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The EU and Japan reported to launch bilateral trade negotiations in the coming months

The EU may be prepared to start, already in March 2013, negotiations with Japan with a view to conclude a free trade agreement (hereinafter, FTA) between the two trading partners. In this regard, preliminary talks on the level of ambition of the FTA (*i.e.*, the so-called '*scoping exercise*') were concluded on 31 May 2012, after which the EU Commission adopted, on 18 July 2012, a recommendation that the EU Council start negotiations with Japan. Trade between the EU and Japan is still considerably affected by tariffs, non-tariff measures (hereinafter, NTMs) and regulatory distinctions that result in burdensome features affecting trade in goods and services, investment and public procurement. A bilateral trade agreement may therefore contribute to the elimination of such barriers, particularly in the agro-food, automotive, pharmaceutical and medical devices sectors.

As for tariffs, and even though both trading partners appear to have generally low tariffs on goods, Japan still subjects to high tariffs certain goods that are key for EU exporters, namely in the agricultural and processed foods sectors. Conversely, the EU should be prepared to lower its tariffs in certain manufacturing sectors (*i.e.*, motor vehicles, electronics and machinery, which are central to the interests of Japanese exporters). In light of the free trade agreement concluded in 2009 by the EU with Korea, Japan would appear to be particularly demanding about the lowering of EU tariffs in the aforementioned manufacturing sectors, where its products are exposed to sharp competition in the EU market *vis-à-vis* those from Korean origin (in addition to those of EU origin).

It is, however, the NTMs that appear to represent the greatest obstacles to trade between the EU and Japan. NTMs embrace a wide variety of measures, other than tariffs, that are capable of restricting trade in goods or services, including both border and behind-the-border requirements. Japanese NTMs essentially affect EU exports in the chemical, automotive, medical services, processed foods, transport equipment, telecommunication and financial services sectors. In the field of trade in goods, technical barriers to trade (hereinafter, TBT) and sanitary and phytosanitary (hereinafter, SPS) measures constitute the main sources of NTMs. When it comes to trade in services, the financial services sector appears to be the sector mostly affected by restrictions in force in Japan. The vast majority of restrictions and requirements appear to affect commercial presence (Mode 3) operations of services suppliers acting in the Japanese market, resulting in an increase of costs for EU services suppliers. In addition, the lack of transparency in public procurement, as well as several problems regarding intellectual property rights' protection, renders access to the Japanese market burdensome for EU companies. Overcoming such obstacles appears to require a combination of trade policy instruments together with domestic regulatory changes, aimed at achieving a degree of regulatory convergence: Japan should be prepared, when negotiating with the EU, to undertake significant regulatory changes in its own domestic system.

The EU-Japan FTA would be in line with the so-called '*EU new generation agreements*' that are currently being negotiated and concluded by the EU and its trading partners (the EU-Korea FTA constitutes an excellent example thereof), and which cover issues that go beyond those traditionally covered by the EU's FTAs (see Trade Perspectives, Issue No. 9 of 4 May 2012). In this respect, the FTA between the EU and Japan will cover a wide number of issues, including tariffs, NTMs affecting trade in goods (including TBT and SPS measures), enhanced market access for services, investment and public procurement, and also provide commitments on investment protection and obligations relating to competition and intellectual property rights. Certain EU business sectors surely stand to benefit from this agreement. However, part of the EU's automotive sector, backed by the Governments of France, Germany and Italy, opposes the conclusion of an FTA with Japan that may further increase the competition in the EU market, with the EU small and mid-sized car manufacturers already severely affected by the concessions granted to Korean competitors under the EU-Korea FTA. Contentious aspects of the EU-Korea FTA negotiations concerned the possibility for Korea to continue applying duty draw-back schemes and the foreign content level for the granting of preferential treatment to automobiles (see Trade Perspectives, Issue No. 6 of 27 March 2009). Since the conclusion of the agreement, the EU has registered an increase on the importation of Korean cars, which has prompted the sector to discuss potential remedies, including the re-negotiation of certain aspects of the agreement to insert a '*snap-back*' provision (similar to the one contained in the US-Korea FTA, which allows the US to impose tariffs on Korean cars if Korea does not comply with the provisions of the agreement) and the activation of the specific remedies envisaged under the EU-Korea FTA. France requested the EU Commission to apply the surveillance mechanism provided for in the EU-Korea FTA and *Regulation (EU) No. 511/2011 of the European Parliament and of the Council implementing the bilateral safeguard clause of the Free Trade Agreement between the European Union and its Member States and the Republic of Korea* for Korean car imports. Such mechanism may lead to triggering the bilateral safeguard clause which, as provided in the EU-Korea FTA, allows the EU to re-impose duties on the importation of certain goods if the EU producers in those sensitive industries are hit by a particularly injurious surge of imports (see Trade Perspectives, Issue No. 13 of 2 July 2010). EU negotiators have reportedly required Japan to remove its non-tariff barriers within one year of launching FTA talks as a move to obtain the support of the automotive sector for these negotiations. However, it is crucial that any future FTA between the EU and Japan contains a well-conceived and effective safeguard mechanism in order to cope with the possible negative effects of the FTA.

