India – Autos* panel would not apply here. That Panel noted that its approach was not required by the DSU but instead responded to a very particular set of circumstances:

[T]he decision taken by this Panel to proceed in this way in the particular circumstances of this case is in no way intended to imply that panels have a general duty to systematically re-evaluate the existence of any violations identified before proceeding with making their recommendations under Article 19.1. This Panel is simply responding to the particular arguments placed before it, where the parties disagree as to the implications of subsequent events on the Panel's power to make recommendations and rulings. The principal aim of the Panel in proceeding in this manner is to discharge its duty in the most efficient way towards resolving the matter at issue in this dispute.<sup>8</sup>

The panel also noted that the impact of the subsequent events had been “discussed before this Panel from the very first stages of the proceedings” and that the parties to the dispute had raised “a number of arguments ... to suggest that certain events having occurred in the course of the proceedings fundamentally affect the existence or persistence of the alleged violations.”<sup>9</sup> In contrast, Mexico has not argued that the January 1, 2005 amendment eliminates the discriminatory treatment of imports imposed by the IEPS.<sup>10</sup>

6. Therefore, for a number of reasons, the approach of the panel in *India – Autos* should not be adopted in this dispute. As the United States noted in its second submission and responses to questions after the second meeting, a number of panels have confronted the issue of how to

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<sup>7</sup> This paragraph summarizes a portion of the U.S. submission to the Appellate Body in the appeal that India filed from the panel report in the *India – Autos* dispute. India ultimately withdrew that appeal, as is evident from the minutes of the DSB referred to in the previous footnote.

<sup>8</sup> Panel Report, *India – Autos*, para. 8.30.

<sup>9</sup> *Id.*, para. 8.16.

<sup>10</sup> See U.S. Second Written Submission, para. 33; see also U.S. Answers to the Questions of the Panel After the Second Meeting, paras. 5-6.

handle post-panel request changes to measures within their terms of reference and each decided to issue findings on the measure as it existed at the time of the panel request.<sup>11</sup>

**54. Do the parties view the so-called “bookkeeping requirements” as a separate measure from the “soft drinks tax” and the “distribution tax”, or rather as a measure which is ancillary to the two last. If it is an ancillary measure, would that fact have any consequence on the way the Panel should analyse those “bookkeeping requirements”?**

7. Mexico states that “the bookkeeping and reporting requirement are contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* published on May 15, 1990, the *Resolución Miscelanea Fiscal Para 2003* (Title 6) published on March 31, 2003, and the *Resolución Miscelanea Fiscal Para 2004* (Title 6) published on April 30, 2004.”<sup>12</sup>

8. To avoid confusion, the measure at issue with respect to the U.S. claim against the “bookkeeping and reporting requirements” is the IEPS.<sup>13</sup> Article 19 of the IEPS requires producers of soft drinks and syrups who use sweeteners other than cane sugar to maintain and submit the following to the Mexican Government:<sup>14</sup>

- annual listing of the goods “produced, transferred or imported in the previous year, as regards consumption by state and the corresponding tax, as well as the services provided by establishment in each state”;<sup>15</sup>
- quarterly reporting of “information regarding [taxpayers’] 50 main clients and suppliers”;<sup>16</sup>

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<sup>11</sup> U.S. Second Written Submission, para. 32 n.47; U.S. Answers to the Questions of the Panel After the Second Meeting, para. 4 n.6; *see also* Panel Report, *India – Autos*, para. 7.26 n. 313. The GATT panel in *Thailand – Cigarettes* also does not support Mexico’s position. GATT Panel Report, *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, BISD 37S/200, adopted on November 7, 1990. In making findings on the measures inclusive of amendments made subsequent to the panel request, the *Cigarettes* panel would appear to have exceeded its terms of reference, although the panel’s report does not reflect that either the parties or the panel considered this issue.

<sup>12</sup> Mexico Responses to Questions of the Panel After the Second Meeting, p. 3 (revised courtesy translation).

<sup>13</sup> *See* U.S. First Written Submission, paras. 46, 155, 161-162; U.S. Answers to the Questions of the Panel After the First Panel Meeting, paras. 50-52.

<sup>14</sup> The following list of bookkeeping and reporting requirements contained in IEPS is cited in the U.S. First Written Submission. U.S. First Written Submission, para. 46.

<sup>15</sup> IEPS as amend, Art. 19.VI, Exh. US-4.

<sup>16</sup> *Id.*, Art. 19.VIII.

- quarterly reporting of the “monthly reading registered by devices used to carry out [physical] inspection” of the volume of goods manufactured, produced, or bottled;<sup>17</sup>
- quarterly reporting of the price, value and volume of goods transferred in the previous quarter;<sup>18</sup> and
- registry by importers and exporters of soft drinks and syrups with the Ministry of Finance and Public Credit.<sup>19</sup>

The “transitional provisions” of the IEPS require soft drink and syrup producers who use sweeteners other than cane sugar to maintain and report their complete inventory of taxable products as of December 31, 2001.<sup>20</sup>

9. The regulations Mexico cites in response to the Panel’s questions<sup>21</sup> guide implementation of the IEPS, including implementation of the IEPS’s bookkeeping and reporting requirements.<sup>22</sup> The United States understands Mexico’s statement that these regulations “are linked inseparably” to the IEPS to mean that Mexico understands that conformity with its obligations under Article III:4 of the GATT with respect to the bookkeeping and reporting requirements (if a breach is found) requires elimination of the discriminatory treatment of imports imposed by the IEPS as well as by these implementing regulations.

