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**THE WTO
APPELLATE
BODY CRISIS –
A WAY FORWARD?**



– THOUGHT LEADERSHIP

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THE WTO APPELLATE BODY CRISIS – A WAY FORWARD?

Faced with criticism from the United States, the World Trade Organization's (WTO) appeals system is grinding to a halt. By the end of the year, the Appellate Body is likely to have too few appointed Members to hear appeals (a division of three Members is required for each case). Unless the United States agrees to the appointment of new Members, the WTO's Appellate Body will cease hearing new disputes, and the continued effectiveness of the dispute settlement system may be threatened.

This briefing provides an overview of the Appellate Body crisis by setting out the legal framework that governs the appeals process and discussing some of its perceived shortcomings. We also consider potential reforms and alternatives to the current system, including recent decisions by the EU, Canada and Norway to establish interim arbitration mechanisms.

Background to the Appellate Body crisis

States have long turned to the WTO system as the primary means of resolving their trade disputes. Since its creation in 1995, member states have brought more than 570 disputes to the WTO. Cases are heard before a dispute settlement panel established specifically for each dispute, and panel decisions may be appealed to a standing Appellate Body. Upon completion of the panel process (or in the event of an appeal, the completion of the Appellate Body process), the decisions are 'adopted' by the Dispute Settlement Body (DSB), which comprises representatives of all WTO member state governments, and become legally binding on the parties to the dispute. Compliance with DSB rulings is generally high, and the WTO framework provides clear remedies if a respondent fails to comply with the rulings of the DSB. This successful track record, along with its unique institutional features, has contributed to the dispute settlement system's reputation as the "crown jewel" of the international trade regime.

But now its crown is slipping. For many years, the United States has been vocally opposed to certain aspects of the WTO's dispute settlement system, and particularly the Appellate Body. As the final adjudicator of WTO trade disputes,

the Appellate Body is designed to have a standing roster of seven serving Members. Since July 2017, however, the US has blocked the appointment of new Members, leading to an increasing number of vacancies. At present, the Appellate Body has been reduced to three individuals, the minimum number required to hear appeals. By the end of 2019, absent new appointments, only one Member will remain in office.

Appointments to the Appellate Body require the consensus of all WTO member states. If the United States continues to block new appointments, the WTO's appeals system will soon cease to function. In that case, a WTO member state that receives an adverse panel decision may block the adoption of that decision (and therefore prevent it from becoming binding) by filing an appeal, safe in the knowledge that there is no Appellate Body to hear the dispute.

However, while the current Appellate Body crisis represents a challenge to the stability and effectiveness of the WTO's dispute settlement function, other elements of the dispute settlement system (including WTO panels) remain active and continue to be well-utilised by WTO member states. For example, more consultations requests (the first stage of a WTO dispute) were filed in 2018 than in any year since 1998. This suggests that,

despite the threat posed by the Appellate Body crisis, the WTO membership continues to view the dispute settlement system as an effective tool for resolving trade disputes.

Overview of the Appellate Body process

The principal procedural rules governing trade disputes are set out in the WTO's Dispute Settlement Understanding (DSU). The DSU provides that the rulings of an initial panel are adopted by the DSB and become binding unless a disputing party appeals the decision or all WTO member states agree not to adopt it (an exceptionally unlikely occurrence). Appeals are heard by the Appellate Body – a standing body of seven persons appointed for an initial term of four years, with the possibility of reappointment for a second term.

Once an appeal has been filed, the case is allocated to a 'division' consisting of three Appellate Body Members, usually chosen by rotation. With three Members remaining, the Appellate Body currently has the minimum number necessary to hear appeals. However, given the Members' considerable workload and the complexity of the disputes in question, the WTO's appeals system is already under significant strain. On 10 December 2019, the terms of two further Appellate Body Members will come to an end.

The DSU establishes prompt timeframes for resolving appeals. Article 17.5 provides that, "[a]s a general rule", the Appellate Body should circulate its report within 60 days of the notice of appeal. If this is not possible, the Appellate Body is required to provide written reasons for the delay. In any event, the appeals process should take no longer than 90 days.

The Appellate Body is tasked with a narrow review of the dispute. Appeals are limited to the panel's legal findings and conclusions. The Appellate Body has no power to examine new evidence or to review the panel's factual conclusions. Importantly, however, the DSU does not authorise the Appellate Body to refer cases back to the panel where factual issues remain open. As a result, the

Appellate Body is sometimes unable to complete its legal analysis where further factual findings are required. For instance, in a recent dispute between Guatemala and Peru (DS457), the Appellate Body concluded that it was not possible to reach a conclusion as to whether a certain measure was inconsistent with WTO rules because the panel report did not contain sufficient undisputed facts.