A WTO Panel will be composed to hear Canada's and Norway's concerns on the EU's seals regime

A WTO panel will soon be composed to assess the WTO consistency of the EU's measures affecting trade in seals products. The dispute dates back to September 2007, with a first request for consultations then lodged by Canada over import restrictions imposed by Belgium and the Netherlands on seal products. In November 2009, Canada lodged a request for consultations over the EU-wide '*seals regime*' adopted by the EU in September 2009. Canada was followed by Norway, which initiated another WTO dispute concerning the EU's measures. After unsuccessful consultations, Canada and Norway requested the establishment of a WTO panel in February and March 2011, respectively (see Trade Perspectives, Issues No. 4 of 25 February 2011 and No. 6 of 24 March 2011). As provided in Article 9.1 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter, DSU) with regard to multiple complainants, the WTO Dispute Settlement Body established a single panel to hear both complaints on 25 March 2011. The composition of the panel has, however, been delayed. The panel will now reportedly be appointed by the WTO Director General according to Article 8.7 of the DSU, following the complainants' request.

The EU's '*seals regime*' is established in *Regulation (EC) No. 1007/2009 of the European Parliament and of the Council of 16 September 2009 on trade in seal products* (hereinafter, the Seals Regulation) and *Commission Regulation (EU) No. 737/2010 of 10 August 2010 laying down detailed rules for the implementation of Regulation (EC) No. 1007/2009 of the European Parliament and of the Council on trade in seal products in Regulation (EC) No. 1007/2009 of 16 September 2009* (hereinafter, the Implementing Regulation). In relevant part, it contains a general prohibition to import and place seals products on the EU market. '*Seals products*' cover all products, either processed or unprocessed, deriving or obtained from specimens of all species of *pinnipeds* (*Phocidae*, *Otariidae* and *Odobenidae*), including meat, oil, blubber, organs, raw fur skins and fur skins, tanned or dressed, including fur skins assembled in plates, crosses and similar forms, and articles made from fur skins.

Under the regime, importation and marketing of seals products in the EU is only allowed in limited, largely non-commercial circumstances, including where the seals products result from hunts by Inuit and other indigenous communities and contribute to their subsistence and where the seals products result from by-products of hunting that is regulated by national law and conducted for the sole purpose of the sustainable management of marine resources. The Implementing Regulation further defines the conditions for importing and placing seals products on the market under the above exceptions. Seals products deriving from hunting or from by-products of hunting must be accompanied by an '*attesting document*' issued by a body recognised by the EU Commission, certifying compliance with the conditions set forth in the Implementing Regulation. The '*attesting document*' is to be presented upon importation as a condition for entry in the EU territory and for being placed on the EU market.