10. Also, to avoid confusion, the U.S. claim against the IEPS’s bookkeeping and reporting requirements is under Article III:4 of the GATT not Articles III:4 and III:2 as Mexico’s response to the Panel’s question suggests.

**58. During the second substantive meeting (paragraph 33 of written version), Mexico has said that its measures may be justified under the NAFTA. Further, in its closing statements, Mexico argued that a NAFTA panel could find that the tax measures imposed by Mexico would be acceptable countermeasures. Does the United States agree with this statement? Could Mexico please elaborate on its statements and provide reference to the provisions of the NAFTA agreement under which its measures would be justified.**

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<sup>17</sup> *Id.* Art. 19.X.

<sup>18</sup> *Id.* Art. 19.XIII.

<sup>19</sup> IEPS as amended, Art. 19.XI, Exh. US-4.

<sup>20</sup> IEPS Disposiciones Transitorias (transitional provisions), Jan. 1, 2002, Art. 2, para. I(a). The transitional provisions were enacted as part of the IEPS on December 30, 2001 and thus form a component of that measure. *See* U.S. First Written Submission, para. 46 and Exh. US-4.

<sup>21</sup> The United States also cites these regulations in its panel request and first written submission. *See* WT/DS308/4; U.S. First Written Submission, paras. 4 and 47.

<sup>22</sup> *See* U.S. First Written Submission, para. 47.

11. As the United States has stated, whether Mexico’s tax measures are inconsistent with the NAFTA is not relevant to resolution of this dispute, which concerns the consistency of Mexico’s tax measures with its obligations under the WTO Agreement.

12. Mexico’s response to the Panel’s question does, however, highlight the complexity of any “defense” Mexico might raise under the NAFTA and why this Panel should not take into account Mexico’s contention that its tax measures would be consistent with the NAFTA in making findings in this dispute. Whether Mexico’s tax measures are inconsistent with the NAFTA is a complex *legal* determination and one this Panel is not in a position to make.<sup>23</sup> As Mexico itself has made very clear, determination of the rights and obligations of parties to the NAFTA is beyond the terms of reference of this Panel.<sup>24</sup>

**59. Do the parties consider that the NAFTA Agreement is part of the United States’ domestic “laws or regulations”? What implication would that fact have for the expression “laws or regulations” as used in paragraph (d) of Article XX of the GATT in this dispute?**

13. To respond to the Panel’s question of whether the NAFTA is part of U.S. laws or regulations, Mexico states that “although NAFTA is an international treaty, it plainly has effects in the domestic legal orders of all three NAFTA Parties that go beyond implementing action taken by any particular signatory.” Thus, when asked directly, Mexico did not assert that the NAFTA is a domestic law or regulation of the United States, as it seemed to be suggesting at the second panel meeting<sup>25</sup>. Mexico now appears to agree that the NAFTA is not a U.S. law or regulation.

14. Contrary to Mexico’s assertion, whether there is a “strict dualist separation between international obligations and domestic law” is not the point. The point is whether “laws or regulations” as the phrase is used in Article XX(d) includes international obligations under an international agreement. As earlier U.S. submissions and statements have explained, the ordinary meaning of the phrase interpreted in its context and in light of agreement’s object and purpose means the domestic laws or regulations of the Member claiming the Article XX(d)

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<sup>23</sup> The United States does not share Mexico’s view that a NAFTA Chapter 20 panel would find its tax measures consistent with the NAFTA, nor does it share Mexico’s interpretation of the NAFTA in this regard. In addition, with all respect to the experience that the members of Mexico’s delegation have with proceedings under Chapter 11 of the NAFTA, that chapter is simply not relevant to this dispute. It is not part of the WTO Agreement; its provisions are different from those at issue here; and it applies in investor-to-state investment disputes (not state-to-state trade disputes, such as, for instance, a hypothetical dispute between Mexico and the United States regarding Article 301 of the NAFTA).

<sup>24</sup> See, e.g., Mexico Responses to Questions of the Panel After the Second Meeting, p. 17 (revised courtesy translation).

<sup>25</sup> Mexico Closing Statement at the Second Meeting, paras. 8-16.

exception.<sup>26</sup> Mexico’s contention that international obligations affect domestic legal orders does not support its argument that the phrase “laws or regulations” means “international agreement” or “treaty.” In fact, it would seem to suggest that Mexico recognizes that international obligations are different from the “domestic legal orders” they may affect.

