

Customs Union or Free Trade Area (CUFTA)  
Moot Dispute Settlement Competition

2008

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**The Dispute:**

*Laviña vs Vetustia: Measures Affecting Imports of Primary Batteries*

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**Vetustian Measures Affecting Imports of Primary Batteries from Laviña**

Dispute before the Permanent Review Court of the Customs Union of Southern Manzania

Factual and Procedural Background

1. The Republic of Vetustia is an economically strong developing country, in spite of its poor social development indicators. Its diplomacy is well-known for supporting multilateralism in virtually all issue areas of international relations, from international security to environmental protection. The Parliamentary Republic of Laviña is a small developing country whose economy is largely dependent on exports of agricultural goods and a few industrial products to Vetustia and to the other member states of the Customs Union of Southern Manzania (CUSM).
2. CUSM is the world's second largest customs union formed only by developing countries. It was established in the Manzanian continent on 02 March 2004, by the Treaty Establishing the Customs Union of the South, also known as the "Treaty of Gedis", in reference to the capital city of Vetustia where it was signed. Apart from Vetustia and Laviña, three other developing countries have signed the Treaty of Gedis: Goldina, Simezia and Trindadi. Goldina is a large developing country whose economy is almost as diversified as Vetustia's. Simezia and Trindadi, like Laviña, are small economies that depend on their larger customs union fellow-members. Following ratification by the five parties, The Treaty of Gedis entered into force on 17 July 2004. All CUSM member states are original Members to the World Trade Organization (WTO).
3. Annex 2 to the Treaty of Gedis provides for dispute settlement and is entirely based on text of the Olivos Protocol for the Settlement of Disputes in Mercosur. The Preamble of the Treaty of Gedis includes the following paragraphs:

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

*“The Parties to this Treaty,*

*RECOGNIZING that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the region’s resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with the promotion of a balanced development in all parts of the region,*

*(...)*

*BEING desirous of contributing to these objectives by liberalizing trade through the progressive abolition, among the Parties, of non-tariff barriers and customs duties levied on imports and exports, and through the adoption of a common external tariff, in order to establish a customs union at the regional level,*

*RESOLVED, therefore, to establish the Customs Unions of Southern Manzanía and hereby agree as follows.”*

4. Batteries are electrochemical devices with the ability to convert chemical energy to electrical energy, so as to provide power to many electronic devices that are commonly used in households. Statistics show that the average person uses and throws out about eight household batteries – mostly, dry-cell batteries that are sold in well-known formats such as A, AA, AAA, 9V, etc. – per year. Batteries contain heavy metals such as mercury, zinc, lead, cadmium, and others, which can contaminate the environment when batteries are improperly disposed of following the end of their useful life. Batteries may produce, *inter alia*, the following potential hazards: they may pollute lakes and streams as the metals vaporize into the air when burned; increase the amount of heavy metals that can potentially leach from solid waste landfills; expose the environment and water to contamination by corrosive acids and heavy metals; cause burns or danger to eyes and skin.<sup>1</sup>

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Source: <<http://www.ehso.com/ehshome/batteries.php>>.

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

5. There are two categories of batteries: primary batteries (also known as disposable batteries) and secondary batteries (also known as storage batteries, which are a type of accumulator). Primary batteries are classified under Heading 85.06 of the Harmonized Commodity Description and Coding System (the “Harmonized System” or “HS”). They include alkaline/manganese, lithium, carbon-zinc, mercuric-oxide, silver-oxide, and other types of batteries. Storage batteries are classified under Heading 85.07 of the HS System and include lead-acid, nickel-cadmium and other batteries.
6. Most primary and secondary batteries are sold in equivalent voltages and shapes and have similar household uses. Primary batteries are much cheaper than storage batteries. However, primary batteries are *non-rechargeable* (i.e. they have to be disposed of after a single lifecycle), while storage batteries may be recharged several times before they reach the end of their useful life.
7. Generally, careless disposal of any types of batteries may be harmful to health or to the environment.<sup>2</sup> Ideally, therefore, from an environmental perspective, batteries should be recycled as much as possible. However, only some types of primary and secondary batteries can in principle be recycled. Furthermore, recycling batteries is quite costly.<sup>3</sup> Even in the most developed countries, there are no known recycling facilities that can practically and cost-effectively reclaim all types of household batteries.<sup>4</sup> Significant subsidies are required from governments or manufacturers to support battery recycling programs. In Vetustia, as well as in many other

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<sup>2</sup> For example, even lithium batteries, which are considered to contain no toxic metals, present the possibility of fire in certain circumstances, such as when the metallic lithium is exposed to moisture while the cells are corroding.

