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DEAL**

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WTO Dispute Settlement Mechanism Without the Appellate Body: Some Observations on the US-China Trade Deal

Weihuan Zhou*

Abstract

The paralysis of the Appellate Body ('AB') has significant ramifications for the effective functioning of WTO's dispute settlement mechanism ('DSM'). It remains unclear how WTO Members will utilise the various options in resolving disputes in the absence of the AB. The recently-concluded US-China Phase One trade deal adds more uncertainties about the future of the DSM and the multilateral trading system in general. It is hoped that the two giant powers can turn their confrontation into cooperation and bridge their divergences through the creation of new and better rules on international trade and dispute settlement so as to lay the groundwork for multilateral negotiations.

I. Introduction

1. On 10 December 2019, the WTO's Appellate Body ('AB') became dysfunctional after the United States' (US) continuous blockage of the appointment of new AB members leaving only one member on the bench of the WTO's highest court while three are required to hear appeals. The US raised a number of concerns to justify the blockage including: (1) judicial activism (i.e. the AB has overstepped its authority to create laws not agreed by WTO Members), (2) creation of a *de facto* system of precedent (i.e. the AB has required panels to follow its rulings unless there is a 'cogent reason'), (3) issuance of advisory opinions unnecessary to resolve disputes, (4) review of issues of fact while the AB's mandate is limited to reviewing issues of law, (5) failure to decide appeals within the mandatory ninety-day timeframe, and (6) continued service by AB members whose term had expired.¹

2. While Article 17.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ('DSU') mandates the Dispute Settlement Body ('DSB') to appoint new AB members when vacancies arise, such a decision must be made by consensus pursuant to Article 2.4 of the DSU. Thus, any WTO Member may exercise a veto against the appointment of new AB members. In order to lift US blockage, other WTO Members have endeavoured to address US concerns through various proposals.² In the latest DSB meeting held on 18 December 2019, 119 WTO Members continued to call for appointment of new AB members to "safeguard and preserve" the AB and the dispute settlement mechanism ('DSM') as a whole.³ In response, the US maintained

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¹ See eg. Office of the United States Trade Representative, '2018 Trade Policy Agenda and 2017 Annual Report of the President of the United States on the Trade Agreements Program', Mar. 2018, at 22–8, available at: <https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2018/2018-trade-policy-agenda-and-2017>.

² See eg. WTO General Council, Informal Process on Matters related to the Functioning of the Appellate Body, JOB/GC/217 (8 May 2019); WTO Dispute Settlement Body, Appellate Body Appointments, WT/DSB/W/609/Rev.10 (16 Apr. 2019).

³ WTO, 'Members Urge Continued Engagement on Resolving Appellate Body Issues', New Items (18 Dec. 2019), available at: www.wto.org/english/news_e/news19_e/dsb_18dec19_e.htm.

its longstanding position that the systemic issues it has raised have not been adequately addressed. However, the US has not made any concrete proposal to clarify why these issues have not been addressed by the other Members' proposals and how they should be resolved. In any event, the killing of the AB would not provide a solution to any of the issues. To the contrary, it is highly likely that these issues will persist with respect to panels or any judicial body that takes over the role of the AB.⁴

3. Faced with the AB impasse, WTO Members and scholars have put forward a series of temporary solutions to maintain a functional DSM. The major ones include: (1) automatic completion of appeals if and when a notice of appeal is lodged;⁵ (2) adoption of a temporary waiver of appellate review under Article IX.3 of the *Marrakesh Agreement Establishing the WTO*;⁶ (3) establishment of an alternate appellate review mechanism without the US;⁷ and (4) creation of an *ex ante* plurilateral agreement among like-minded WTO Members to ensure binding dispute settlement,⁸ such as the agreements between the EU and Canada,⁹ and between the EU and Norway,¹⁰ under Article 25 of the DSU. The last option has attracted most attention so far and will be discussed in Section II along with other major consequences of the paralysis of the AB.

4. The US's dissatisfaction is not limited to the AB but has involved concerns about the multilateral trading system in general. One of the US's major concerns has been a lack of sufficient rules to tackle China-related systemic issues (e.g. non-market economy ('NME'), state-owned enterprises ('SOEs'), industrial policies and subsidies, 'forced' technology transfer, currency manipulation, non-transparency, etc.). Consequently, the US has started to lose confidence in the efficacy of the system and has resorted to other means to push China to change behaviour and practices. After almost two years of trade sanctions against China, the US has successfully compelled China to agree on a Phase One trade deal which includes rules on some of these systemic issues and dispute settlement procedures that only apply to disputes that arise under the bilateral deal.¹¹ Although the details of the deal have not been released, Section III will offer some preliminary observations on the implications of the US-China trade tensions for the AB impasse particularly the bilateral dispute settlement mechanism contemplated in the Phase One deal. Section IV concludes.