**60. As parties are aware, the Appellate Body has stated that, in order to evaluate the “necessity” of a measure under Article XX(d), a panel would need to examine, among other factors, “the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect” (Appellate Body Report, *Korea - Various Measures on Beef*). Could parties please explain, in their view, what would be “the common interests or values” that the NAFTA Agreement is intended to protect.**

15. In its response, Mexico identifies several “common interests or values” it attributes to the NAFTA, for example the elimination of barriers to trade in goods and the promotion of conditions of fair competition in the free trade area. Ironically, Mexico’s tax measures advance neither of these interests or values. Instead, Mexico’s tax measures effectively block U.S. exports of HFCS to Mexico and eliminate the possibility of fair competition between HFCS and cane sugar in the Mexican market. Mexico freely admits its tax measures were put in place to stop the displacement of Mexican cane sugar by imported HFCS (i.e., to protect its domestic industry from imports).

16. Mexico’s citation to the U.S. statements about simultaneous or redundant proceedings in multiple fora would appear to be inapposite.<sup>27</sup> The only dispute settlement forum to which the United States has submitted this dispute is the WTO dispute settlement mechanism. And, despite Mexico’s arguments otherwise, this dispute is a dispute over the consistency of Mexico’s tax measures with Mexico’s WTO obligations. Mexico’s NAFTA grievances against the United States with respect to market access for Mexican sugar are simply a different matter.

17. Mexico also states in its response that the United States has made “false statements” with regard to the status of the NAFTA proceeding. The United States trusts that this is an error in translation and that Mexico does not truly intend to make such a spurious charge. The United States cannot see how there is any dispute that: (1) the United States has engaged in consultations with Mexico, both bilaterally and under the auspices of the Free Trade Commission; (2) because the consultations did not resolve the dispute and because Mexico requested a panel, a NAFTA panel was established; (3) the parties have not agreed on panel composition and, because of the lack of automaticity in the panelist selection stage under the NAFTA, a panel has not yet been composed; and (4) the NAFTA dispute remains pending.

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<sup>26</sup> See, e.g., U.S. Answers to Questions of the Panel After the First Meeting, paras. 71-74; U.S. Second Written Submission, paras. 42-48; U.S. Opening Statement at the Second Meeting, paras. 5-7.

<sup>27</sup> See Mexico Response to Questions of the Panel After the Second Meeting, p. 15 (revised courtesy translation).

18. As mentioned at the first meeting of the Panel,<sup>28</sup> the fact that a NAFTA panel has not been composed is not indicative of a lack of dedication on the part of the parties to resolve their differences under the NAFTA. Before and during these proceedings before the WTO, the United States and U.S. sugar producers have continued to engage with Mexico and its industry on the NAFTA sugar issue. The current WTO proceeding is to resolve a separate dispute over the consistency of Mexico’s tax measures with Mexico’s obligations under the WTO Agreement.

**61. Could parties share their views on whether a successful invocation of an Article XX(d) defence would require that the contested measure be necessary to prevent or correct a breach of the underlying “law or regulation”?**

19. Mexico has suggested in its response that “measures that *make some contribution*” to securing compliance with the law or regulation at issue which, in Mexico’s view, “includes measures that are instruments to achieve the prevention or correction of a breach of the underlying law or regulation, can be justified under Article XX(d) of the GATT 1994.”<sup>29</sup> In *Korea - Beef*, however, the Appellate Body explained that “a ‘necessary’ measure is . . . located significantly closer to the pole of ‘indispensable’ than to the opposite pole of simply ‘making a contribution to.’”<sup>30</sup> Mexico has made no attempt to explain how a measure that it concedes is merely at what the Appellate Body has called the “opposite pole” of “making [some] contribution to” securing compliance can meet the requirements of Article XX(d).

20. In this dispute, the only “contribution” Mexico claims its tax measures make to securing compliance with alleged NAFTA obligations is the harm such measures cause U.S. HFCS exporters which Mexico asserts creates “the desired dynamic” to “induce” the United States to change its sugar regime.<sup>31</sup> As the United States has previously stated, imposition of Mexico’s discriminatory tax measures has not contributed to a resolution of concerns under the NAFTA.<sup>32</sup> Mexico’s response also implicitly concedes that Mexico does not claim that its tax measures do anything more than “make some contribution to” securing compliance, and in its closing statement at the second panel meeting, Mexico appears to acknowledge that any “effect aimed at resolution” its tax measures might have “has been a minor one.”<sup>33</sup>

**63. In its second written submission and also during the second substantive meeting (paragraphs 43-52 of written version), Mexico has stated that a WTO panel**

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<sup>28</sup> U.S. Closing Statement at the First Meeting of the Panel, para. 9.

<sup>29</sup> Mexico Responses to Questions of the Panel After the Second Meeting, p. 16 (revised courtesy translation) (emphasis added).

<sup>30</sup> Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, adopted on Jan. 10, 2001, para. 161.

<sup>31</sup> Mexico Second Written Submission, para. 83; *see also* Mexico Responses to Questions of the Panel After the Second Meeting, p. 28 (revised courtesy translation) (stating “the U.S. HFCS obviously is not pleased with the measures and they have communicated that the U.S. authorities”).

<sup>32</sup> U.S. Answers to Questions of the Panel After the First Meeting, para. 78.

<sup>33</sup> Mexico Closing Statement at the Second Panel Meeting, para. 18.