<sup>3</sup> Current battery recycling methods require a high amount of energy. It takes six to ten times the amount of energy to reclaim metals from recycled batteries than it would through other means (source: <<http://www.batteryuniversity.com/print-partone-20.htm>>). The cost to recycle batteries in Vetustia is about US\$2,000 per ton, excluding collection and transportation costs, which can also be significant.

<sup>4</sup> As a result, most collected batteries are finally disposed of in hazardous waste landfills.

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

countries, a tax added to each manufactured battery, in addition to other governmental subsidies, is used to fund recycling schemes.

8. Vetustia has important industries of both primary and secondary batteries. There is only one Laviñan company – Baratas Baterías S.A. – that produces batteries, all of them primary / non-rechargeable. It employs about eight hundred Laviñan citizens. About 80% of its production is exported to Vetustia. A few small companies in Simezia and Trindadi also produce and export non-rechargeable batteries to Vetustia.
9. On 16 June 2004, the Trade Minister of Vetustia, Mr. R. Silva, issued Decree 21/2004, Article 1 of which prohibited all imports of batteries classified under HS Code 85.06.<sup>5</sup> At the time, Mr. Silva declared, in a speech addressed to the Economic Commission of the National Congress, that the prohibition sought to protect the important Vetustian industries of storage and disposable batteries. Pursuant to the Decree, the prohibition entered into force on 16 August 2004.
10. On 17 October 2004, following an unfruitful attempt to negotiate with Vetustia, the government of Laviña decided to challenge the prohibition imposed by Decree 21/2004 in arbitration proceedings, as provided for in Chapter VI of Annex 2 to the Treaty of Gedis. Before the appointed Ad Hoc Arbitration Court, Laviña maintained that the prohibition violated Article 3(1) of the CUSM Treaty, a “stabilization” clause which provides that no new tariff or non-tariff barriers may be imposed after the entry into force of the Treaty. The main objective of such provision is to secure a harmonious progression towards free regional trade during the four-year transitional period accorded by and between the parties.<sup>6</sup> Vetustia’s legal team, headed by Attorney-General M. Peil, argued that the prohibition did not violate the CUSM Treaty

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<sup>5</sup> Rechargeable batteries are not within the scope of Decree 02/2001.

<sup>6</sup> Article 1 of the Treaty of Gedis, which was not relied upon by Laviña on that occasion, reads as follows: “Without prejudice to any transitional or exceptional provisions in this Treaty, there shall be no tariff or non-tariff barriers to trade in goods between the Parties.” Article 3 specifies, apart from the stabilization clause, several stages (and their respective specific requirements) for the gradual implementation of the customs union.

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

because Decree 21/2004 had been issued before the entry into force of the former and, consequently, the Decree was not a “new” trade measure within the meaning of Article 3(1). No additional substantive arguments were presented in Vetustia’s defense. The Ad Hoc Court issued its arbitration award on 10 January 2005. The Arbitration Court found that Vetustia was in violation of Article 3(1) of the Treaty of Gedis and, therefore, had to bring its challenged measure into conformity with the regional treaty. There was no motion for review of the award.

11. On 10 February 2005, the Trade Ministry of Vetustia issued Decree 02/2005, amending Article 1 of Decree 21/2004 in order to provide that the import prohibition encompass batteries classified under HS Code 85.06 originating in any country, *except CUSM member states*. The Preamble to Decree 02/2005 specified that its purpose was to bring Decree 21/2004 into compliance with the Ad Hoc Arbitration Award of 10 January 2005.<sup>7</sup> Decree 02/2005 entered into force immediately upon its publication.

12. On 01 March 2005, Richilia, a developed WTO Member, requested formal consultations with Vetustia concerning its measures affecting imports of disposable batteries, pursuant to the Dispute Settlement Understanding (DSU, Annex 2 to the Agreement Establishing the World Trade Organization).