⁴ See eg. Weihuan Zhou & Henry Gao, 'Overreaching' or 'Overreacting'? Reflections on the Judicial Function and Approaches of WTO Appellate Body', (2019)53(6) *Journal of World Trade* 951, 972-73.

⁵ Steve Charnovitz, 'How to Save WTO Dispute Settlement from the Trump Administration', International Economic Law & Policy Blog (3 Nov. 2017), available at: <https://worldtradelaw.typepad.com/ielpblog/2017/11/how-to-savewto-dispute-settlement-from-the-trump-administration.html>.

⁶ Tetyana Payosova, Gary Clyde Hufbauer & Jeffrey J. Schott, 'The Dispute Settlement Crisis in the World Trade Organization: Causes and Cures', Peterson Institute for International Economics Policy Brief 18-5 (Mar. 2018), at 10, available at: <https://piie.com/system/files/documents/pb18-5.pdf>.

⁷ Pieter Jan Kuijper, 'What To Do About the US Attack on the Appellate Body?', International Economic Law & Policy Blog (15 Nov. 2017), available at: <https://worldtradelaw.typepad.com/ielpblog/2017/11/guest-post-from-pieterjan-kuijper-professor-of-the-law-of-international-economic-organizations-at-the-faculty-of-law-of-th.html>.

⁸ Geraldo Vidigal, 'Addressing the Appellate Body Crisis: A Plurilateral Solution', Amsterdam Law School Legal Studies Research Paper No. 2019-14.

⁹ Canada and the European Union, 'Interim Appeal Arbitration Pursuant to Article 25 of the DSU', 25 Jul. 2019, available at: https://trade.ec.europa.eu/doclib/docs/2019/july/tradoc_158273.pdf.

¹⁰ The European Union and Norway, 'Interim Appeal Arbitration Pursuant to Article 25 of the DSU', 21 Oct. 2019, available at: https://trade.ec.europa.eu/doclib/docs/2019/october/tradoc_158394.pdf.

¹¹ Office of the United States Trade Representative, 'Agreement between the United States of America and the People's Republic of China – Fact Sheet' (13 Dec. 2019), available at: <https://ustr.gov/sites/default/files/US-China-Agreement-Fact-Sheet.pdf>.

II. The Resolution of Disputes without the Appellate Body

5. The presence of a dysfunctional AB does not preclude WTO Members from invoking the right of appeal under Article 16.4 of the DSU. Therefore, any Member, typically a losing party in a dispute, may appeal an unfavourable panel report to block the adoption of the report and leave the dispute unresolved. The abuse of this *de facto* veto right is no longer a remote possibility – in the DSB meeting on 18 December 2019 the US notified its appeal of the decision of the compliance panel in DS436 where the panel has found that US countervailing measures against certain steel goods from India remain inconsistent with WTO rules.¹² Meanwhile, the US stated that “it would confer with India so that the two sides may determine the way forward in the dispute, including whether the matters at issue may be resolved at this stage or to consider alternatives to the appellate process.”¹³

6. This statement suggests that a losing party may use the right of appeal as a lever to push a winning party to enter into a mutually agreed solution (‘MAS’). An increasing use of MAS would result in the rise of non-compliance and undermine the effectiveness of the DSM in inducing compliance.¹⁴ If MAS becomes the standard approach to resolving disputes, Members will gradually lose the incentive to resort to the DSM. Over time, it is not unlikely that the well-established rules-oriented system will return to a power-oriented one whereby powerful Members may “buy out” WTO obligations¹⁵ or influence outcomes through threat of retaliation. In practice, the resolution of disputes via a MAS does provide room for such use of power.¹⁶ If one draws on the experience in the GATT era, the increasing number of powerful Members and the growing complexity of cases under the WTO would only mean that it is more likely for WTO Members to abuse the veto so as to avoid binding decisions and implementation.¹⁷ If disputants are both powerful Members, the crippled DSM may result in “retaliation and counter-retaliation without the normal DSU controls and, ultimately, escalating ‘trade wars’”.¹⁸

7. The abuse of veto may be effectively controlled or avoided if disputing parties reach an agreement to not appeal a panel report or to use an alternative appeal review mechanism. The former does not require a formal agreement or a notification to the DSB, although an *ex ante* agreement before or at an early stage of the adjudication process would provide the certainty that is much needed under the current DSM.¹⁹ It would still work, without such an *ex ante* agreement,

¹² See above n 3. Panel Report, *United States – Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India (Recourse to Article 21.5 of the DSU by India)*, WT/DS436/RW (circulated 15 Nov. 2019).

¹³ *Ibid.*

¹⁴ John H Jackson, ‘The WTO Dispute Settlement Understanding – Misunderstandings on the Nature of Legal Obligation’, (1997)91(1) *American Journal of International Law* 60.