**does not have a legal obligation to issue findings on the claims raised by a complaining Member, but rather has the flexibility to decide whether to issue rulings or to make recommendations, as appropriate. Is it the parties view that that discretion, if it in fact exists, is vested by the WTO agreements on panels or rather on the Dispute Settlement Body (or the Contracting Parties acting jointly, in the case of the GATT)?**

21. Mexico's response inexplicably continues to ignore Article 19.1 of the DSU. Article 3.1 of the DSU provides that "Members affirm their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of the GATT 1947, and the rules and procedures as further elaborated and modified herein." Thus, the DSU both affirmed the principles and modified the dispute settlement practices of the GATT, for instance adopting the negative consensus rule for adoption of panel reports and other important changes to GATT 1947 panel practice. Even assuming Article XXIII of the GATT provided GATT panels "flexibility" in the recommendations they might make,<sup>34</sup> such flexibility does not exist under the DSU, as Article 19.1 expressly states that "[w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." Article 19.1 further provides that "[i]n addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations." Therefore, even suggestions under Article 19.1 are limited to ways in which the Member could implement a recommendation to bring its measure into conformity and do not extend to the type of "recommendation" Mexico suggests.

22. It is true that in the 1971 *Jamaica – Margins of Preference* dispute Mexico cites, the panel decided to provide a ruling on Jamaica's obligations, and then drafted a waiver decision and left it to the GATT Council to decide whether to adopt the waiver. But if a WTO panel today were to make such a recommendation, or to make the type of recommendations sought by Mexico during these panel proceedings, that panel would be acting inconsistently with DSU Article 19. The panel in the recent *EC – Sugar* report, presented with a request to permit the defending party to correct its schedule of export subsidy commitments, refused to grant that request, finding that

In the Panel's view, the European Communities' assertion that in the light of the circumstances the only course of action is for the Complainants to agree to the correction or revision of the European Communities' Schedule is not a matter for which the Panel has any authority as it goes beyond the scope of a panel recommendation which, under Article 19.1 of the DSU, should be limited to

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<sup>34</sup> As the United States has already explained, any "flexibility" Article XXIII of the GATT continues to afford is vested in the Members acting jointly, not panels. See U.S. Responses to the Questions of the Panel After the Second Meeting, para. 35.

recommending the concerned Member "bring the measure into conformity with the Agreement on Agriculture."<sup>35</sup>

**64. Mexico has said throughout the case that the Panel would not need to interpret NAFTA rules. However, in an Article XX(d) defence, a panel may need to interpret the underlying “law or regulation” to assess whether a measure is actually justified. Would that mean, in the parties’ opinion, that this Panel may in fact have to interpret NAFTA rules?**

23. In its response, Mexico lists several “facts” that it asserts the Panel can “see and consider” without having to determine whether the United States is in breach of its NAFTA obligations. The “facts” Mexico asks the panel to “see and consider,” however, do not establish the elements Mexico would need to establish for a defense under Article XX(d). To sustain its defense under Article XX(d), Mexico must show that its tax measures are “necessary to secure compliance” with laws or regulations. Even under Mexico’s theory, if the United States is already in compliance with its obligations under the NAFTA with respect to market access for Mexican sugar – as it maintains it is – Mexico’s tax measures could not be “necessary to secure compliance” with those obligations. The Panel, therefore, cannot assess whether Mexico’s tax measures are “necessary” or are designed to “secure compliance” without resolving the question of whether the United States is in breach of its NAFTA obligations.

24. Mexico’s response also appears to contradict itself. On the one hand Mexico is quite clear in stating that the Panel does not have “jurisdiction” to decide “whether the United States has breached its obligations established under NAFTA Annex 703.2,” but, on the other hand, asks the Panel to “determine whether ... [the United States] failed to comply with its obligation to submit Mexico’s grievance to dispute settlement.”<sup>36</sup> Mexico protests that this latter inquiry “does not involve fine points of law peculiar to the FTA” and “is essentially one of fact to be determined by reference to the plain text of Chapter Twenty and does not involve the kind of evidence and interpretation that would be put before the NAFTA panel on the other issues.”<sup>37</sup> Yet such an undertaking would manifestly constitute interpretation and application of the NAFTA. The mere fact that Mexico believes the question of whether the United States is in breach of its obligations under Chapter 20 is less complicated than whether the United States is in breach of its NAFTA market access obligations does not mean the former is any less a request for this Panel to engage in interpretation and application of the NAFTA – something Mexico has been very clear this Panel may not do.

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<sup>35</sup> Panel Report, *EC – Export Subsidies on Sugar*, WT/DS265/R, circulated on October 15, 2004 (pending Appellate Body Report on other issues) para. 7.353.

<sup>36</sup> Mexico Response to Questions of the Panel After the Second Meeting, p. 18-19 (revised courtesy translation).

<sup>37</sup> *Id.* at 19 (revised courtesy translation).

25. Mexico is also incorrect in what it identifies as “facts” and that these alleged “facts” have not been disputed by the United States.<sup>38</sup> Mexico’s assertion that “Mexico’s attempts to find solution through the institutional mechanism [of the NAFTA] have been frustrated by the United States’ acts and omissions”<sup>39</sup> is not a fact. It is a conclusion drawn by Mexico and based on an opinion – that the United States does not share – of what the NAFTA dispute settlement provisions required and how dispute settlement under such provision should proceed.

