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How Listing Ukraine As A Priority Foreign Country In Special 301 Violates WTO Agreements

By Professor Sean Flynn [1]

In this year's Special 301 report, the United States Trade Representative listed Ukraine as a "Priority Foreign Country" (aka PFC), triggering a 30 day countdown to initiate an investigation under Section 301 of the Trade Act to determine trade sanctions. 19 USC 2412(2)(A). This is only the second time that the U.S. has threatened a WTO-member country with sanctions as a PFC. And thus it is an appropriate time to ask what restrictions the World Trade Organization places on the operation of the Special 301 program. As described more fully below, any sanction of Ukraine, including removal of General System of Preferences (GSP) benefits, would likely violate WTO rules. Indeed, the listing of Ukraine as a PFC, and the more general operation of "watch lists" threatening sanctions for intellectual property matters, could be challenged under the WTO even prior to any sanction actually going into effect.

A. Special 301 is a Unilateral Adjudication of Foreign Countries for IP Matters both Covered and not Covered Under any Trade Agreement

Special 301 is an offshoot of the more general "Section 301" program which authorizes the USTR to unilaterally sanction foreign countries for domestic laws which either "violates, or is inconsistent with, the provisions of, or otherwise denies benefits to the United States under, any trade agreement" or which does not itself violate any agreement but nevertheless "is unreasonable or discriminatory and burdens or restricts United States commerce." 19 USC § 2411. One ground for finding an "unreasonable" policy subject to trade sanction includes the denial of "fair and equitable . . . provision of adequate and effective protection of intellectual property rights notwithstanding the fact that the foreign country may be in compliance with the specific obligations of the Agreement on Trade-Related Aspects of Intellectual Property Rights." 19 USC 2411(d)(3)(VB)(ii). Possible sanctions can include the suspension of "benefits of trade agreement concessions," "duties or other import restrictions," or the suspension of General System of Preferences (GSP) benefits. 19 USC 2411(c).

Special 301 is integrated into the Section 301 sanctioning process through a public adjudication and notification mechanism. Under Special 301, the USTR is required to annually publish in the Federal Register a list of countries that deny "adequate and effective protection of intellectual property" or "deny fair and equitable market access for U.S. firms that rely on intellectual property," and then designate among those countries the subset of worst actors to be designated "priority foreign countries." 19 U.S.C. § 2242. USTR holds an annual hearing and publishes an annual report containing two levels of "Watch Lists" below the "Priority Foreign Country" designation. As described by USTR in the 2013 report:

> *Placement of a trading partner on the Priority Watch List or Watch List indicates that particular problems exist in that country with respect to IPR protection, enforcement, or market access for persons relying on IPR. Countries placed on the Priority Watch List are the focus of increased bilateral attention concerning the problem areas.*

Designation as a "Priority Foreign Country" is a statutory criteria that triggers a 30-day countdown during which targeted countries must "(enter) into good faith negotiations" or "(make) significant progress in bilateral or multilateral negotiations" or face an investigation under the Section 301 process for determining unilateral sanctions. Priority foreign country determinations are reserved for countries "that have the most onerous or egregious acts, policies, or practices," that "have the greatest adverse impact (actual or potential) on the relevant United States products," and for which "there is a factual basis for the denial of fair and equitable market access as a result."

This framework for unilaterally sanctioning foreign countries for intellectual property matters pre-dates the World Trade Organization's rules. Indeed, it was the lack of binding international trade adjudication, such as that created under the WTO, which was the primary justification for

Congress's enactment of the 301 unilateral adjudication in the 1980s. [See 301 Historical Primer]. There has always been a serious question as to how the statutory program could continue after the WTO, and there has been one adjudication of the more general 301 program explained below.

One of the noticeable trends in Special 301 in the Post-WTO 1994 period is the steep drop off in listings of countries as a "Priority Foreign Country," most directly threatening trade sanctions. Only three countries were designated as PFCs after 1994: China in 1996, Paraguay in 1998, and Ukraine in 2001-05. Of these, only Paraguay was a member of the WTO in the year it was list as a PFC. Ukraine was not a WTO member when it was initially listed, but now it is.

B. Using 301 to Adjudicate TRIPS Violations Would Violate the WTO Dispute Settlement Understanding and U.S. Law

On their face, the 301 complaints against Ukraine do not appear to raise challenges to Ukraine's implementation of the WTO agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The 2013 Special 301 Report describes three grounds for Ukraine's PFC listing:

> *[T]he specific grounds for the U.S. Trade Representative's designation of Ukraine as a PFC are: (1) the unfair, nontransparent administration of the system for collecting societies, which are responsible for collecting and distributing royalties to U.S. and other rights holders; (2) widespread (and admitted) use of illegal software by Ukrainian government agencies; and (3) failure to implement an effective means to combat the widespread online infringement of copyright and related rights in Ukraine, including the lack of transparent and predictable provisions on intermediary liability and liability for third parties that facilitate piracy, limitations on such liability for Internet Service Providers (ISPs), and enforcement of takedown notices for infringing online content.*

None of these grounds explicitly refer to complaints under TRIPS. Unilateral adjudication of TRIPS violations is prohibited by Article 23 of the Dispute Settlement Understanding, explaining under the title "Strengthening of the Multilateral System":

> *1. When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding.*
>
> *2. In such cases, Members shall:*
>
> *(a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding*

The import of this language is fairly clear. The Dispute Settlement Understanding (DSU) procedures, and only those procedures, can be used for findings that lead to the "suspension of concessions or other obligations" under GATT.

