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PHILIPPINES – TAXES ON DISTILLED SPIRITS

AB-2011-6

Reports of the Appellate Body

Note:

The Appellate Body is issuing these Reports in the form of a single document constituting two separate Appellate Body Reports: WT/DS396/AB/R; and WT/DS403/AB/R. The cover page, preliminary pages, Sections I through VI and the Annexes are common to both Reports. The page header throughout the document bears two document symbols, WT/DS396/AB/R and WT/DS403/AB/R, with the following exceptions: Section VII on pages EU-97 to EU-99, which bears the document symbol for and contains the Appellate Body's findings and conclusions in the Appellate Body Report WT/DS396/AB/R; and Section VII on pages US-97 to US-99, which bears the document symbol for and contains the Appellate Body's findings and conclusions in the Appellate Body Report WT/DS403/AB/R.

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CASES CITED IN THESE REPORTS

Short Title	Full case title and citation
Australia – Apples	Appellate Body Report, *Australia – Measures Affecting the Importation of Apples from New Zealand*, WT/DS367/AB/R, adopted 17 December 2010
Australia – Salmon	Appellate Body Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/AB/R, adopted 6 November 1998, DSR 1998:VIII, 3327
Border Tax Adjustments	Report of the Working Party, *Border Tax Adjustments*, L/3464, adopted 2 December 1970, BISD 18S/97
Brazil – Retreaded Tyres	Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted 17 December 2007, DSR 2007:IV, 1527
Canada – Periodicals	Appellate Body Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:I, 449
Chile – Alcoholic Beverages	Panel Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by Appellate Body Report WT/DS87/AB/R, WT/DS110/AB/R, DSR 2000:I, 303
Chile – Price Band System (Article 21.5 – Argentina)	Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products – Recourse to Article 21.5 of the DSU by Argentina*, WT/DS207/AB/RW, adopted 22 May 2007, DSR 2007:II, 513
Dominican Republic – Import and Sale of Cigarettes	Panel Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/R, adopted 19 May 2005, as modified by Appellate Body Report WT/DS302/AB/R, DSR 2005:XV, 7425
EC – Asbestos	Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
EC and certain member States – Large Civil Aircraft	Appellate Body Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R, adopted 1 June 2011
EC – Fasteners	Appellate Body Report, *European Communities – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, WT/DS397/AB/R, adopted 28 July 2011
EC – Hormones	Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135
Indonesia – Autos	Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1 and 2, adopted 23 July 1998, and Corr. 3 and 4, DSR 1998:VI, 2201
Japan – Alcoholic Beverages I	GATT Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, L/6216, adopted 10 November 1987, BISD 34S/83
Japan – Alcoholic Beverages II	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97

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Short Title	Full case title and citation
Japan – Alcoholic Beverages II	Panel Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by Appellate Body Report WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, DSR 1996:I, 125
Korea – Alcoholic Beverages	Appellate Body Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, DSR 1999:I, 3
Korea – Alcoholic Beverages	Panel Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by Appellate Body Report WT/DS75/AB/R, WT/DS84/AB/R, DSR 1999:I, 44
Mexico – Taxes on Soft Drinks	Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R, adopted 24 March 2006, as modified by Appellate Body Report WT/DS308/AB/R, DSR 2006:I, 43
Philippines – Distilled Spirits	Panel Reports, *Philippines – Taxes on Distilled Spirits*, WT/DS396/R, WT/DS403/R, circulated to WTO Members 15 August 2011
US – Carbon Steel	Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R and Corr.1, adopted 19 December 2002, DSR 2002:IX, 3779
US – Continued Zeroing	Appellate Body Report, *United States – Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, adopted 19 February 2009
US – Cotton Yarn	Appellate Body Report, *United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan*, WT/DS192/AB/R, adopted 5 November 2001, DSR 2001:XII, 6027
US – Section 211 Appropriations Act	Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, adopted 1 February 2002, DSR 2002:II, 589
US – Steel Safeguards	Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Certain Steel Products*, WT/DS248/AB/R, WT/DS249/AB/R, WT/DS251/AB/R, WT/DS252/AB/R, WT/DS253/AB/R, WT/DS254/AB/R, WT/DS258/AB/R, WT/DS259/AB/R, adopted 10 December 2003, DSR 2003:VII, 3117
US – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005, DSR 2005:I, 3
US – Upland Cotton (Article 21.5 – Brazil)	Appellate Body Report, *United States – Subsidies on Upland Cotton – Recourse to Article 21.5 of the DSU by Brazil*, WT/DS267/AB/RW, adopted 20 June 2008, DSR 2008:III, 809
US – Wheat Gluten	Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/AB/R, adopted 19 January 2001, DSR 2001:II, 717