26. Mexico also asserts that “[i]t is incorrect to suggest that a Panel can never state an opinion on an international treaty other than the WTO.”<sup>40</sup> The U.S. position, however, is not that “a Panel can never state an opinion on an international treaty other than the WTO” Agreement, but rather that nothing in this dispute calls, or provides a basis, for the Panel to do so. This Panel was established to resolve a WTO dispute over the consistency of Mexico’s tax measures with Mexico’s WTO obligations. Opinions as to what the NAFTA obligates parties to do, and whether the United States is compliance with those obligations, are not relevant to this inquiry.

**66. Could the parties please expand upon the views they hold regarding the relevance of Article 23 of the DSU to the present dispute?**

27. Article XXIV of the GATT states that the GATT “shall not prevent ... the formation of ... a free trade area ... [p]rovided that” certain conditions are met. Mexico’s citation to Article XXIV, however, does not resolve the dilemma Mexico creates by reading “laws or regulations” in Article XX(d) to mean obligations under an international agreement. If “laws or regulations” includes obligations under an international agreement, as Mexico contends, then it includes obligations under any international agreement, including the WTO Agreement. There is nothing about Mexico’s interpretation of the phrase “laws or regulations” that limits it to agreements concerning free trade areas. Mexico’s interpretation of Article XX(d), therefore, remains in conflict with Article 23 of the DSU and, if accepted, would render Article 23 meaningless. WTO Members would no longer be required to use and abide by DSU rules in seeking to redress a violation of obligations under the covered agreements, but would, by way of Article XX(d), be permitted to decide on their own accord when such a breach has occurred and the remedies to be taken therefor.

**68. In the opinion of the parties, does Article 60 of the Vienna Convention on the Law of Treaties codify a principle of international law by which a material breach of a bilateral treaty by one of the parties may allow the other to invoke that breach as a ground for, inter alia, suspending the operation of that treaty in whole or in part, but not for suspending the operation of a different multilateral treaty?**

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<sup>38</sup> See, e.g., U.S. Responses to Questions of the Panel After the Second Meeting, paras. 61-67.

<sup>39</sup> Mexico Response to Questions of the Panel After the Second Meeting, p. 18 (revised courtesy translation).

<sup>40</sup> *Id.*

28. From its response, it appears Mexico shares the U.S. view that Article 60 is not relevant to this dispute.

### 3. For Mexico

#### 82. Could Mexico please provide the following information regarding the operation of the "distribution tax":

(a) The Panel notes that, according to the legislation that has been provided, the "distribution tax" seems to be imposed at an ad valorem rate of 20 per cent, not of the price of the soft drinks or syrups, but rather on the value of the services provided. Could Mexico please explain if, in practice, the value of the services provided would in any manner be linked to the value of the goods related to those services or to the volume of the products to be transferred?

29. In response to the Panel’s question, Mexico states that the “distribution of goods that are subject to the IEPS tax is exempt from the tax payment unless services of commercial intermediation, which involve the participation of a third party through which the transfer of the goods takes place, are used.” Although it is true that the distribution tax does not apply to goods distributed by the soft drink or syrup producer, this is not because the IEPS “exempts” goods distributed by the soft drink or syrup producer from the distribution tax. Rather, this is because the distribution tax applies to goods *transferred* through the use of distribution, representation, brokerage, agency and consignment services. Therefore, if a soft drink or syrup producer acted as its own distributor, this would not constitute a transfer of goods through the use of distribution services. Mexico’s response to Questions 82(b) and 82(c) confirm this interpretation. Mexico’s response to Question 82(b) states that the distribution tax is not applicable when the services concerned “are related to the transfer of goods that are not subject to the IEPS tax.”<sup>41</sup> Question 82(c) states that individuals and legal persons that supply distribution services are subject to the IEPS “with regard to the transfers of ... soft drinks and its concentrates.”<sup>42</sup>

(c) Could Mexico please explain if, according to the legislation, the person legally liable for the payment of the tax is the supplier of the service. If so, could Mexico please clarify what effect, if any, does the fact that the producers seem to retain the tax and pay it directly to the tax authorities have in practice.

30. The United States points out that the burden of retaining and paying the distribution tax is a burden soft drink and syrup producers incur only if they use HFCS or another non-cane sugar sweetener to sweeten their products.

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<sup>41</sup> Mexico’s Responses to the Questions of the Panel After the Second Panel Meeting, p. 25 (revised courtesy translation) (emphasis added).

<sup>42</sup> *Id.* at 26 (revised courtesy translation) (emphasis added).