As with panel reports, the so-called 'reverse consensus' rule requires the DSB to adopt Appellate Body reports within 30 days of circulation to the WTO membership unless all WTO member states object. Since a reverse consensus can only be achieved if the successful party opposes the report, this condition has never been met. On adoption by the DSB, the Appellate Body Report (and, to the extent not overruled, the panel report) becomes final and binding, and any domestic measures found to be inconsistent with WTO obligations must be brought into conformity with these rules within a "reasonable period of time". If a WTO member state fails to comply with a DSB ruling, the successful complainant may apply to the DSB for permission to implement temporary retaliatory measures.

US concerns about the Appellate Body

Washington's dissatisfaction with the operation of the WTO appeals system is not new. For nearly a decade, the United States has been an outspoken critic of a range of Appellate Body practices, vetoing some appointments as early as 2011.

On that occasion, the Obama Administration caused controversy when it refused to support the routine re-appointment of Jennifer Hillman, a US national, giving no reasons for its decision. In 2016, the Obama Administration went further by blocking the re-appointment of South Korean Appellate Body Member Seung Wha Chang, arguing that Chang had failed to act within his mandate and that "his performance [did] not reflect the role assigned to the Appellate Body ... in the DSU".

The issue of judicial overreach is perhaps the most serious charge directed at the Appellate Body. This complaint covers a number of systemic criticisms, including Members' alleged propensity to opine on issues not in dispute, the practice of following previous rulings without sufficient independent analysis (i.e. the use of precedent), Members' interpretive approach to WTO agreements and to issues of municipal law, the length and complexity of proceedings, and the Appellate Body's perceived tendency to regulate its own conduct in a manner allegedly inconsistent with the DSU.

Obiter dicta

In a statement explaining its decision to veto Chang's re-appointment, the United States highlighted the increasing prevalence of obiter dicta – judicial statements that are not directly relevant to the dispute in question. In some cases, the United States has argued, obiter dicta make up the majority of the Appellate Body's report. This is said to introduce unnecessary complexity to WTO cases and render the dispute settlement process less efficient.

Moreover, the United States objects to the Appellate Body's practice of laying down purportedly authoritative interpretations of WTO rules extending beyond the specific context of the dispute before it. In effect, this allows the Appellate Body to bind WTO member states even before a dispute has arisen, a power that is not envisaged by the DSU.

Precedent

The United States considers this to be particularly problematic because the Appellate Body rarely departs from its previous decisions. Under this emerging system of precedent, a report issued by the standing body can have a lasting influence on subsequent disputes. Since there is no mechanism to challenge an Appellate Body report, the United States is concerned that rigid adherence to precedent will enshrine what it considers to be erroneous interpretations of law. The principle of following previous decisions in similar circumstances, known as *stare decisis*, is not provided for in the DSU.

Interpretation of law

The United States has also been critical of the Appellate Body's approach to questions of fact and law. As noted above, under the terms of the DSU, the appeals stage of a WTO dispute is strictly confined to legal issues. In this respect, the United States has repeatedly complained that the Appellate Body takes an overly broad view of the matters that it can review. First, the United States has complained that a number of Appellate Body interpretations (in particular of the Agreement on Subsidies and Countervailing Measures) have significantly restricted the ability of WTO member states to counter-act tradedistorting subsidies provided through state-owned enterprises. This, the United States argues, has the effect of adding to or diminishing member states' rights or obligations, which is expressly prohibited by the DSU. Secondly, the United States considers that the Appellate Body has no power to revisit the panel's findings concerning the meaning of municipal (or domestic) law, i.e. the national law of a WTO member state. As the US delegation argued at a DSB meeting in August 2018: "In the WTO system, as in any international law dispute settlement system, the meaning of municipal law is an issue of fact."

In addition to the systemic issues outlined above, the United States has repeatedly raised a number of procedural concerns.

Timeliness of reports

One further criticism concerns the efficiency of proceedings. Despite the clear targets specified in the DSU, the Appellate Body process often exceeds the 90-day timeframe required under the rules, and most recent appeals took more than five months to conclude.