Canada and Norway argued that the EU '*seals regime*' is inconsistent with EU's obligations under the WTO system. In particular, they claimed that the EU's seals regime is a quantitative restriction on trade inconsistent with Article XI:1 of the General Agreement on Tariffs and Trade (hereinafter, GATT) and/or Article 4.2 of the Agreement on Agriculture (this latter claim was supported only by Norway). Article 3 of the Seals Regulation clarifies that the restrictions apply '*at the time or point of import*', which results in an import ban according to the complainants. Besides the import prohibition, the exception for products traditionally hunted by Inuit and other indigenous communities requires compliance with strict conditions, which must be certified by bodies recognised by the EU. These procedures and formalities lead to a burdensome system for authorised products, which may result in a discretionary licensing system prohibited under Article XI:1 of the GATT. The complainants also argue that, inasmuch as the EU's seals regime constitutes a '*technical regulation*' within the meaning of Annex 1.1 of the WTO Agreement on Technical Barriers to Trade (hereinafter, TBT Agreement), the EU measures create an unnecessary obstacle to international trade and are more trade restrictive than necessary to fulfil the legitimate objective that they intend to pursue, if any exists. Additionally, the complainants consider that the EU measure is discriminatory against Canadian and Norwegian seal products *vis-à-vis* EU domestic products and products originating from other WTO Members products, in violation of the Most Favoured Nation (hereinafter, MFN) and national treatment principles embedded in Articles I and III of the GATT, as well as Article 2.1 of the TBT Agreement.

Before the WTO Panel, the EU will most likely invoke the general exceptions contemplated under Article XX of the GATT in order to justify its measures, specifically those listed under sub-paragraphs (a) (*i.e.*, public morals), and (b) (*i.e.*, animal life and health) thereof. The '*seals regime*' was conceived to respond to the public's concerns over animal welfare aspects of the killing and skinning of seals, and took stock, *inter alia*, of an assessment from the European Food Safety Authority, which pointed out the inhumane killing and skinning of seals for commercial purposes and that consistent verification and control of hunters' compliance with animal welfare requirements is not feasible in practice or, at least, is very

difficult to achieve in an effective way. Article XX of the GATT requires that the EU measures neither constitute a disguised restriction on international trade nor be applied in an arbitrary or unjustifiable discriminatory manner. The panel will be called to assess whether the EU measures comply with the principles of proportionality and least-trade restrictiveness, while avoiding discrimination between countries where the same conditions prevail.

Should the EU's '*seals regime*' qualify as a '*technical regulation*', it will be assessed under the provisions of the TBT Agreement. Of particular importance will be the argument based on Article 2.2 of the TBT Agreement, which requires an analysis of whether the EU measures are more-restrictive than necessary to achieve the EU's objectives. The WTO Appellate Body in *US-Tuna II (Mexico)* stated that, when arguing a violation of this provision, the complainant has to identify possible alternative measures that are less trade restrictive, considering their equivalent contribution to the relevant objective, and their reasonable availability. In the context of the EU's legislative procedure leading to the adoption of the '*seals regime*', Canada proposed a worldwide '*Seal Hunting Ethics Code*' to include strict standards on slaughtering of seals, on seal products and on the protection of the species (for more details, see Trade Perspectives, Issue No. 6 of 27 March 2009). Before the Panel, as an alternative measure, Canada and Norway may propose a system based on certification of compliance with a predetermined set of standards on killing of seals coupled with a labelling scheme. In this context, the Panel will have to consider the extent to which the proposed alternative measure would fulfil the EU's objectives. In line with the Appellate Body in *US-COOL*, the assessment of the Panel will have to involve a '*relational analysis*' of the trade-restrictiveness of the measure, the degree of contribution that it makes to the achievement of the legitimate objective, and the risks that non-fulfilment would create, in accordance with the notion of '*necessity*' under Article 2.2 of the TBT Agreement. As clarified by the Appellate Body in *US-Tuna II (Mexico)*, the non-fulfilment factor should be assessed '*in the light of the nature of the risks at issue and the gravity of the consequences*', which suggests a '*further element of weighing and balancing*' in the analysis under Article 2.2 of the TBT Agreement. Considering that the EU Regulation was rooted on consumers' concerns about animal welfare, the labelling policy tool appears particularly suited for achieving the legitimate objective of the '*prevention of deceptive practices*'. The Panel will need to assess whether such scheme may ensure attainment of this objective in a less trade restrictive manner than the general prohibition imposed by the EU.