**83. In its first written submission and also during the second substantive meeting (paragraph 18 of written version), Mexico said that the tax measures were "not intended to afford protection to domestic production within the meaning of article III of the GATT 1994". Could Mexico please elaborate on this assertion. In Mexico's opinion, does the intent of a measure relate to the expression contained in Article III:1 that measures should not be applied "so as to afford protection to domestic production"?**

31. Although the "intent" of Mexico's tax measures does not answer the question of whether Mexico's tax measures are "applied so as to afford protection to domestic production" within the meaning of Article III of the GATT, the numerous statements made by Mexico's legislators at the time of the IEPS's enactment demonstrate a very clear intent to protect Mexico's cane sugar industry.<sup>43</sup> Mexico's Supreme Court reached the same conclusion on multiple occasions stating quite plainly that the intent of Mexico's tax measures is to "protect the sugar industry."<sup>44</sup> Mexico's assertions in this dispute that the purpose of its tax measures is to enforce alleged U.S. NAFTA obligations appear to be simply an attempt to rationalize the imposition of Mexico's tax measures *post hoc*.

**84. During the second substantive meeting, Mexico made reference to specific provisions in the WTO covered agreements that use expressions such as "laws", "regulations", "international law" in different forms. Could Mexico identify more precisely those specific provisions.**

32. Mexico's response argues that there are many references to "laws and regulations" in the WTO Agreement, and that when the drafters intended to limit these references to a Member's own domestic measures they did so explicitly, and that therefore the reference to "laws or regulations" in the text of Article XX(d) includes not just the domestic laws or regulations of the Member whose measure is at issue (here, Mexico), but also the domestic laws or regulations of other Members, and international law as such.

33. Restating Mexico's argument fully, as above, illustrates how far Mexico's textual argument reaches, and how many consequences would follow from endorsing it. Any Member could take measures necessary to secure compliance with *another* Member's laws or regulations, or to secure compliance with any obligation arising under an international agreement.

34. Mexico has submitted a list of provisions referring to "laws and regulations," although it has not provided any analysis of that list (and the United States has not been able to review each and every entry on the list). It is obvious, however, that while a number of the examples cited in Mexico's list (such as Article III:4 of the GATT) do not include provisions explicitly limiting

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<sup>43</sup> U.S. First Written Submission, para. 48.

<sup>44</sup> *Id.*, paras. 49-53, Exh. US-31.

their scope to *domestic* law, they are implicitly so limited based on the context and the function that the provision performs. Article III:4, for instance, can by definition only concern *domestic* measures.

35. Where the drafters intended to address an international agreement or international law generally, or the laws or regulations of a Member other than the Member to which the right or obligation in the relevant provision applied, they provided so explicitly and on an exceptional basis. As an example, the United States recalls the provisions in Article X:1 of the GATT requiring publication of international agreements affecting trade in services or goods, *explicitly in addition* to publication of "laws or regulations." With respect to the measures of other Members, the United States notes as an example the provisions in Article 12.8 of the *Agreement on Safeguards* regarding cross-notification of other Members' measures.

**85. In paragraph 70 of its second written submission, Mexico observed that "international law is no less law than domestic law" and added that "[t]he NAFTA has effect in the internal legal order of its signatories." Could Mexico please elaborate on that statement. Does Mexico mean that the NAFTA agreement is part of Mexican domestic law and how would Mexico sustain that assertion by reference to its law?**

36. In its response to the Panel's question, Mexico states that it is due to its own constitutional and legal system that the NAFTA has direct effect in Mexican law. Just as it is Mexico's own constitutional and legal system that makes the NAFTA have direct effect in Mexico, it is the U.S. constitutional and legal system that makes the NAFTA not have direct effect in the United States.

**86. Could Mexico please explain why it considers that its measures "actually greatly contribute to the end pursued by Mexico, that is, the securing of U.S. compliance with the NAFTA" (paragraph 83 of its second written submission).**

37. Please see comments on question 61.

**87. In its second written submission (paragraph 14) and also during the second substantive meeting (paragraph 37 of written version), Mexico has referred to "a general principle of international law" by which "one party cannot avail himself of the fact that the other has not fulfilled some obligation, or has not had recourse to some means of redress, if the former party has, by some illegal act, prevented the latter from fulfilling the obligation in question, or from having recourse to the tribunal which would have been open to him". Could Mexico clarify what is the "illegal act" that it is alleging the United States is committing in this regard?**

38. In response to the Panel's question, Mexico states: "There are two breaches of the NAFTA at issue here: the denial of market access and the persistent refusal to submit that

grievance to dispute settlement when the United States has a positive obligation to do so under Chapter Twenty.”<sup>45</sup> Mexico’s assertion that the United States is in breach of NAFTA dispute settlement provisions, however, appears to contradict Mexico’s earlier acknowledgment of the “lack of automaticity in the operation of [dispute settlement under] NAFTA’s Chapter Twenty” and the “fault in the panelist appointment process under NAFTA’s Chapter Twenty.”<sup>46</sup> Mexico cannot conflate what it obviously perceives as shortcomings of the NAFTA’s dispute settlement provisions with allegations that the United States has breached those provisions.

39. The United States also points out that Mexico’s allegation that the United States is in breach of the NAFTA – either with respect to provisions on market access for sugar or relating to dispute settlement<sup>47</sup> – are just that: allegations. They are not legal determinations (or “illegal acts”) that this Panel may take as a “fact” in this dispute.