The United States considers that this disregard for the time limit provided by the DSU evidences a deliberate change of approach by the Appellate Body, noting that the practice of regularly ignoring the deadline only began in 2011. Tying this criticism to some of its other complaints, the United States has pointed out that a clearer focus on the issues in dispute would reduce the time required to produce a report. Crucially, the US Trade Representative has argued that the

Appellate Body “has never explained on what legal basis it could choose to breach a clear and categorical rule set by WTO [member states]”.

Term extensions

Another US complaint relates to the failure to comply with Appellate Body Members’ term limits. Under Rule 15 of the Appellate Body’s Working Procedures, Members may continue working on their allocated cases even after their term has expired. The rule, adopted to ensure that new appointments do not delay proceedings that have already commenced, has not been expressly approved by the DSB. The United States contends that the Appellate Body does not have authority to extend the terms of Members without the DSB’s consent.

At its core, the US position on most of the points discussed above is that the Appellate Body is acting outside the powers granted to it by the DSB. At the October 2019 WTO General Council meeting, for instance, US Ambassador Dennis Shea reiterated that “the fundamental problem is that the Appellate Body is not respecting the current, clear language of the DSU”. Some of these concerns have been acknowledged or echoed by other states. For example, in a joint statement in December 2018, a group of 12 WTO member states, including the EU and China, agreed that the meaning of municipal measures should not be considered a question of law under the DSU and that the Appellate Body should only address such issues as are necessary to resolve a dispute.

Proposals for reform

Over the past few years, WTO delegations, academics and legal commentators have put forward various ways in which the appeals system could be reformed. To identify which solutions might enjoy the support of the DSB, the chair of the WTO’s General Council has tasked New Zealand Ambassador David Walker with overseeing the reform process.

Many proposals focus on amendments to the legal texts governing the appeals process. In order to alleviate concerns about the excessive use of obiter dicta, for instance, the DSU or the Appellate

Body’s Working Procedures could include an express rule limiting the scope of Appellate Body reports to the questions raised on appeal. By prohibiting Appellate Body Members from addressing issues that are not directly relevant to the appeal, cases should be quicker and easier to resolve. Some WTO member states, such as the United States, would also welcome clarification that the Appellate Body cannot issue authoritative interpretations of law on matters unrelated to the case at issue.

Similar rule changes could be made in relation to term limit extensions. To minimise the likelihood of Members having to resolve appeals once their terms have expired, new rules could be introduced that govern the allocation of disputes in those circumstances. For example, a draft proposal coordinated by Ambassador Walker provides that Appellate Body Members may not be assigned to a new division any later than 60 days before their term expires.

However, individual Members would still be able to complete any appeals in which the oral hearing has been held during his or her term.

As regards the issue of precedent, the EU, China and other states have proposed annual meetings between the Appellate Body and the WTO membership. This would enable WTO member states to “express their views in a manner unrelated to the adoption of particular reports” and allow for regular discussions of trends in the Appellate Body’s jurisprudence. By contrast, the draft proposal supported by Ambassador Walker simply states that “[p]recedent is not created through WTO dispute settlement proceedings”, but that previous panel and Appellate Body reports should be taken into account.

The difficulty of implementing these reforms depends on where the new rules would be recorded. Amendments to the DSU require the consent of all 164 WTO member states, which would pose a significant challenge. Changes to the Working Procedures, by contrast, are made by the Appellate Body itself. On the face of it, this would be a much lower hurdle. However, since “decisions

shall be taken by the Appellate Body as a whole”, it is unclear whether the Appellate Body can change its rules while appointments are outstanding. In any case, given that most US criticisms relate to alleged deviations from the DSU, any rule changes made without the agreement of the DSB would risk a further escalation of tensions.

Interim alternatives to the Appellate Body

WTO member states have undertaken several rounds of consultations aimed at finding workable solutions, but to date no significant procedural or substantive changes have been implemented. Indeed, in October 2019, the United States expressed its view that it does “not see convergence among Members with respect to an understanding and appreciation of the concerns [the US has] raised”. Instead of reforming the current rules, the United States argues that the existing agreements – especially the DSU – should be respected.

It now seems unlikely that there will be any major breakthroughs before 10 December 2019. The United States is thus expected to continue to block Appellate Body Member appointments, culminating in the effective shutdown of the Appellate Body by the end of the year.

Against that background, supporters of the WTO’s dispute settlement system are looking to alternatives that replicate its main features, at least until a permanent solution is found. Some proposals envisage ways to bypass the Appellate Body altogether, such as by removing the option to appeal. This approach, which has been endorsed by the WTO’s former Director-General Pascal Lamy, would see the DSB adopting all panel reports as final and binding, leaving the parties with no mechanism to challenge the initial ruling. This radical step could arguably be implemented without the DSB’s approval, requiring only a change to the Working Procedures. However, many WTO member states would no doubt be reluctant to do away with the appeals

system in its entirety. On that basis, it is unlikely that the remaining Appellate Body Members would adopt such a controversial solution without a clear mandate from the DSB.