In this dispute, the WTO dispute settlement organs will be called to assess the delicate balance between WTO Members' right to adopt domestic measures aimed at pursuing legitimate policies (in this case, policies responding to public morals and animal health) and their trade obligations under the WTO. The decision on the EU's seals regime stands to have important implications for other regimes that the EU (and other WTO Members) has adopted and maintains, such as, *inter alia*, those in place in the area of sustainable fishing and timber trade, also characterised by comparable licensing schemes or requirements. The economic impacts of these regulations are undeniable, and equally important are the objectives that they intend to protect. It is crucial that, where possible, these policies be adopted on the basis of the widest (multilateral) consent, and be crafted in a manner that they do not constitute disguised protection of domestic interests and be based on the least trade-restrictive measures available. Business and Governments must work together to identify these measures, if need be through flexible and creative policy-making, and ensure that neither the environment nor world trade become victims of their unilateral approaches.

EU postpones decision on an application to allow US wine exports to Europe to use the word '*Château*'

On 25 September 2012, at the 366th Meeting of the EU Management Committee for the Common Organisation of Agricultural Markets, the Committee did not, as originally foreseen,

vote on a Commission Implementing Regulation recognising a traditional term (*i.e.*, '*Château*') provided for in *Council Regulation (EC) No. 1234/2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products* (hereinafter, *Single CMO Regulation*). Currently, US wines which use the denomination '*Château*' on their label cannot be marketed in the EU, which reserves the use of the historical expression to wines coming from an estate, which really exists or which is called exactly by this word. It appears that the vote has been postponed after concerns have been raised by the French Delegation in the Committee addressing fears of French wine producers, particularly of the Bordeaux region.

Article 118u(1) of the *Single CMO Regulation* states that a '*traditional term*' means a term traditionally used in EU Member States for products referred to in Article 118a(1) (*i.e.*, certain grapevine products) to designate: (a) that the product has a protected designation of origin or a protected geographical indication under EU or national law; and (b) the production or ageing method or the quality, colour, type of place, or a particular event linked to the history of the product with a protected designation of origin or a protected geographical indication. Paragraph 2 of Article 118u of the *Single CMO Regulation* provides that '*traditional terms*' shall be recognised, defined and protected by the EU Commission.

On 22 June 2010, *Wine America* and the *California Export Association*, two representative professional organisations established in the US, submitted to the EU Commission an application for protection of the traditional term '*Château*' in relation to certain grapevine products bearing a name of origin listed in Annex V to the *Agreement between the European Community and the United States of America on trade in wine*, approved by Council Decision 2006/232/EC. The grapevine products covered by the application belong to the categories '*1. Wine*', '*3. Liqueur wine*', '*4. Sparkling wine*', '*5. Quality sparkling wine*', '*8. Semi-sparkling wine*' and '*9. Aerated semi-sparkling wine*' provided in Annex XIb to the *Single CMO Regulation*.

After the application was published in the Official Journal of the EU in accordance with Article 33 of *Commission Regulation (EC) No. 607/2009 of 14 July 2009 laying down certain detailed rules for the implementation of Council Regulation (EC) No. 479/2008 as regards protected designations of origin and geographical indications, traditional terms, labelling and presentation of certain wine sector products,* France submitted an objection to the recognition pursuant to Article 37 of *Regulation (EC) No. 607/2009.* France particularly objected that it is allowed, according to the US definition of the traditional term '*Château*', to use grapes harvested outside vineyards exploited by the wine-making undertaking using the term '*Château*', while French wines using the term '*Château*' have to be produced exclusively from grapes harvested in vineyards exploited by this undertaking. This could create a risk of confusion as regards the nature or the quality of the product.

The EU Commission considered that the criticism voiced by France on this point appeared to concern a risk of misleading consumers rather than a risk of confusion and that consumers will not be misled as to the true origin of the products since wines from the US bearing the traditional term '*Château*' would be labelled with an American name of origin. Furthermore, the EU Commission noted that, the fact that Luxembourgish, Italian and Chilean wines bearing the traditional term '*Château*' are accepted on the EU market, demonstrates that the risk of misleading consumers as regards the true origin of the product does not justify the rejection of the application. The EU Commission furthermore considered that there is no risk of consumers being misled as to the nature or the quality of the product. In the case of the traditional term '*Château*', the conditions of use for French, Italian and Luxembourgish wines coincide, in that those wines should be produced exclusively from grapes harvested in vineyards exploited by the wine-making undertaking using the term '*Château*' and, therefore, in that the main stages involved in the process of wine-making have to be carried out under the exclusive responsibility of a wine-grower with whom the quality of the product can be