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LIST OF ABBREVIATIONS USED IN THESE REPORTS

Abbreviation	Description
ATC	*Agreement on Textiles and Clothing*
BIR	Philippines' Bureau of Internal Revenue
DSB	Dispute Settlement Body
DSU	*Understanding on Rules and Procedures Governing the Settlement of Disputes*
Expert study	T. Allen, "Tasting and Congener Content Analysis of 31 Distilled Spirits" (30 September 2010) (Panel Exhibit PH-30 (BCI))
GATT 1994	*General Agreement on Tariffs and Trade 1994*
HS	Harmonized Commodity Description and Coding System of the World Customs Organization
HSEN	HS Explanatory Note
ml	millilitre
NIRC	Philippines' National Internal Revenue Code of 1997
NRP	net retail price
Panel Reports	Panel Reports, *Philippines – Taxes on Distilled Spirits*, WT/DS396/R / WT/DS403/R, 15 August 2011
PHP	Philippine pesos
ppl	per proof litre
Substitutability studies	*Euromonitor International*, "Consumer perceptions regarding substitutability in the Philippines distilled spirits market" (August 2010) (Panel Exhibits EU-41 and US-41); and M.J. Abrenica and J. Ducanes, "On Substitutability between Imported and Local Distilled Spirits" (University of Philippines School of Economics Foundation, 10 October 2010) (Panel Exhibit PH-49)
Working Procedures	*Working Procedures for Appellate Review*, WT/AB/WP/6, 16 August 2010
WTO	World Trade Organization

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WORLD TRADE ORGANIZATION
APPELLATE BODY

Philippines – Taxes on Distilled Spirits	**AB-2011-6**
Philippines, *Appellant/Appellee* European Union, *Other Appellant/Appellee* United States, *Appellee*	Present:
Australia, *Third Participant* China, *Third Participant* Colombia, *Third Participant* India, *Third Participant* Mexico, *Third Participant* Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, *Third Participant* Thailand, *Third Participant*	Van den Bossche, Presiding Member Hillman, Member Ramírez-Hernández, Member

I. Introduction

1. The Philippines and the European Union each appeals certain issues of law and legal interpretations developed in the Panel Reports, *Philippines – Taxes on Distilled Spirits*[1] (the "Panel Reports"). The Panel was established to consider complaints by the European Union[2] and the United States[3] regarding the consistency of the Philippines' excise tax regime applicable to distilled spirits with Article III:2, first and second sentences, of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994").[4]

2. Pursuant to a joint request from the European Union and the United States, the Panel issued its findings in the form of a single document containing two separate reports with common descriptive and analytical sections but separate conclusions and recommendations for each complaining party, each of which bears only the document symbol for that report.[5] The Panel Reports were circulated to Members of the World Trade Organization (the "WTO") on 15 August 2011.

[1]WT/DS396/R (the "EU Panel Report"); WT/DS403/R (the "US Panel Report"), 15 August 2011.
[2]Request for the Establishment of a Panel by the European Union, WT/DS396/4.
[3]Request for the Establishment of a Panel by the United States, WT/DS403/4.
[4]At its meetings on 19 January and 20 April 2010, the Dispute Settlement Body (the "DSB") established a single panel for both complaints in accordance with Articles 6 and 9 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"). (See WT/DS396/5, WT/DS403/5, para. 1)
[5]Panel Reports, para. 8.1.