13. During the period of WTO consultations, Vetustia’s Minister for the Environment, Mr. M. Oliveira, publicly stated that the import ban on non-rechargeable batteries had always been supported by his Ministry and that its rationale had always been environmental. Following such statement, the Environment Ministry issued, on 15 April 2005, Environmental Rule 10/2005, which requires producers of primary batteries to collect and forward to a recycling plant one battery suitable for recycling for every four primary batteries produced. According to the same Rule, producers of rechargeable

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<sup>7</sup> The Preamble also referred to Articles 26 and 27 of Annex 2 to the Treaty of Gedis, as well as to Article 51 of the Vetustian Constitution, which provides that “[r]atified international treaties shall have the same legal hierarchy of Vetustian national laws”.

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

batteries are required to collect (and direct to a recycling plant) one battery suitable for recycling for every twelve storage batteries produced. Since April 2005, the Vetustian government also provides certain tax incentives to producers of rechargeable batteries.<sup>8</sup>

14. Before the 2004 import ban, about 70 percent of the household batteries sold in the Vetustian market were primary batteries. Approximately half of these primary batteries were imported. Since the import ban and the 2005 measures, the market share of primary batteries in Vetustia has been slightly declining. In 2008, about 30% of the household batteries sold in Vetustia (about a fourth of which imported from CUSM countries) are still primary batteries, because Vetustian consumers are price sensitive and many of them tend to prefer buying the cheaper non-rechargeable batteries. 70% of the batteries sold are rechargeable, both domestically-produced and imported.

15. In May 2005, the government of Goldina also decided to impose an import ban on primary batteries. Laviña challenged the measure before another CUSM Ad Hoc Arbitration Court. Laviña claimed that the Goldinean measure violated Article 1 of the Treaty of Gedis, while Goldina sought to justify its measure under Article 20(b) of the same Treaty.<sup>9</sup> The Court decided to reverse the burden of proof and found that Laviña failed to show that Goldina's measure could *not be* justified under Article 20(b). Laviña filed a motion for review of the award with CUSM's Permanent Review Court, which found (on 10 September 2005) that the Ad Hoc Arbitration Court had erred in reversing the burden of proof and that Goldina failed to adduce evidence sufficient to show that its measure was necessary within the meaning of Article 20(b). The Permanent Review Court requested Goldina to revoke the import ban and specified that its decision would be valid until

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<sup>8</sup> The National Association of Vetustian Primary Battery Manufacturers protested these measures, which in their view represented unfair discrimination against them and in favor of storage battery producers.

<sup>9</sup> Article 20 of the Treaty of Gedis is equivalent, *mutatis mutandis*, to Article XX of the General Agreement on Tariffs and Trade.

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

CUSM members adopted, through the appropriate institutional means, a regional common policy concerning the importation and disposal of batteries.

16. On 12 November 2005, Richilia requested the establishment of a WTO Panel. Richilia claimed that the measures provided for in Decree 21/2004, as amended by Decree 02/2005, violated the following General Agreement on Tariffs and Trade<sup>10</sup> (GATT) provisions: Article XI:1, because the import ban on primary batteries was a prohibited quantitative restriction; and Articles I:1 and XIII:1, because the non-application of the ban to CUSM member states was discriminatory towards other WTO Members. Vetustia, assisted by International Litigation Senior Attorneys (ILSA) – a distinguished institution that provides support in WTO dispute settlement proceedings to developing countries – alleged that its measures were justified under Article XX(b) of the GATT, and also under Article XXIV (as concerned the non-application of the ban to CUSM member states).

17. The WTO Panel found that Vetustia was able to demonstrate that its measures were necessary to protect human, animal and plant life or health. In sum, the Panel considered that Vetustia had the right to pursue what it defined throughout the Panel proceedings as its *non-generation (or least possible generation)* policy towards waste batteries.<sup>11</sup> The Panel was persuaded by Vetustia's econometric evidence showing that the import ban prevented a situation where rechargeable batteries (with a longer total lifespan) in the Vetustian market would be substituted with imported non-rechargeable batteries, which would become waste sooner than the former. It also called attention to the fact that Vetustia had a limited capacity to recycle batteries. Thus, the Panel found that the measures could be regarded as necessary within the meaning of paragraph (b) of Article XX.