associated. However, the EU Commission argued that the definitions of a traditional term do not need to be identical in all countries. In addition, according to the conditions of use of the term '*Château*' set out in the US application, the vineyards have to have been traditionally used by the producer. That condition equally implies that the wine-grower controls the process of wine-making. The EU Commission concluded that the application for the protection of the traditional term '*Château*', which relates to US wines, satisfied the conditions laid down in Article 118u(1) of the *Single CMO Regulation* and in Articles 31 and 35 of *Commission Regulation (EC) No. 607/2009* for wine products of categories '*1. Wine*', '*3. Liqueur wine*', '*4. Sparkling wine*' and '*5. Quality sparkling wine*', however not for the other categories covered by the application.

The decision on the US application to recognise the traditional term '*Château*' for certain US wines has been postponed to one of the next EU Management Committee meetings. The matter is particularly sensitive in the French region of Bordeaux, where the denomination '*Château*' is considered identical with wine-producing estates. Even those estates that have no building which resembles a '*Château*' (which can be translated into English as '*castle*' or '*mansion*'), use the term '*Château*' on their labels. France now has the chance to present alternative proposals and find '*allies*' in the EU Management Committee meeting, in order not to be outvoted.

Russia may contest EU energy laws at the WTO

Reports have suggested that Russia may soon launch its first trade dispute before the WTO against some provisions of EU's *Third Energy Package* (in particular, *Directive 2009/73/EC of the European Parliament and of the Council of 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC*, hereinafter, the Directive). Prior to its WTO accession, Russia had maintained that the application of the EU rules in question, which oblige energy companies to '*unbundle*' or separate their production and supply activities from the running of transmission networks, represents a confiscation of property in terms of the loss of control which the Russian company Gazprom can exert over its European pipeline assets. *Inter alia*, the *Package* stipulates that EU and third country companies wishing to acquire a significant interest over an EU network must seek certification from national regulators in the EU Member States in advance of operating. In relation to third country companies, the certification to operate in the EU can be refused where either they do not '*demonstratably and unequivocally*' comply with the requirements of unbundling or where, under the '*third country clause*', it is considered that such certification would threaten the EU's energy security. The Directive foresees three types of unbundling: (i) '*ownership unbundling*' (ownership of energy production must be separated from ownership of transmission activities); (ii) the '*Independent System Operator*' (both activities can be carried out by a vertically integrated company, provided that management of technical and commercial operations of the transmission network are entrusted to a company under distinct ownership); and (iii) the '*Independent Transmission Operator*' (both activities can be carried out by a vertically integrated company, provided that specific independency requirements apply to the transmission subsidiary and subject to additional controls). Although it had been rumoured that Gazprom would comply with these requirements in an attempt to halt the EU Commission's on-going investigation into its suspected anti-competitive practices, it appears that Russia may instead challenge the requirements by invoking the WTO rules applicable to energy ahead of the March 2013 deadline for compliance.

Due to differences in opinion between energy exporting and importing Members of the WTO, no specific rules have been negotiated to date in order to tackle trade distortions in respect of energy as a distinct sector. Although it is unusual to encounter market access problems in energy export markets (because tariffs in this area are generally quite low), it is widely

accepted that the existing WTO rules are applicable to this and other issues attributed to trade in energy, such as transit problems, restrictive practices by exporters or importers and monopoly positions. Since the WTO rules regulate goods and services differently, the definition of energy in terms of a product (*i.e.*, a '*gas product*') or a service (*i.e.*, energy-related services, such as transmission and distribution) is important in determining what treatment must be afforded to energy.

