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The imposition of quality standards for imported fruits and vegetables

The Indonesian Ministry of Agriculture has announced this week the establishment in 2012 of a new national quality standard on imported horticultural products to avoid that the Indonesian market be '*flooded with low-quality fruits and vegetables and to make sure that only high-quality fruits and vegetables will be able to be sold on the domestic market*'. In relation to fruits such as oranges, durians and pineapples, the quality standard would cover colour, sweetness, acid content and ripeness, but more details of the new standards were not announced as they were still being developed. According to the Ministry, Indonesia has abolished import duties on most fresh fruits since 2006, even before the ASEAN-China Free Trade Agreement came into force, which has led to an increase of imported fruit, mainly durians from Thailand and oranges from China and Australia. According to the Indonesian Central Statistics Agency, in 2006 the country imported around 100,000 tons of oranges (valued at 71.8 million USD) and 16,000 tons of durians (valued at 15.4 million USD), while in 2008 143,000 tons of oranges (worth 124 million USD) and 24,600 tons of durians (valued at 30.8 million USD) were imported.

The imposition of standards for imported fruits and vegetables is a tool often used to ensure that only high-quality products enter a certain market. In the EU, for example, there are quality standards for the marketing of fresh fruit and vegetables and certain types of dried fruit. These are based on the standards of the Codex Alimentarius and the United Nations Economic Commission for Europe (hereinafter, UNECE), which develops global agricultural quality standards that are used internationally by Governments, producers, traders, importers, exporters and international organisations to facilitate international trade, to encourage high-quality production and to protect consumers' interests.

The main requirements of EU standards are related to quality classification and labelling information. The general standard provides that fruit and vegetables, which are intended to be sold fresh to the consumer, may only be marketed if they are, *inter alia*, sound, clean, free of pests and damages, of marketable quality and if the country of origin is indicated. The EU importer of (fresh) fruit and vegetables is responsible for compliance with the standards in order to be allowed to market them within the EU. Checks on conformity to the marketing standards of fresh fruit and vegetables from outside the EU are carried-out with a so called 'Certificate of Conformity' issued by a competent authority to confirm that the products concerned conform to the relevant marketing standard. Since 1 July 2009, there are only 10 types of fruit and vegetables covered by specific standards (*i.e.*, apples, citrus fruit, kiwifruit, lettuces and curled leaved and broad-leaved endives, peaches and nectarines, pears, strawberries, sweet peppers, table grapes, tomatoes) instead of the former 36 types. Regulation (EC) No. 1221/2008 has introduced those rules regarding marketing standards and associated checks, following the reform of the common market organization for the fruit and vegetables sector. Fruit and vegetables not covered by a specific marketing standard shall conform to the general marketing standard. However, where the holder is able to show that they are in conformity with any of the applicable standards adopted by the UNECE, the product shall be considered as conforming to the general marketing standard.

In the US, USDA quality standards are based on measurable attributes that describe the value and utility of the product. Standards for each product describe the entire range of quality for a product, and the number of grades varies by commodity. There are more than 312 grades for fruit, vegetable, and specialty product standards. For fresh fruit, vegetable, nut and specialty crops, US

grade standards provide the produce industry with a uniform language for describing the quality and condition of commodities in the marketplace. In partnership with industry members, the Agricultural Marketing Service (AMS) develops and revises these documents so that they always reflect modern business practices.

The general question is how all these quality standards may be interpreted under WTO rules. In the past, quality standards have sometimes been interpreted as a disguised form of protectionism, 'abused' mainly by developed member countries. The WTO Agreement on Technical Barriers to Trade (hereinafter, the TBT Agreement) and the WTO Agreement on Sanitary and Phytosanitary Measures (hereinafter, the SPS Agreement), provide for a number of obligations that WTO Members must comply with in adopting quality standards and rules having an effect on trade. In particular, under the TBT Agreement, WTO Members must ensure that quality standards and rules (whether they are embodied in technical regulations or standards) are not applied with the view to, or with the effect of, creating unnecessary obstacles to international trade and must not be discriminatory. Technical regulations (that, differently from standards, are mandatory rules) must not be more trade-restrictive than necessary to fulfil legitimate objectives, which include national security requirements, the prevention of deceptive practices, the protection of human health or safety, animal or plant life or health or the environment. In addition, the SPS Agreement requires that sanitary and phytosanitary measures be based on scientific principles, are not maintained without sufficient scientific evidence and are applied only to the extent that is necessary to protect human, animal, plant life or health. In the development of quality standards, a careful approach should be taken, in line with internationally-accepted models and in compliance with the WTO requirements.