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<sup>10</sup> Reference is made to the provisions of the GATT 1947, which have been incorporated into the GATT 1994, currently in force as one of the WTO Agreements.

<sup>11</sup> The alleged objective of such policy was to reduce the amount of battery waste *to the maximum extent possible*.

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

Furthermore, the panel considered that the fact that the ban was not applied to CUSM countries did not result in arbitrary or unjustifiable discrimination between countries where the same conditions prevailed (within the meaning of the *chapeau* of GATT Article XX), because (i) the non-application to CUSM countries only existed by virtue of a decision of a CUSM Ad Hoc Arbitration Court, therefore it was not *arbitrary*, and (ii) the amount of batteries imported into Vetustia from CUSM countries was proportionally very small (roughly 5% of the amount that had been imported annually from non-CUSM members before the entry into force of Decree 21/2004), and therefore was not *unjustifiable*.<sup>12</sup>

18. Unsatisfied with the Panel's Report, Richilia decided to appeal its findings. The Appellate Body maintained the Panel decision concerning paragraph (b) of Article XX, but reversed the decision in relation to the *chapeau*. In other words, the Appellate Body found that, while the ban could be regarded as necessary for protecting human, animal and plant life or health, its non-application to CUSM countries resulted in arbitrary and unjustifiable discrimination.<sup>13</sup> Consequently, Vetustia was required to bring its measures into conformity with its obligations under the WTO Agreements. The Panel's Report, as modified by the Appellate Body's Report, was adopted by the WTO Dispute Settlement Body (DSB) on 12 February 2007.

19. Following the DSB's decision, Vetustia and Richilia were able to agree on a "reasonable period of time" of eight months for implementation. The Vetustian press reported that the government's intention was to negotiate, during that period, a regional battery waste management scheme, which would be in compliance with WTO norms and would cure the violation found of the *chapeau* of Article XX.

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<sup>12</sup> The fact that the production of primary batteries was allowed in Vetustia was not seen as contrary to the *chapeau* of Article XX(b), essentially because of what was required from producers under Environmental Rule 10/2002. Finally, in regard to GATT Article XXIV, the Panel decided to exercise judicial economy.

<sup>13</sup> According to the Appellate Body, the Panel erred, for example, in considering that the amount of batteries imported from CUSM countries was pertinent to the *unjustifiable discrimination* standard.

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

20. In April 2007, Vetustia proposed the inclusion of the topic “discussion of a common battery waste management scheme” in the agenda of the scheduled meeting of the CUSM General Council, the main institutional body of the customs union. Any decisions in the General Council need to be made by consensus, including the setting of the agenda of any meetings. Laviña blocked the inclusion of the proposed topic in the agenda.
21. Between May and October 2007, Vetustia entered into bilateral negotiations with Goldina, Simezia and Trindadi. The result of such negotiations was the establishment of a so-called *Common Battery Recycling and Disposal Scheme* (the “Common Scheme”), pursuant to a “memorandum of understanding” signed between Vetustia and those three countries (on 31 October 2007). According to the understanding, Vetustia would allow the importation of primary batteries originating in countries parties to the Common Scheme, *provided that* (i) they prohibited imports from any countries that were not CUSM members and from any CUSM members that did not adhere to the Common Scheme, and (ii) they paid a contribution equivalent to 2% of the total value of primary batteries exported to Vetustia to fund recycling schemes in Vetustia. Vetustia, on the other hand, would accept the importation of a limited amount of used batteries collected in the referred countries and suitable for recycling, and would provide technical assistance for the establishment of recycling plants and for the disposal of batteries in such countries. The text of the memorandum of understanding also provided that it would be in force until the establishment of an official CUSM regional battery waste management scheme. It entered into force on 01 December 2007.
22. On 30 November 2007, Vetustia’s Trade Ministry issued Decree 29/2007, revoking Decrees 21/2004 and 02/2005 and providing, in its Article 1, that “imports of batteries classified under HS Code 85.06 originating in any country, except CUSM member states that adhered to the Common Battery Recycling and Disposal Scheme, shall be prohibited as from 01 December 2004.” The Preamble to Decree 29/2007 indicated that its purpose was to

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

bring Vetustian measures on imports of primary batteries into compliance with the DSB recommendations of 12 February 2007.