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3. Before the Panel, the European Union and the United States claimed that the Philippines has acted inconsistently with Article III:2, first and second sentences, of the GATT 1994, in applying different tax treatment to distilled spirits produced from the sap of the *nipa*, coconut, cassava, *camote*, or *buri* palm, or from juice, syrup, or sugar of the cane ("designated raw materials"), and to distilled spirits made from other raw materials ("non-designated raw materials").[6] For the reasons set out in its Reports, the Panel found, in relation to the complaint by the European Union, that the Philippines has acted inconsistently with its obligations under Article III:2, first sentence, of the GATT 1994.[7] More specifically, the Panel found that:

> … through its excise tax, the Philippines subjects imported distilled spirits made from raw materials other than those designated in its legislation to internal taxes in excess of those applied to like domestic spirits made from the designated raw materials, and is thus acting in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.[8]

4. The Panel found, in relation to the complaint by the United States, that the Philippines has acted inconsistently with its obligations under Article III:2, first and second sentences, of the GATT 1994. More specifically, the Panel found that:

> (a) through its excise tax, the Philippines subjects imported distilled spirits made from raw materials other than those designated in its legislation to internal taxes in excess of those applied to like domestic spirits made from the designated raw materials, and is thus acting in a manner inconsistent with Article III:2, first sentence, of the GATT 1994[9]; and
>
> (b) through its excise tax, the Philippines applies dissimilar internal taxes on domestic distilled spirits made from designated raw materials and to directly competitive or substitutable imported distilled spirits made from other raw materials in a manner so as to afford protection to the Philippine domestic production of distilled spirits and is thus acting in a manner inconsistent with Article III:2, second sentence, of the GATT 1994.[10]

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[6] Panel Reports, para. 2.3.

[7] The Panel abstained from making findings with respect to the European Union's claim under Article III:2, second sentence, of the GATT 1994, because it considered that this claim was advanced as an alternative claim to be addressed should the Panel not find that the measure at issue is inconsistent with the first sentence of the same provision. (EU Panel Report, WT/DS396/R, para. 8.3)

[8] EU Panel Report, WT/DS396/R, para. 8.2.

[9] US Panel Report, WT/DS403/R, para. 8.2(a).

[10] US Panel Report, WT/DS403/R, para. 8.2(b).

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5. On 23 September 2011, the Philippines notified the Dispute Settlement Body (the "DSB") of its intention to appeal certain issues of law covered in the Panel Reports and certain legal interpretations developed by the Panel, pursuant to Articles 16.4 and 17 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal[11] and an appellant's submission[12] pursuant to Rules 20 and 21, respectively, of the *Working Procedures for Appellate Review*[13] (the "*Working Procedures*").

6. On 28 September 2011, the European Union notified the DSB of its intention to appeal certain issues of law covered in the Panel Reports and certain legal interpretations developed by the Panel, pursuant to Articles 16.4 and 17 of the DSU, and filed a Notice of Other Appeal[14] and an other appellant's submission pursuant to Rule 23(1) and (3), respectively, of the *Working Procedures*. On 11 October 2011, the European Union, the Philippines, and the United States each filed an appellee's submission.[15] On 14 October 2011, Australia and Mexico each filed a third participant's submission[16] and, on the same day, China, India, and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu each notified its intention to appear at the oral hearing as a third participant.[17] On 17 and 20 October 2011, Colombia and Thailand, respectively, notified its intention to appear at the oral hearing as a third participant.[18]

[11]WT/DS396/7, WT/DS403/7 (attached as Annex I to these Reports).

[12]The Philippines provided the third participants with copies of its appellant's submission that did not contain certain information that was considered business confidential information in the Panel proceedings (pursuant to the Additional Working Procedures Concerning Business Confidential Information, adopted by the Panel on 31 August 2010). This information was, however, included in the copies of the Philippines' appellant's submission filed with the Appellate Body and served on the European Union and the United States. Following an enquiry from the Appellate Body Secretariat on 14 October 2011, the Philippines provided, on 18 October 2011, copies of its appellant's submission containing the business confidential information to the third participants. The Philippines requested the third participants to treat such information as confidential. In response to questioning at the oral hearing in this appeal, the participants and third participants confirmed to the Appellate Body that the information the Philippines had designated as business confidential in its appellant's submission was governed by the confidentiality rules of Article 18.2 of the DSU.

[13]WT/AB/WP/6, 16 August 2010.

[14]WT/DS396/8, WT/DS403/8 (attached as Annex II to these Reports).

[15]Pursuant to Rules 22 and 23(4) of the *Working Procedures*.

[16]Pursuant to Rule 24(1) of the *Working Procedures*.