**90. Could Mexico please provide information on any measures it may have had in place during the last five years (such as tariffs, quantitative restrictions, trade preferences, subsidies, anti-dumping measures, countervailing measures, sanitary or phytosanitary measures) that have affected the importation or domestic sales of the products that are relevant for the present case (soft drinks; hydrating or rehydrating drinks; concentrates, powders, syrups, essences or flavour extracts that can be diluted to produce soft drinks and hydrating or rehydrating drinks; and, syrups or concentrates for preparing soft drinks sold in open containers which use automatic, electric or mechanical equipment, cane sugar, beet sugar, and High-Fructose Corn Syrup, HFCS).**

40. Mexico’s response to this question has listed five measures by name, but has not provided any information on them, and has not provided texts of the measures. The United States provides these comments and the texts of the measures listed by Mexico.

#### *HFCS*

41. The first measure listed by Mexico, a notice published in the official gazette (*Diario Oficial*) on October 11, 2001, raised Mexico’s MFN applied tariff on fructose to 156% for HS

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<sup>45</sup> Mexico Responses to the Questions of the Panel After the Second Meeting, p. 28 (revised courtesy translation).

<sup>46</sup> Mexico Closing Statement at the Second Meeting of the Panel, para. 27.

<sup>47</sup> Mexico’s response appears to be the first time Mexico has alleged that the United States has breached, in addition to market access provisions with respect to sugar, the dispute settlement provisions of Chapter 20. As the United States has read Mexico’s Article XX(d) defense, Mexico claims its tax measures are necessary to secure compliance with alleged U.S. obligations under the NAFTA with respect to market access for Mexican sugar. Mexico’s contention here that the United States is also allegedly in breach of NAFTA Chapter 20 provisions demonstrates the unfortunate readiness with which Mexico is willing to shift its position to try to sustain an unsustainable defense.

1702.4099 and 210% for HS 1702.5001, 1702.6001, 1702.6002 and 1702.6099, effective October 12, 2001. It is attached as Exhibit US-59.

42. The second measure listed by Mexico is attached as Exhibit US-60. In this decree, published on December 31, 2001 in the *Diario Oficial*, the Mexican government published its 2002 tariff rates under various preferential trade agreements. Article 49 of this decree, at page 114, requires an import license issued by the Secretary of Economy (“SE”) as a condition for importation of goods of North American origin at the preferential rate. It provides that this license is to be issued automatically except that if SE determines to suspend benefits under NAFTA, as a result of non-compliance by the United States with its obligations regarding sweeteners, then SE shall limit or cease to grant such licenses.

43. The third measure listed by Mexico is attached as Exhibit US-61. In this measure, published in the *Diario Oficial* on April 22, 2002, Ernesto Derbez, Secretary of the Economy, refers *inter alia* to the December 31, 2001 decree, alleged U.S. denial of sugar market access through limitation of Mexican sugar to a 148,000 MT TRQ, alleged frustration of means under the NAFTA to settle disputes, and the purpose of this measure as reestablishing the balance in the sweeteners sector. Through the notice, SE terminates automatic licensing and establishes a tariff rate quota of 148,000 MT valid only through September 30, 2002, for imports at the preferential duty rate of U.S.-origin merchandise classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002 and 1702.6099.

44. The fourth measure listed by Mexico is the Ley del Impuesto Especial Sobre Producción y Servicios (IEPS), which the United States has submitted as Exhibit US-1 (with its amendments at Exhibits US-2, -3 and -4).

45. The fifth measure is Mexico's revocation of its WTO- and NAFTA-inconsistent antidumping duties on HFCS, published on May 13, 2002.

46. Because Mexico has failed to provide information on other significant measures responsive to the Panel's request, the United States submits information on those measures as comments to Mexico's response.

(1) A resolution published in the *Diario Oficial* on March 1, 2002: *Acuerdo que modifica el similar que establece la clasificación y codificación de mercancías cuya importación y exportación está sujeta al requisito de permiso previo por parte de la Secretaría de Economía*. This resolution establishes a prior import licensing requirement for all imports of NAFTA originating goods of U.S. origin classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002, 1702.6099 and 1702.9099. The *Acuerdo que establece la clasificación y codificación de mercancías cuya importación y exportación está sujeta al requisito de permiso previo por parte de la Secretaría de Economía* (Resolution establishing the classification and codification of merchandise whose importation and exportation is subject to a requirement of a prior licensing permit



from the Secretariat of the Economy), as published in the *Diario Oficial* on March 26, 2002 amended to December 15, 2003, is available on the SE website at <http://www.economia.gob.mx/pics/p/p1376/A60.pdf>. Article 4 of this resolution provides an import licensing requirement applying to NAFTA originating goods of U.S. origin classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002, 1702.6099 and 1702.9099. A copy of the March 1, 2002 resolution is provided as Exhibit US-62 and a copy of the amended import licensing resolution is provided as Exhibit US-63.

(2) A decree published in the *Diario Oficial* on December 31, 2002: the *Decreto por el que establece la Tasa Aplicable durante 2003, del Impuesto General de Importación, para las mercancías originarias de America del Norte*. The text of this decree is provided as Exhibit US-64. In this decree, the Mexican government published the NAFTA tariff rates to go into effect on January 1, 2003. January 1, 2003 was the final date for tariff elimination for many products under NAFTA, including fructose. The second transitory provision to this decree, at pages 8-9, provides that in conformity with the international rights and obligations of Mexico, from January 1, 2003 onward, the duty-free importation of U.S.-origin products classified under HS 1702.4099, 1702.5001, 1702.6001, 1702.6002 and 1702.6099 require an import license from SE to be accorded under terms and conditions to be established by SE in a resolution (acuerdo) to be published in the *Diario Oficial*. The relevant resolution appears to be the resolution published on March 20, 2003, discussed below.