¹⁵ John H Jackson, ‘International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to “Buy Out”?’, (2004)98(1) *American Journal of International Law* 109.

¹⁶ See eg. Johannes Norpoth, ‘The Mutually Agreed Solution between Indonesia and the United States in *US – Clove Cigarettes*: A Case of Efficient Breach (or Power Politics)?’ in Giovanna Adinolfi et al. (eds) *International Economic Law: Contemporary Issues* (Switzerland: Springer 2017) 129–47.

¹⁷ Joost Pauwelyn, ‘WTO Dispute Settlement Post 2019: What to Expect?’, (2019)22(3) *Journal of International Economic Law* 297, 305–6.

¹⁸ *Ibid.*, at 308.

¹⁹ An example of such an *ex ante* agreement can be found in WTO, *Indonesia – Safeguard on Certain Iron or Steel Products*, Understanding Between Indonesia and Viet Nam Regarding Procedures Under Arts 21 and 22 of the DSU, WT/DS496/14 (27 Mar. 2019).

so long as the parties do not exercise the right of appeal voluntarily or based on mutual understanding after panel decisions have been circulated.²⁰

8. The latter, however, would need to be based on a formal agreement which sets out the rules and procedures of the alternate mechanism. The approach adopted among the EU, Canada and Norway based on Article 25 of the DSU has attracted growing attention. Article 25 provides an alternative means for parties to resolve disputes in an expeditious manner based on agreed procedures which may or may not follow the DSU procedures. The agreements reached among the EU, Canada and Norway seek to reinstitute the AB mechanism under Article 25 on a temporary basis (i.e. before the AB is fully composed) by “replicat[ing] as closely as possible all substantive and procedural aspects as well as the practice of Appellate Review pursuant to Article 17 of the DSU including the provision of appropriate administrative and legal support to the arbitrators by the Appellate Body Secretariat” and by appointing former AB members as arbitrators. Moreover, under Article 25, the arbitration awards will be subject to the same DSU rules on adoption, enforcement, compensation and retaliation. Therefore, the Article 25 approach, as adopted among the EU, Canada and Norway, provides the best option so far that would maintain the existing AB mechanism, “automatic bindingness of dispute settlement rulings”,²¹ and the efficacy of the DSM in inducing compliance and constraining unilateral and unauthorised retaliation. However, whether this approach will be widely adopted remains to be seen.

9. In response to the AB impasse, the EU released a proposal on 12 December 2019 to amend its Enforcement Regulation to enable the use of countermeasures in cases where a WTO panel ruling in its favour cannot be adopted and enforced because “the other party appeals ... “into the void” and has not agreed to” Article 25 arbitration.²² In such circumstances, the EU will retaliate by expeditiously suspending its WTO obligations at levels “commensurate to the nullification or impairment of its commercial interests caused by the measures” of the other party. This proposal, therefore, seeks to use countermeasures to discourage the abuse of the right of appeal and encourage the use of the interim appeal arbitration under Article 25. While both the use of countermeasures and the level of retaliation would create issues of WTO-legality as they are self-determined rather than WTO-authorized, it is hard to argue that the EU has acted in “bad faith”. Faced with the unprecedented crisis and the failure of WTO Members to move the selection of AB members based on existing WTO rules,²³ the EU’s approach is arguably a last resort to maintain the integrity and effectiveness of the DSM. Nevertheless, how effective the EU’s approach would be – e.g. whether it would promote the use of Article 25 arbitration or restrain the abuse of the right of appeal – remains unclear. Even more uncertain is whether EU

²⁰ Such a mutual understanding seems to have been reached in DS529. See Panel Report, *Australia – Anti-dumping Measures on A4 Copy Paper*, WT/DS529/R (dated 4 December 2019). Also see Lexy Nantu, ‘WTO Wins Indonesia over Paper Dispute Against Australia’, *The Insider Stories* (5 December 2019), available at: <https://theinsiderstories.com/wto-wins-indonesia-over-paper-dispute-against-australia/>.

²¹ See above n 17, Pauwelyn, ‘WTO Dispute Settlement Post 2019: What to Expect?’, at 312.

²² European Commission, Proposal for a Regulation of the European Parliament and of the Council of 12 Dec. 2019 amending Regulation (EU) No 654/2014 of the European Parliament and of the Council concerning the exercise of the Union’s rights for the application and enforcement of international trade rules, COM(2019) 623 final, at 3. Also see European Commission, ‘Commission Reinforces Tools to Ensure Europe’s Interests in International Trade’, News – Dispute Settlement (12 Dec. 2019), available at: <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2091>.

²³ For a summary of some of the suggestions, see Henry Gao, ‘The Resurrection of the Appellate Body: Three Proposals’, *International Economic Law & Policy Blog* (22 Dec. 2019), available at: <https://ielp.worldtradelaw.net/2019/12/the-resurrection-of-the-appellate-body-three-proposals.html>.

countermeasures would eventually push the US to withdraw its blockage of new AB members (given the unlikelihood that the US will agree to Article 25 arbitration).