[17]Pursuant to Rule 24(2) of the *Working Procedures*.

[18]We note that Colombia, in its notification, expressed its intention to attend the oral hearing pursuant to Rule 24(2) of the *Working Procedures*. Colombia's notification was received on 17 October 2011 and, therefore, fell outside the 21-day time-limit stipulated in Rule 24(2) of the *Working Procedures*, which ended on 14 October 2011. Nevertheless, the Division hearing this appeal decided to accept Colombia's notification as a notification made pursuant to Rule 24(4) of the *Working Procedures*.

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7. The oral hearing in this appeal was held on 25 and 26 October 2011. The participants and one of the third participants, Australia, made oral statements. The participants and third participants responded to questions posed by the Members of the Appellate Body Division hearing the appeal.

II. Arguments of the Participants and the Third Participants

A. *Claims of Error by the Philippines – Appellant*

8. The Philippines maintains that the text of, and jurisprudence on, Article III:2 of the GATT 1994 make clear that this treaty provision does not prohibit the application of differential taxes to products that are not "like" or "directly substitutable", both because of their different physical characteristics and because their price is well beyond the means of the consumer. The Philippines claims that the Panel made a number of legal errors relating to the interpretation and application of this provision. According to the Philippines, the Panel's errors in this case are not a matter of failing to weigh the evidence correctly, but that the Panel misinterpreted the relevance of the evidence, and in certain instances ignored evidence, because it was applying the wrong legal standard.

9. In the view of the Philippines, the Panel treated this dispute as simply another Article III:2 trade dispute involving distilled spirits. In this respect, the Philippines argues, the Panel failed to recognize important differences in this case, which have consequences for the interpretation and application of Article III:2 in a manner that is faithful to its text and its object and purpose. The Philippines explains that the challenged measure makes no distinction based on the country of origin of the products. The specific tax provided for under Section 141(a) of the Philippines' National Internal Revenue Code of 1997 (the "NIRC") applies to distilled spirits produced from the designated raw materials (provided that such materials are produced commercially in the country where they are processed into distilled spirits), while distilled spirits produced from any other raw material are taxed at the specific tax levels provided for under Section 141(b) of the NIRC. The Philippines points out that the raw material base, not the country of origin, is the key to determining whether the lower tax of Section 141(a), or the higher, tiered taxes of Section 141(b), apply.

On 20 October 2011, Thailand submitted its delegation list for the oral hearing to the Appellate Body Secretariat and the participants and third participants in this dispute. Without prejudice to rulings the Appellate Body may make in future appeals, we have interpreted Thailand's action as a notification expressing its intention to attend the oral hearing pursuant to Rule 24(4) of the *Working Procedures*. While we wish to emphasize that strict compliance with Rule 24(4) of the *Working Procedures* requires *written* notification to the Secretariat that expresses an intention to appear at the oral hearing, we are satisfied that, in this case, the lack of strict compliance with Rule 24(4) did not raise any due process concerns.

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10. According to the Philippines, its tax measure does not alter the competitive opportunities of imported distilled spirits in relation to like domestic distilled spirits in the Philippine market. Instead, it achieves the fiscal goals of a sovereign government in a manner that allows consumers to consume the same distilled spirits that they would consume even if no excise taxes were imposed. The Philippines contends that Article III:2 of the GATT 1994 does not prohibit such a measure. The Philippines requests the Appellate Body to reverse various legal findings and conclusions of the Panel under Article III:2 of the GATT 1994 and to apply Article III:2 in a manner that is consistent with its text and its object and purpose.

1. Article III:2, First Sentence, of the GATT 1994

11. The Philippines claims on appeal that the Panel erred in its interpretation and application of the term "like products" under Article III:2, first sentence, of the GATT 1994, and failed to apply the appropriate standard for the interpretation of that term when assessing the subject products' physical characteristics, consumer tastes and habits, and tariff classification. The Philippines also claims that the Panel erred in its assessment of the evidence under Article 11 of the DSU because it ignored relevant expert evidence that imported and domestic products were physically dissimilar, disregarded its own findings regarding the tariff classification of certain products, and had no evidentiary basis to support its finding that the majority of consumers would view the imported and domestic products as substitutable. The Philippines requests the Appellate Body to reverse the Panel's finding under Article III:2, first sentence, of the GATT 1994 for the following reasons.