If Russia claims that the rules set out in the *Third Energy Package* result in a restriction on the exportation of energy products and in discrimination in the access to, and sale within, the EU market, then the provisions of the GATT may be applicable. In order to establish that the measures violate the MFN and national treatment principles under Article I and III of the GATT, Russia must show that, as a result of the requirements under the *Third Energy Package*, its energy products are being discriminated *vis-à-vis* third country products or EU products in the EU market. In addition, the quantitative restrictions prohibition embedded in Article XI of the GATT may be relevant if Russia argues that access to pipelines and other export distribution networks is restricted by the measures.

The rules of the General Agreement on Trade in Services are relevant inasmuch as the *Third Energy Package* may be restricting the ability of Russian operators to supply a service, such as energy transmission and distribution. Energy services are not classified as a separate sector under the WTO. However, commitments on energy-related services are scheduled under services incidental to mining, services incidental to energy distribution, and pipeline transportation of fuels. In respect of such services, the EU must afford Russian companies treatment no less favourable that that applied to other WTO Members' services suppliers. However, the EU does not appear to have undertaken specific commitments in such sectors, so that the EU does not appear bound to grant market access and national treatment conditions equivalent to those that apply to its domestic operators, which, as already noted by certain scholars, is particularly relevant for the assessment of the energy security clause, which applies to third country suppliers only.

Any decision in this area will be significant for both the EU and Russia (since half of its energy exports are destined for the EU market), as well as in the development of WTO law. While recent discussions have revolved around the environmental aspect of energy trade, it is expected that, with the WTO accession of one of the world's few net energy exporters, greater clarity will be afforded to the exact definition and application of energy rules to trade, as well as the rights of WTO Members to impose regulations related to their national policy objectives in ensuring the preservation of the security of supply of energy.

Recently Adopted EU Legislation

Market Access

- *Commission Implementing Decision of 27 September 2012 amending Annex I to Decision 2004/211/EC as regards the entries for Bahrain and Brazil in the list of third countries and parts thereof from which the introduction into the Union of live equidae and semen, ova and embryos of the equine species are authorised (notified under document C(2012) 6732)*

Trade Remedies

- *Commission Regulation (EU) No. 875/2012 of 25 September 2012 initiating an investigation concerning the possible circumvention of anti-dumping measures imposed by Council Implementing Regulation (EU) No. 990/2011 on imports of*

bicycles originating in the People's Republic of China by imports of bicycles consigned from Indonesia, Malaysia, Sri Lanka and Tunisia, whether declared as originating in Indonesia, Malaysia, Sri Lanka and Tunisia or not, and making such imports subject to registration

Food and Agricultural Law

- *Commission Implementing Regulation (EU) No. 872/2012 of 1 October 2012 adopting the list of flavouring substances provided for by Regulation (EC) No. 2232/96 of the European Parliament and of the Council, introducing it in Annex I to Regulation (EC) No. 1334/2008 of the European Parliament and of the Council and repealing Commission Regulation (EC) No. 1565/2000 and Commission Decision 1999/217/EC*

- *Commission Regulation (EU) No. 873/2012 of 1 October 2012 on transitional measures concerning the Union list of flavourings and source materials set out in Annex I to Regulation (EC) No. 1334/2008 of the European Parliament and of the Council*

- *Commission Implementing Regulation (EU) No. 889/2012 of 27 September 2012 amending Annex I to Regulation (EC) No. 669/2009 implementing Regulation (EC) No. 882/2004 of the European Parliament and of the Council as regards the increased level of official controls on imports of certain feed and food of non-animal origin*

- *Commission Implementing Regulation (EU) No. 865/2012 of 21 September 2012 amending Regulation (EC) No. 867/2008 laying down detailed rules for the application of Council Regulation (EC) No. 1234/2007 as regards operators' organisations in the olive sector, their work programmes and the financing thereof*

- *Council Decision of 23 July 2012 on the signing, on behalf of the European Union, of the Food Assistance Convention*

Other

- *Council Decision of 24 September 2012 amending and extending the period of application of Decision 2007/641/EC on the conclusion of consultations with the Republic of the Fiji Islands under Article 96 of the ACP-EC Partnership Agreement and Article 37 of the Development Cooperation Instrument*

- *Commission Delegated Regulation (EU) No. 874/2012 of 12 July 2012 supplementing Directive 2010/30/EU of the European Parliament and of the Council with regard to energy labelling of electrical lamps and luminaires*

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