III. US-China Trade War and the Phase One Deal

10. The US-China trade war has provoked a spiral of retaliatory tariffs and other forms of retaliation beyond trade in goods. All Chinese actions, however, have been taken to retaliate against US trade sanctions. China's attitude seemed to be clear: it would not initiate WTO-inconsistent actions but would have to retaliate if such measures are used by others against China. In this way, China has arguably sought to achieve a balance between the protection of the multilateral trading system and the protection of its national interest. China's firm support for the WTO was officially communicated in a White Paper titled "China and the World Trade Organization" released by China's State Council on 28 June 2018.²⁴

11. Under the US-China Phase One trade deal, China has undertaken a series of obligations which may entail WTO-unlawful actions,²⁵ although China has indicated that the implementation of these obligations must comply with WTO rules.²⁶ As far as dispute settlement is concerned, the summary of the deal provided by the USTR is reproduced below:

The Dispute Resolution chapter sets forth an arrangement to ensure the effective implementation of the agreement and to allow the parties to resolve disputes in a fair and expeditious manner. This arrangement creates regular bilateral consultations at both the principal level and the working level. It also establishes *strong procedures for addressing disputes related to the agreement and allows each party to take proportionate responsive actions that it deems appropriate.* (emphasis added)

12. Apparently, this mechanism is not intended to establish a standard adjudicative framework based on an independent adjudicating body, binding decisions and enforcement in a rules-oriented manner. Rather, the intention appears to be encouraging the two parties to resolve disputes by negotiation and failing that, to take the law into their own hands. Thus, this mechanism would likely lead to the continuation of the existing confrontational approach to the resolution of trade tensions between the two nations. It would encourage the abuse of power and would not reduce the uncertainties in the prospect of the US-China trade relations.

13. Moreover, this mechanism would drag the two largest trading nations and major users of the DSM away from resorting to the multilateral mechanism. It would create a significant fragmentation which would further undermine the central position of the WTO in the resolution of trade disputes. Given the experience of the trade war, this bilateral mechanism would likely lead to the use of more WTO-unlawful measures in either negotiation outcomes or unilateral reactions.

14. It is unfortunate that China had to yield to US pressure. The impacts of the US measures on the Chinese economy are becoming increasingly evident and significant such that it is no longer economically and politically viable for the Chinese government to continue the fight. However, the bilateral dispute resolution mechanism does not seem to have precluded the parties

²⁴ The State Council of China, 'White Paper: China and the World Trade Organization' (28 Jun. 2018), available at: http://english.www.gov.cn/archive/white_paper/2018/06/28/content_281476201898696.htm.

²⁵ Henry Gao, 'Trade War: From a Phase One Deal to Perpetual Peace', The Interpreter of Lowy Institute (18 Nov. 2018), available at: www.lowyinstitute.org/the-interpreter/trade-war-phase-one-deal-perpetual-peace.

²⁶ Xinhua News, 'China, U.S. Agree on Text of Phase One Trade Deal', Xinhuanet (13 Dec. 2019), available at: www.xinhuanet.com/english/2019-12/13/c_138629377.htm.

from using the DSM. This provides room for China to join forces with other WTO Members in exerting influence on the US in cases where the US invokes the DSM and wins. In such cases, China could use the right of appeal in a positive way with an aim to pushing the US to adopt Article 25 arbitration based on the EU-Canada-Norway model (which is essentially based on the use of the paralysed AB) or face blockage of adoption of decisions in its favour. Over time, if the US cannot use the DSM to enforce its rights against *all* major trading partners due to the absence of the AB, then its domestic politics may change to support the rescue of the ‘crown jewel’ of the multilateral trading system.

IV. Concluding Remarks

15. The DSM, and the multilateral trading system in general, is at a crossroads. Collective efforts from all major players are needed to save the system from becoming increasingly irrelevant. While the US was a key founding party of the system, all involved have taken tremendous efforts in building and maintaining it and cannot afford to lose it. This is not to suggest that the system is perfect. Quite to the contrary, major reforms are clearly required to ensure the WTO as an institution, and its rules and DSM become more competent and efficient in addressing cutting-edge issues in international trade and generating positive outcomes. The US-China trade war has caused significant damages on the two economies, and world trade and the multilateral trading system more broadly. However, if the two giant powers can turn their confrontation into cooperation, then they may bridge their divergences through the creation of new and better rules on international trade and dispute settlement. A successful US-China negotiation could lay the groundwork for negotiations on a multilateral basis which would then provide an opportunity to recompose the AB. Hopefully the US-China Phase One trade deal is a move to that direction rather than another blow to the multilateral trading system.