Alternatively, parties to a particular dispute could waive their right to appeal on a bilateral basis. In March 2019, Indonesia and Vietnam signed a joint Understanding that the panel report in dispute DS496 would, in the absence of a functioning Appellate Body, be adopted as binding. The document notes the parties’ agreement that “if, on the date of the circulation of the panel report ..., the Appellate Body is composed of fewer than three Members available to serve on a division in an appeal in these proceedings, they will not appeal that report ...”.

Other suggestions envisage a temporary institution to act in lieu of the paralysed Appellate Body. This could either be in the form of ad hoc arbitration or under a plurilateral arbitration agreement. Article 25 of the DSU provides for “expeditious arbitration ... as an alternative means of dispute settlement”, subject to mutual agreement of the parties. WTO member states could thus agree to refer any appeal to an independent arbitration panel, binding themselves to accept the final award as if it were an Appellate Body report. Since this option requires the parties’ agreement, any arbitration mechanism would only apply to those states that have given their express consent.

The EU’s interim appeals systems

In July 2019, Canada and the EU announced the launch of an interim appeal arbitration arrangement based on existing WTO rules to hear appeals in disputes between them while the Appellate Body has fewer than three Members. Both parties have indicated their intention not to pursue regular appeals while the Appellate Body is unable to hear cases. Instead, appeals will be resolved by a division of three arbitrators made up of former Appellate Body Members. This arrangement is

envisaged to be temporary and will cease to apply once the Appellate Body is operational.

The Canada-EU interim appeals system will operate under substantially the same principles, methods and rules as the Appellate Body, including the provisions of the DSU and the Working Procedures. The arbitration tribunal will also have the same powers as the Appellate Body and may uphold, modify or reverse the legal findings and conclusions of the panel. To initiate an appeal under the interim arrangement, Canada and the EU will have to notify their agreement pursuant to Article 25 of the DSU within 60 days of the establishment of the DSB panel. The parties will therefore commit to the use of the arbitration mechanism at the outset and will not be able to wait until after the panel report has been issued.

Under the terms of the agreement, the arbitration tribunal will only hear appeals in disputes between Canada and the EU. However, officials have signalled that

other WTO member states will be able to sign up to the arrangement, lending support to the plurilateral agreement approach discussed above. Jennifer Hillman, the former Appellate Body Member, has indicated that she would be willing to serve as an arbitrator and has urged other countries to join the system. Consistent with that ambition, the European Commission recently adopted a formal mandate to enter into interim arbitration agreements for WTO disputes with other third countries.

In October 2019, the EU and Norway notified the WTO that they had agreed an interim appeals system modelled on the EU-Canada mechanism. The new text is virtually identical to the agreement concluded between the EU and Canada, which suggests that it will serve as a template for the EU's future appeals arrangements. The EU is thus expected to seek to further expand its network of arbitration counterparties in the coming months, offering a practical interim alternative to the Appellate Body.

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CLIFFORD CHANCE

CONTACTS



Jessica Gladstone
Partner
London
T: +44 20 7006 5953
E: jessica.gladstone@cliffordchance.com



Janet Whittaker
Senior Counsel
Washington DC
T: +1 202 912 5444
E: janet.whittaker@cliffordchance.com



Thomas Voland
Partner
Dusseldorf
T: +49 211 4355 5642
E: thomas.voland@cliffordchance.com

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www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

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Phillip Souta
Head of UK Public Policy
London
T: +44 20 7006 1097
E: phillip.souta@cliffordchance.com



Gail Orton
Head of EU Public Policy
Paris
T: +33 1 4405 2429
E: gail.orton@cliffordchance.com



Kieran John McCarthy
Lawyer (Country Qualified:
New York)
London
T: +44 20 7006 1374
E: kieranjohn.mccarthy@cliffordchance.com



Mark Feldner
Lawyer
London
T: +44 20 7006 1574
E: mark.feldner@cliffordchance.com



Jeremy Stewart
Foreign Law Clerk
New York
T: +1 212 878 4938
E: jeremy.stewart@cliffordchance.com



Federico Ortino
Consultant to Clifford Chance
London
T: +44 20 7006 1000
E: federico.ortino@cliffordchance.com