The WTO established a panel to rule on *Philippines – Taxes on Distilled Spirits*

Following a request from the EU, on 19 January 2010, the WTO Dispute Settlement Body established a panel in the case *Philippines – Taxes on Distilled Spirits*. Australia, China, Chinese Taipei, Mexico, Thailand and the US reserved their third party rights. In addition, the US began its own proceedings against the Philippines with a request for WTO consultations of 14 January 2010.

The EU submitted its request for the establishment of a panel on 10 December 2009 after the consultations held with the Philippines concerning its tax regime applied on distilled spirits led to no solution (See Trade Perspectives, Issue No. 16 of 4 September 2009). The EU's complaint concerns Section 141 of the Philippines National Internal Revenue Code and a number of Revenue Regulations, in which a distinction is made between '*local distilled spirits*' and '*imported distilled spirits*'. The EC alleges that the Philippines' tax regime, which has been in place for several years, provides for a price band system that subjects imported spirits to higher taxes than those applicable to domestically produced spirits. In particular, distilled spirits produced from a number of (what appears to be) indigenous raw materials, (*i.e.*, the sap of nipa, coconut, cassava, samote or buri palm, or from the juice, syrup or sugar of the cane, provided that such materials are produced commercially in the country where they are processed into distilled spirits) are subject to a flat tax rate, which reached a level of 11.65 Pesos in 2009. The imported spirits produced from other raw materials are subject to a system of price bands at substantially higher tax rates (which were established between 126 Pesos and 504 Pesos in 2009). As a consequence, according to the EU, in the entire period in which this tax regime has been in place, its exports to the Philippines have decreased by more than 50%.

The EU alleges that the Philippines excise tax regime is inconsistent with the Philippines' obligations under the GATT, in particular, the first and second sentences of Article III:2. The first sentence of Article III:2 provides that products from the territory of one WTO Member imported into the territory of another WTO Member cannot be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. The EU also claims that the Philippines is applying internal taxes to imported products so

as to afford protection to domestic production, in violation of the second sentence of Article III:2 of the GATT, concerning the taxation of directly competitive and substitutable products.

The obligations and requirements of Article III of the GATT have been previously interpreted by WTO panels and the Appellate Body in several instances. To support its first claim, the EU must show (i) that the taxed imported and domestic distilled spirits are 'like products', and (ii) that the taxes applied to the imported products are 'in excess of' those applied to domestic products. The likeness of the products will be determined by a number of factors such as the product's end-uses in a given market, the tariff classification of the product, consumers' tastes and habits and the product's properties, nature and quality. With respect to the claim concerning the second sentence of Article III:2 of the GATT, the issues that need to be examined are (i) whether the imported and domestic distilled spirits are 'directly competitive or substitutable products' which are in competition with each other; (ii) whether such products are 'not similarly taxed'; and (iii) whether the dissimilar taxation of such products is applied 'as to afford protection to domestic production'. The 'directly competitive or substitutable' nature of a product has to be determined on a case-by-case basis, for which the decisive criterion is whether the imported and domestic products have common end-uses, *inter alia*, as shown by the elasticity of substitution.

Reports indicate that the Government of the Philippines replied to the EU allegations that the tax regime for imported spirits is construed in such a way to protect the indigenous Filipino population that produces distilled spirits from indigenous raw materials, and is in line with the Philippines' commitments under the different WTO Agreements. Such defence could be constructed around the definition of 'like product', as the likeness of the products is determined by factors including consumers' tastes and habits and the product's properties, nature and quality. What could be more difficult to prove is that domestic and imported distilled products are not 'directly competitive or substitutable' products. This is a broader concept, which includes a more extensive range of products that are in competition with each other and deemed interchangeable.