After the WTO accords went into effect, the U.S. did not dismantle the Section 301 or Special 301 programs, which became the subject of a trade dispute in the WTO in *United States – Sections 301-310* [2]. In that case, a WTO panel held that Section 301 sanctions were only still legal under the DSU because of a "Statement of Administrative Action" pledging to "base any section 301 determination" on "panel or Appellate Body findings adopted by the DSB" and only sanction countries with "authority from the DSB to retaliate."

The panel decision went further, discussing in a key package that the U.S. also could not threaten to sanction countries in ways that, if actually implemented, would likewise threaten the WTO:

> *Members faced with a threat of unilateral action, especially when it emanates from an economically powerful Member, may in effect be forced to give in to the demands imposed by the Member exerting the threat… To put it differently, merely carrying a big stick is, in many cases, as effective a means to having one's way as actually using the stick. The threat alone of conduct prohibited by the WTO would enable the Member concerned to exert undue leverage on other Members. It would disrupt the very stability and equilibrium which multilateral dispute resolution was meant to foster and consequently establish, namely equal protection of both large and small, powerful and less powerful Members through the consistent application of a set of rules and procedures.*

After this ruling, the USTR has been relatively carefully not to use Special 301 to explicitly threaten other countries with trade sanctions for alleged violations of TRIPS. It more commonly

describes Special 301 as being a component of the evaluation of whether it will grant other countries GSP benefits, which it asserts unilateral authority to determine the criteria for. And the criteria listed in the 301 reports most commonly refers to the lack of domestic policies that are "TRIPS-plus" – i.e. go be beyond those required by the TRIPS agreement. But, as explained below, the developed countries do NOT have unilateral authority to determine GSP benefit criteria. Under the reasoning of the Sections 301-310 panel, any country on the various Special 301 Watch Lists would likely have standing to challenge the Special 301 program as threatening denial of GSP benefits for criteria that violate the WTO accords.

C. TRIPS-Plus standards may be challenged as not being "non-discriminatory" and "non-reciprocal" criteria tailored to "respond positively to the development, financial and trade needs of developing countries."

The U.S. legal authority for denying GSP benefits based on intellectual property policies is contained in 19 USC 2462(c) [3], requiring consideration of the "the extent to which such country is providing adequate and effective protection of intellectual property rights." The **2013 Special 301 report** signals that it intends to evoke this criteria with respect to Ukraine, stating:

> *When Ukraine was designated a PFC in the past, it failed to address the grounds for its designation during the following investigation. As a result, Ukraine lost its eligibility for benefits under the Generalized System of Preferences (GSP). Once Ukraine addressed the issues that led to its designation as a PFC, its eligibility for GSP benefits was reinstated.*

Thus, the central question under the WTO accords may be: *may the U.S. suspend GSP benefits from a country as a sanction for not adopting TRIPS-plus policies?* Current law under the WTO Appellate Body provides a strong argument that the U.S. cannot maintain such policies.

The starting point for the trade law analysis is the WTO's requirement of Most Favored Nation (MFN) treatment for all members, contained in Article I:1 of the General Agreement on Tariffs and Trade 1994 (GATT). The MFN principle requires

> *any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country be accorded immediately and unconditionally to the like product originating in or destined for territories of all other contracting parties*

By withdrawing trade benefits from one country (e.g. Ukraine), but not from other WTO-members, the U.S. GSP program facially authorizes conduct that violates MFN treatment. The conduct must, therefore, be authorized by an exemption to MFN.

GSP programs are authorized by the exception to MFN known as the GSP "Enabling Clause." [4] The two key provisions in this clause for our purposes are located in Paragraphs 2 and 3. Paragraph 2 (footnote 3) of the Clause states that GSP programs are authorized only in so far as their criteria are "generalized, non-reciprocal and non discriminatory." Paragraph 3 of the Clause adds the additional requirement that GSP criteria "be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries." The use of TRIPS-plus criteria to deny GSP benefits does not appear to meet either standard.