23. In December 2007, Laviña threatened to take “compensatory measures”, pursuant to Article 31 of Annex 2 to the Treaty of Gedis, against Vetustia, by virtue of its alleged non-compliance with the Ad Hoc Arbitration Award of 10 January 2005. Subsequently, in March 2008, the parties agreed to submit a new dispute to the CUSM dispute settlement system. According to the negotiations between the two countries, the dispute will be submitted directly to the Permanent Review Court, pursuant to Article 23 of Annex 2 to the Treaty of Gedis, and Laviña will appear before the Court as Claimant and Vetustia as Respondent. The dispute shall be limited to the claims specified below.

24. Laviña claims that Vetustia has acted inconsistently with its CUSM obligations because:

- a) Article 1 of Decree 29/2007 is inconsistent with Articles 26 and 27 of Annex 2 to the Treaty of Gedis, because its effect is to prohibit imports of primary batteries from Laviña, in violation of the Ad Hoc Arbitration Award of 10 January 2005;
- b) Article 1 of Decree 29/2007 violates Article 4 of the Treaty of Gedis,<sup>14</sup> because it grants an advantage to imports from some CUSM members that is not extended immediately and unconditionally to like products originating in Laviña;
- c) Decree 29/2004 is not justifiable under paragraphs (b), (d) or (g) of Article 20.

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<sup>14</sup> *“Article 4: Most-favored-nation clause. As from the entry into force of this Treaty, and including the transitional period, any advantage, favor, exemption, immunity or privilege granted by any party to any product originating in or destined for any other country, with respect to customs duties, charges, taxes, rules and formalities of any kind in connection with importation or exportation, shall be extended immediately and unconditionally to the like product originating in or destined for the territories of all other parties.*”

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

25. Vetustia alleges that Article 1 of Decree 29/2007 does not violate Articles 26 and 27 of Annex 2 of the Treaty of Gedis because *res judicata* does not apply. Vetustia also maintains, in any event, that Decree 29/2007 as a whole is justified under Article 20(d) of the Treaty of Gedis. Furthermore, Vetustia argues that the non-application of the import ban to countries that adhered to the Common Scheme is justified under paragraphs (b) and (g) of Article 20.
26. Written submissions shall be submitted to the Permanent Review Court in accordance with the Official Schedule provided for in the Official Rules of the 2008 CUFTA Moot Court Competition, which shall apply to the proceedings. The oral hearings will be held in Belo Horizonte, as provided as well in the Official Schedule.\

### **Indicative References:**

#### WTO Cases:

- *Brazil – Measures Affecting Imports of Retreaded Tyres* (Report of the Panel, WT/DS332/R; Report of the Appellate Body, WT/DS332/AB/R)
- *Canada – Certain measures affecting the automotive industry* (Report of the Panel, WT/DS139/R; WT/DS142/R)
- *European Communities – Conditions for the granting of tariff preferences to developing countries* (Report of the Panel, WT/DS246/R)
- *Mexico – Tax measures on soft drinks and other measures* (Report of the Appellate Body, WT/DS308/AB/R)
- *United States – Import prohibition of certain shrimp and shrimp products, Recourse to Article 21.5 of the DSU by Malaysia* (Report of the Appellate Body, WT/DS58/AB/RW)

## The 2008 CUFTA Moot Regional Dispute Settlement Mechanism Competition

### Treaties:

- Annex 2 to the Treaty of Gedis (Regional Dispute Settlement):  
see, *mutatis mutandis*, the Olivos Protocol for the Settlement of Disputes  
in Mercosur <[http://untreaty.un.org/unts/144078\\_158780/5/7/13152.pdf](http://untreaty.un.org/unts/144078_158780/5/7/13152.pdf)>
- General Agreement on Tariffs and Trade 1947  
<[http://www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_e.pdf](http://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf)>
- Dispute Settlement Understanding  
<[http://www.wto.org/english/docs\\_e/legal\\_e/28-dsu.pdf](http://www.wto.org/english/docs_e/legal_e/28-dsu.pdf)>