The Philippines' market for distilled spirits is one of the largest of the Asian-Pacific region. Traders in distilled spirits should monitor closely the outcome of this case, as it could offer renewed and more favourable market access. In the past, the US and the EU were successful in challenging similar tax regimes on alcoholic beverages in Chile, Japan and Korea.

The future of sustainable packaging

On 28 January 2010, the Global Packaging Project announced that the packaging, food manufacturing and retail industries have reached an agreement concerning sustainable packaging definitions and principles, which reflects the guidelines on packaging and sustainability developed by ECR Europe (Efficient Consumer Response Europe) and Europen (the European Organization for Packaging and the Environment).

In the EU, after a report of the EU Commission on the Implementation of the Community Waste Legislation of 20 November 2009, the discussion about sustainable packaging re-emerged, with the aim of finding a definition of sustainable packaging in order for governments and industries to come up with clear guidelines on how they should proceed in adopting related rules. The importance of sustainable packaging becomes clear through the goal set up by Council Directive (EC) No. 1999/31 of 26 April 1999 on the landfill of waste (hereinafter, the Directive (EC) No. 1999/31) and elaborated in the Waste Acceptance Criteria Decision (EC) No. 2003/33. This EU legislation aims at providing measures, procedures and guidance to prevent or reduce as far as possible the negative effects of waste and landfills on the environment, (*e.g.*, the pollution of surface water, groundwater, soil and air), and on the global environment, including the greenhouse effect, as well as on any resulting risk to human health, from land-filling of waste, during the whole lifecycle of the landfill. In particular, Directive (EC) No. 1999/31 requires EU Member States to set up a national strategy ensuring that, by 17 July 2006, the amount of biodegradable municipal waste going to landfills would have been reduced to 75% compared to the amount of 1995. By 17

July 2009, this should have been 50% and 35% by 17 July 2016. An EU Commission Staff Working Document of 20 November 2009 on implementing European Community Environmental Law states that only five EU Member States (*i.e.*, Austria, Belgium, Ireland, Italy and the Netherlands) reported that they have complied with the Directive and have reached the 2009 goal. However, for Italy and Ireland this was later found to be incorrect in a Commission study on the implementation of the Directive (EC) No. 1999/31.

Sustainable packaging can play a role in helping EU Member States to achieve the goals set forth in Directive (EC) No. 1999/31. There is no agreement on what constitutes 'sustainable packaging' inside the EU, not even in the European Parliament and Council Directive (EC) No. 1994/62 of 20 December 1994 on packaging and packaging waste (hereinafter, Directive (EC) No. 1994/62). However, this directive can be of use in determining certain characteristics, which should be taken into consideration when developing a comprehensive and workable definition (*i.e.*, the reduction of the quantity and of the harmfulness for the environment in terms of resources used and emissions produced during the production and the effects of the use itself, reusability, (organic) recyclability, energy recovery, *etc.*). Further, this directive states that packaging has to be manufactured in such a way that the packaging volume and weight be limited to the minimum adequate amount to maintain the necessary level of safety, hygiene and acceptance for the packed product and for the consumer.

A number of EU Member States and industries have undertaken initiatives to come up with a definition or a strategy to implement Directive (EC) No. 1994/62, but not all attempts have been successful. In 2008, France issued the law 'Grenelle Environnement', which states that packaging must be as limited as possible, while respecting the needs of product safety, hygiene and logistics. However, under Directive (EC) No. 1994/62 packaging requirements are also subject to the characteristics of the product and acceptance by consumers. Europen stated that, by leaving the part on consumer acceptance out, the French law had violated Directive (EC) No. 1994/62. In particular, Europen considered that the elaborate packaging, which is often associated with goods in the luxury market and which is accepted by the consumer due to the character of the product, would no longer be possible in France.