(3) A resolution published in the *Diario Oficial* on March 20, 2003: *Acuerdo que establece los criterios para otorgar permisos previos por parte de la Secretaría de Economía, a las importaciones definitivas de fructosa originarias de los Estados Unidos de América*. Article 2 of this resolution provides that for U.S.-origin products classified under HS 1702.4099, 1702.6001, 1702.6002 and 1702.6099, in conformity with the international rights and obligations of Mexico, criteria for granting licenses for importation for these products will be published “when the necessary conditions exist for that purpose” (and not until that time). Article 1 of this resolution provides for automatic licensing of small amounts of crystalline pure fructose classified in HS 1702.5001; the recitals make it clear that the automatic licensing is only provided because crystalline pure fructose is not produced in Mexico, it is not substitutable with sugar, and users of this product outside the bottling industry had been negatively affected by the duty on imports of this input. Articles 3 and 4 of the March 20 resolution provide that automatic import licensing will continue for temporary importation of HFCS (for use in products to be exported) and for imports of HS 1702.9099. A copy of this resolution is attached as Exhibit US-65.

47. As the above measures indicate, imports of HFCS of U.S. origin are subject to non-automatic import licensing, except for imports under HS 1702.5001 and 1702.9099 and temporary imports. No criteria for obtaining non-automatic licenses have been published. In addition, imports of HFCS of U.S. origin are subject to the MFN duty rate unless SE has issued a

license. In early January, a large U.S. exporter sent a truckload of HFCS as a test shipment to the Mexican border. The truckload was denied entry without reference to duty liability, because the shipment lacked an import license. The company then applied to SE for an import license. At the end of January, SE informed the company that the license was denied because of alleged U.S. denial of market access for Mexican sugar, and that the license would not be granted until the bilateral sugar issue has been resolved. Representatives of the company then met in Mexico City with a senior level official from SE, who informed them that the official had been instructed to deny the import licenses for HFCS indefinitely, until the sugar market access issue is resolved. Another company importing HFCS into Mexico has also informed the United States that SE has denied it import licenses for HFCS, on the basis that importation of HFCS is subject to a licensing requirement and the criteria for such licenses have not been published.

### *Sugar*

48. On September 26, 2003, the Mexican government published in the *Diario Oficial* a decree establishing a tariff rate quota for sugar for the period until December 31, 2003. This decree was submitted by the United States as Exhibit US-9 and is discussed in footnote 30 of the First U.S. Submission. On November 12, 2004, the Mexican government published a decree establishing a tariff rate quota for sugar, and a separate tariff rate quota for sugar of Costa Rican origin, for the period until December 31, 2004. In both cases, imports within the TRQ were channeled exclusively through FEESA, a Mexican government entity, as discussed in footnote 30 of the First U.S. Submission.

**TABLE OF EXHIBITS**

| <b>Exhibit<br/>US-</b> | <b>Title of Exhibit</b>  |
|------------------------|--|
| 59                     | <i>Decreto por el que se modifican diversos aranceles de la Tarifa de la Ley del Impuesto General de Importación published in Diario Oficial on October 11, 2001</i>   |
| 60                     | <i>Decreto por el que se establece la Tasa Aplicable para el 2002 del Impuesto General de Importación para las Mercancías Originarias de América del Norte, la Comunidad Europea, los Estados de la Asociación Europea de Libre Comercio, el Estado de Israel, El Salvador, Guatemala, Honduras, Nicaragua, Costa Rica, Colombia, Venezuela, Bolivia, Chile y la República Oriental del Uruguay published in the Diario Oficial on December 31, 2001</i> |
| 61                     | <i>Acuerdo por el que se establece un cupo de importación para la fructosa de los Estados Unidos de América published in the Diario Oficial on April 22, 2002</i>  |
| 62                     | <i>Acuerdo que modifica el similar que establece la clasificación y codificación de mercancías cuya importación y exportación está sujeta al requisito de permiso previo por parte de la Secretaría de Economía published in Diario Oficial on March 1, 2002</i>   |
| 63                     | <i>Acuerdo que establece la clasificación y codificación de mercancías cuya importación y exportación está sujeta al requisito de permiso previo por parte de la Secretaría de Economía, Article 4, published in Diario Oficial March 26, 2002, amended to December 31, 2003</i>   |
| 64                     | <i>Decreto por el que establece la Tasa Aplicable durante 2003, del Impuesto General de Importación, para las mercancías originarias de America del Norte published in Diario Oficial on December 31, 2002</i>   |
| 65                     | <i>Acuerdo que establece los criterios para otorgar permisos previos por parte de la Secretaría de Economía, a las importaciones definitivas de fructosa originarias de los Estados Unidos de América published in Diario Oficial on March 20, 2003</i>  |