12. The Philippines observes that "likeness" under Article III:2, first sentence, necessarily requires that the products at issue compete in the marketplace and have essentially the same physical characteristics. Therefore, the "highest degree" of both physical similarity and competitiveness in the relevant market is required in order for the products to be considered "like".[19] The Philippines claims that the Panel applied the wrong standard of "likeness" under Article III:2, first sentence. To state, as the Panel does, that the concept of "like products" is not limited to "identical products" does not capture the Appellate Body's narrow definition of "like products" under Article III:2, first sentence. The Philippines argues that the test that should have been applied is whether the products are "sufficiently close" in nature such that they could be deemed to fit within the narrow category of "like products" within the meaning of Article III:2, first sentence, as interpreted by the Appellate Body.[20]

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[19]Philippines' appellant's submission, para. 27.
[20]Philippines' appellant's submission, para. 29.

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13. Regarding the products' properties, nature, and quality, the Philippines argues that the narrow scope of the category of "like products" means that any significant physical difference, even if not perceptible to the consumer, will be considered sufficient to disqualify a product from being considered "like" another product. The physical differences between the products at issue begin with the raw materials from which they are made, which result in other differences in physical properties and qualities. The Panel in this case found that "sugar-based" and "non-sugar-based" distilled spirits are "like" despite numerous physical differences between the products and, in particular, the additives used to make "sugar-based" whisky, brandy, gin, and tequila. According to the Philippines, the simple fact that "sugar-based" distilled spirits in the Philippines are physically different from their "non-sugar-based" counterparts should have been viewed by the Panel as disqualifying these products from being considered physically "like".[21]

14. The Philippines contends that such error by the Panel occurred not only in relation to the Panel's analysis of each imported "non-sugar-based" spirit and its domestic "sugar-based" counterpart, but also in relation to the broader category of "non-sugar-based" distilled spirits compared with "sugar-based" distilled spirits. This led the Panel to make "'the extraordinary finding' that non-sugar-based whiskies were 'like' sugar-based brandies, etc."[22] The Philippines contends that these groups of products are so different that even the complainants themselves did not claim that all "non-sugar-based" distilled spirits are "like" "sugar-based" distilled spirits for the purposes of Article III:2, first sentence.[23]

15. The Philippines argues that the Panel applied the wrong standard by relying on a "perceptible differences" test from the perspective of the hypothetical consumer as the sole determinant of whether the products are physically different or not.[24] According to the Philippines, the perception of the consumer is relevant to the "likeness" criterion of consumer tastes and habits. Such a perception is not related to the physical characteristics of the product, which are empirical, physical attributes. The Philippines recalls that, in *EC – Asbestos*, the Appellate Body found that products with differences in molecular structure, chemical composition, and fibrillation capacity, which are not detectable to the consumer upon purchasing, were not considered physically "like". Moreover, the Appellate Body

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[21]Philippines' appellant's submission, para. 39. The Panel found that "all distilled spirits produced in the Philippines are made from designated raw materials" and that "most of the distilled spirits produced in the Philippines are made from one particular designated raw material: sugar cane molasses". (Panel Reports, para. 2.17)

[22]Philippines' appellant's submission, para. 40 (referring to Panel Reports, paras. 7.39 and 7.77).

[23]Philippines' appellant's submission, para. 41 (referring to Panel Reports, paras. 7.4-7.6).

[24]Philippines' appellant's submission, para. 44.

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held that physical characteristics deserve a separate examination and should not be confused with any of the other elements in the traditional likeness analysis.[25]

16. The Philippines thus contends that, having selected the wrong standard, the Panel found physical similarity between "sugar-based" and "non-sugar-based" distilled spirits in spite of important physical differences between these types of distilled spirits, such as the very different levels of certain key "congeners"—chemical substances produced during fermentation that affect the taste and aroma—and the use of additives in "sugar-based" distilled spirits to replicate the colour, odour, and taste traditionally associated with certain "non-sugar-based" distilled spirits. The Philippines argues that the Panel's improper analysis of "likeness" under Article III:2, first sentence, of the GATT 1994 manifests itself in the fact that the Panel did not take into account differences in quality between the "sugar-based" and the "non-sugar-based" products.