Such problems arise due to a lack of agreement by all EU Member States and industries about what constitutes a good and workable definition or strategy for sustainable packaging. The pressure is high to come up with clear guidelines. However, due to the large number of stakeholders involved (*i.e.*, the retailers, packers, fillers, consumers, industries, governments, NGOs, etc.), the process appears to advance at a slower pace as each stakeholder group has a number of conflicting interests, including commercial and environmental ones. A first step in this direction is achieved through the agreement on definitions and principles reached by the packaging, food manufacturing and retail industries, which reflects the guidelines produced by ECR Europe and Europen in May 2009. Such guidelines state that sustainable packaging is regarded as a way to contribute to sustainable development. Accordingly, '*sustainable packaging should be designed in a holistic way and be made from responsibly sourced materials. In addition, the packaging has to be safe and effective throughout its lifecycle, meet criteria for performance and cost, meet consumers' choice and expectations and, finally, it has to be recovered efficiently after use*'.

However, even though such definitions and principles represent a significant first step, there appears to be the need for a regulatory framework, preferably at the EU level, to avoid disparate and fragmented legislations on sustainable packaging that could ultimately create barriers to trade. Such framework should be crafted with care in order not to violate the EU's obligations in relation to the WTO Agreement on Technical Barriers to Trade, which specifically states that technical regulations and standards, including packaging, marking and labelling requirements, and procedures for assessment of conformity with technical regulations and standards should not create unnecessary obstacles to international trade. This agreement further states in its Article 2.2 that such technical regulations have to be drawn up in such way that is not more trade-restrictive than necessary to fulfil a legitimate objective, in the case at stake the environmental protection. A

new regulatory framework on sustainable packaging could also result in additional costs for the industries that have to deal with the implications of, and adaptation to, the new rules. EU legislators, as well as stakeholders involved, should make sure that such rules would strike a balance between the legitimate objective of protection of the environment and (*inter alia*) the commercial cost that they could imply.

The European Court of Justice clarifies the definition of '*substantial processing or working*'

In a judgment of 10 December 2009, the European Court of Justice (hereinafter, the ECJ) gave its preliminary ruling in the proceeding Bundesfinanzdirektion West (the Western Federal Revenue Office) versus HEKO Industrieerzeugnisse GmbH (HEKO) concerning the clarification of the concept of '*substantial processing or working*' for the determination of non-preferential origin.

The German Finance Court of Dusseldorf was asked to rule in a case concerning the rules of origin, following the issuance of 5 so-called '*binding origin information*' (hereinafter, BOIs) issued by the Western Federal Revenue Office. BOIs are customs decisions issued by the competent authorities of EU Member States, which are binding on the customs authorities of all other EU Member States in respect of goods imported or exported after their issuance. HEKO requested BOIs from the Western Federal Revenue Office for various types of steel cables classified under heading 7312 of the Combined Nomenclature (*i.e.*, stranded wire, ropes, cables, plaited bands, slings and the like of iron and steel, not electrically insulated) manufactured in North Korea using stranded wire originating in China, also coming under heading 7312 of the Combined Nomenclature (hereinafter, CN). Through the BOIs, the Western Federal Revenue Office determined that the various types of steel cables had Chinese origin, on the basis that, in the absence of a change in tariff heading, the operations that were necessary to manufacture the steel cable from the stranded wire did not constitute '*substantial processing*' according to Article 24 of the EU's Customs Code. In its determinations, the Revenue Office relied on the 'list rules', drawn up by the EU Commission and aimed at defining the terms of the Customs Code, according to which goods falling under the heading of 7312 of the CN cannot be regarded as having undergone their last substantial processing or working, unless they change tariff heading. HEKO challenged the BOIs before the German Finance Court of Dusseldorf which ruled in favour of the plaintiff on the grounds that the 'list rules' do not constitute a legally binding EU act and they are incompatible with EU case-law. The Western Federal Revenue Office appealed against the ruling to the Bundesfinanzhof (hereinafter, the referring court) that referred the case to the ECJ.

In particular, the question for a preliminary ruling concerned the interpretation of Article 24 of the EU Customs Code. This article establishes that '*goods whose production involves more than one country shall be deemed to originate in the country where they underwent their last, substantial, economically justified processing or working in an undertaking equipped for that purpose and resulting in the manufacture of a new product or representing an important stage of manufacture*'. The referring court requested clarifications on whether the term '*substantial processing or working*' with regard to goods classified under heading 7312 of the CN must be interpreted as covering only such processing or working that leads to a change of CN tariff heading.