The WTO Appellate Body (the highest court in the WTO and the authority on matters of WTO interpretation) was tasked with interpreting the GSP enabling clause requirements in the case of *EC – Preferential Tariffs*. The matter involved a challenge by India of the EC's program to award additional GSP benefits to countries that participated in a special drug eradication program. The Appellate Body held that GSP programs could have criteria that result in different benefits being afforded to different developing countries, but that such differential treatment must itself be based on criteria that meet the Paragraph 3 requirement of responding "positively to the development, financial and trade needs of developing countries." The Appellate Body explained:

> *In granting such differential tariff treatment, [ ] preference-granting countries are required, by virtue of the term "nondiscriminatory", to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the "development, financial and trade needs" to which the treatment in question is intended to respond.*

The Appellate Body continued:

> *[T]he expectation that developed countries will "respond positively" to the "needs of developing countries" suggests that a sufficient nexus should exist between, on the one hand, the preferential treatment provided under the respective measure authorized by paragraph 2, and, on the other hand, the likelihood of alleviating the relevant "development, financial [or] trade need". In the context of a GSP scheme, the particular need at issue must, by its nature, be such that it can be effectively addressed through*

> *tariff preferences. Therefore, only if a preference-granting country acts in the "positive" manner suggested, in "respon[se]" to a widely-recognized "development, financial [or] trade need", can such action satisfy the requirements of paragraph 3(c).*

Under this standard, TRIPS-plus criteria may be challenged for being insufficiently related to the needs of developing countries and rather tailored to meet U.S. intellectual property industry export needs. The U.S. is not free to define any "needs" it chooses as GSP criteria for developing countries. The Appellate Body admonished that "a 'need' cannot be characterized as one of the specified "needs of developing countries" in the sense of paragraph 3(c) based merely on an assertion to that effect by, for instance, a preference-granting country or a beneficiary country." Such need, the Appellate Body held, must be assessed according to an "objective," "[b]road-based recognition of a particular need," such as those "set out in the WTO Agreement or in multilateral instruments adopted by international organizations."

Here, the U.S. is on the horns of a dilemma. For the criteria to be sufficiently "broad based," the WTO Appellate Body suggests that they need to be incorporated into a broad multilateral agreement like TRIPS. But the U.S. cannot unilaterally adjudicate TRIPS disputes.

The specific issues that the U.S. raises — the administration of collecting societies, rules on the government use of copyrighted software, and intermediary liability and "enforcement of takedown notices for infringing online content" are not subject to broad-based international standards. None are explicitly recognized duties under TRIPS. There are very general standards in the WIPO Internet Treaties on copyright in the digital environment, but only a small number of controversial international agreements – in the form of bilateral trade agreements with the U.S. – contain standards on intermediary and third party liability and the enforcement of takedown notices for online infringement. The U.S. would like these to be areas of broad-based agreement, but thus far they are not.

Ukraine may also argue that using removals of GSP benefits as a sanction for disfavored policies and practices is not a "positive" use of GSP benefits. The Appellate body explained that the GSP Enabling Clause "mandates that the response provided to the needs of developing countries be 'positive,'" which it defined as "consisting in or characterized by constructive action or attitudes." It continued:

> *This suggests that the response of a preference-granting country must be taken with a view to improving the development, financial or trade situation of a beneficiary country, based on the particular need at issue.*

It is difficult to explain the use of PFC listings under Special 301 as "positive" in this respect. The PFC listing is rather clearly designed as a threat to withdraw benefits as a punitive sanction for acting against U.S. interests, not as an enticement or reward for responding to its own development needs. As one commenter [5] noted: "The EC rewards "good" behavior with extra preferences; the U.S. penalizes "bad" behavior by taking away preferences." Whether the WTO allows the latter use of GSP criteria as a sanction is yet to be decided by the Appellate Body.

D. Conclusion

The implications of the two lines of cases discussed above suggest that Ukraine has strong arguments for challenging its PFC listing, and any subsequent denial of GSP benefits, in the WTO. In addition, using the discussion of the prohibition of "threats alone" from the*Section 301-310* case, other countries on the various watch lists could challenge Special 301 as implicitly threatening GSP benefit withdrawal for criteria that do not meet the WTO's standards. Doing so and succeeding would relieve the world of a much hated vestige of the Pre-WTO "aggressive unilateralism" in U.S. trade policy.

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[1] Professor Sean Flynn: **#bio**
[2] United States – Sections 301-310: **http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds152_e.htm**
[3] 19 USC 2462(c): **http://www.law.cornell.edu/uscode/text/19/2462**
[4] "Enabling Clause.": **http://www.worldtradelaw.net/tokyoround/enablingclause.pdf.**
[5] one commenter: **http://worldtradelaw.typepad.com/ielpblog/2012/04/questions-about-suspending-gsp-benefits-to-argentina.html**
[6] WTO Dispute Panel Formed On Australia Tobacco Law: **http://www.ip-watch.org/2012/09/28/wto-dispute-panel-formed-on-australia-tobacco-law/**
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[8] WTO TRIPS Council To Consider New Brazil-United States Item On Innovation: **http://www.ip-watch.org/2012/11/05/wto-trips-council-to-consider-new-brazil-united-states-item-on-innovation/**