Reference was made to, *inter alia*, Article 2 of the WTO Agreement on Rules of Origin which states, in relevant part, that during the transition period (*i.e.*, before the harmonisation process of rules of origin has been concluded), when issuing administrative determinations of rules of origin where the criterion of change of tariff classification is applied, WTO Members must ensure that such rule (and any exception to it) should be clearly specifying the subheadings or headings within the tariff nomenclature to which it applies. The EU Commission '*list rules*' provide such concrete criteria. However, they have no binding legal force and their content must be compatible with Article 24 of the Customs Code. The ECJ stated that, although relevant acts of secondary legislation must be interpreted in the light of the agreements adopted in the context of the WTO, as established through previous ECJ case law, the WTO Agreement on Rules of Origin today only

establishes a harmonisation work programme for a transitional period, which offers the WTO Members a significant margin of discretion. As the ECJ reported, this principle was also confirmed by the WTO panel report of 20 June 2003 in the case *US – Rules of Origin for Textiles and Apparel Products* that found that WTO Members are free to determine the criteria which are use to confer origin, to alter those criteria over time, or to apply different criteria to different goods.

Therefore, the ECJ could not base its preliminary ruling concerning the interpretation of '*substantial processing or working*' of Article 24 of the EU Customs Code on the WTO Agreement on Rules of Origin. Instead, it referred to ECJ previous case law and established that processing or working is '*substantial*' only if the product resulting from it has (i) its own properties and, (ii) a composition of its own, which it did not possess before that process or operation. Therefore, according to the ECJ, a significant qualitative change in the properties of the product is required for the change of origin. In addition, previous case law determined that it is not sufficient to rely upon the tariff classification of processed products, since the Common Customs Tariff has been conceived to fulfil special purposes and not in relation to the determination of the origin of goods. In fact, the latter has to be based on a real and objective distinction between the basic product and the processed product, which depends in essence on the specific material qualities of each of those products. According to the ECJ, when a product is the result of an assembly operation of different elements, and where some doubt arises in relation to the differences and properties of the basic product and the processed product, other criteria are to be considered, such as the value added.

The ECJ determined that the change of a tariff heading is not based on a real and objective distinction between the basic product and the processed product or on their specific material qualities and it does not take into account the specific processing or working. Therefore, a change of tariff heading could only indicate the substantial nature of that processing or working, but it cannot be a decisive element, as this would only restrict the scope of Article 24 of the EU Customs Code.

Such interpretative problems are likely to arise more often as no harmonisation has been achieved inside the framework of the WTO. The judgment of the ECJ shows that the consequences of such lack of uniformity can even be felt within the EU. As rules of origin are a complex matter with a big scope of application that have already resulted in the so called '*spaghetti bowl syndrome*' across the globe, harmonisation is key. If a solution inside the WTO framework remains pending, at least inside the EU a uniform interpretation of such rules should be ensured to avoid any related problems amongst the EU Member States. A uniform interpretation would facilitate the operations of companies as they are ultimately affected by the different interpretative rules inside the EU.

Recently Adopted EU Legislation

- *Council Implementing Regulation (EU) No. 54/2010 of 19 January 2010 imposing a definitive anti-dumping duty on imports of ethanolamines originating in the United States of America*
- *Council Implementing Regulation (EU) No. 77/2010 of 19 January 2010 amending Regulation (EC) No. 452/2007 imposing a definitive anti-dumping duty on imports of ironing boards originating, inter alia, in the People's Republic of China*
- *Commission Regulation (EU) No. 42/2010 of 15 January 2010 concerning the classification of certain goods in the Combined Nomenclature*
- *Commission Regulation (EU) No. 37/2010 of 22 December 2009 on pharmacologically active substances and their classification regarding maximum residue limits in foodstuffs of animal origin*

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FRATINIVERGANO
EUROPEAN LAWYERS

Rue de Haerne 42, B-1040 Brussels, Belgium Tel.: +32 2 648 21 61 - Fax: +32 2 646 02 70
www.FratiniVergano.eu