17. The Philippines claims that the Panel erred in considering that the complainants' regulatory regimes, which prohibit the marketing of whisky and brandy made from sugar cane molasses as "whisky" and "brandy", were "irrelevant".[26] While it is true that the Philippine market is the relevant market for the determination of "likeness" when considering the conditions of competition between the foreign and domestic products at issue, the Panel confused the analysis of competition with the analysis of the products' physical characteristics. The complainants' regulatory regimes show that the difference in raw materials is a legitimate and commonly applied basis for distinguishing between distilled spirits. If a distilled spirit is made from something other than what is specified in the relevant regulations, it may not be sold as a whisky, brandy, or other such regulated spirit within the complainants' own markets. The Philippines contends that the domestic regulatory regimes of both complainants are useful in identifying physical differences between the products that are commonly recognized as important to that particular product's identity.

18. The Philippines also claims that the Panel failed to make an objective assessment of the matter before it, in accordance with Article 11 of the DSU, because it disregarded expert evidence demonstrating that "sugar-based" and "non-sugar-based" distilled spirits are different in terms of physical characteristics and quality. In particular, the Panel disregarded critical portions of the Philippines' evidence, and substituted its own judgement for that of the expert testimony presented by the Philippines, when it found that there was no evidence that differences in the organoleptic properties create a distinction between distilled spirits made from designated raw materials and

[25]Philippines' appellant's submission, paras. 43 and 47 (referring to Appellate Body Report, *EC – Asbestos*, paras. 111 and 114).
[26]Philippines' appellant's submission, para. 51.

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distilled spirits made from non-designated raw materials, and that the differences in chemical composition that do exist were not of assistance in its analysis of "likeness".[27]

19. The Philippines maintains that the expert evidence that it submitted to the Panel demonstrates that "sugar-based" and "non-sugar-based" distilled spirits have different organoleptic properties, which result from differences in their chemical composition and congener content, and that this evidence remained unrebutted throughout the Panel proceedings. The Philippines claims that each of the Panel's statements and conclusions is directly contradicted by the expert evidence, and that, in making these findings in relation to all the distilled spirits under consideration, the Panel did not, and could not, rely on contradictory expert evidence from the complainants, as none was submitted.

20. Regarding consumer tastes and habits, the Philippines recalls that, in *EC – Asbestos*, the Appellate Body noted that evidence in respect of end-uses and consumer tastes and habits was particularly relevant "in cases where the evidence relating to properties establishes that the products at issue are physically quite different".[28] According to the Appellate Body, in such cases, "a higher burden is placed on complaining Members to establish that, despite the pronounced physical differences, there is a competitive relationship between the products."[29] Therefore, where products are physically different, a higher burden is imposed on the complainants to show direct competition and substitutability. Moreover, the Philippines claims that, in order to give proper meaning to the term "like" under Article III:2, first sentence, the degree of competition between products must be greater than that required for "directly competitive or substitutable" products under Article III:2, second sentence.

21. The Philippines thus contends that the Panel erred in finding that, in this case, the degree of competition and substitutability among "sugar-based" and "non-sugar-based" distilled spirits satisfies the higher standard of "likeness" under Article III:2, first sentence, while acknowledging that a large proportion of consumers do not have access to, and are not willing to purchase, "non-sugar-based" distilled spirits instead of "sugar-based" distilled spirits, and that the competition and substitutability that exists is limited to exceptional "special occasion" purchases.[30] The Philippines disagrees with the Panel that a product that is not accessible to 98.2 per cent of the population, but may be accessible to some unidentified miniscule segment of the population on special occasions, could be deemed to be

[27]Philippines' appellant's submission, paras. 140 and 141 (referring to Panel Reports, para. 7.40).
[28]Philippines' appellant's submission, para. 64 (quoting Appellate Body Report, *EC – Asbestos*, para. 118).
[29]Philippines' appellant's submission, para. 64 (quoting Appellate Body Report, *EC – Asbestos*, para. 118).
[30]Philippines' appellant's submission, para. 69.

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engaged in the degree of competition required under Article III:2, first sentence, with a product that is purchased as a routine consumption good and that is accessible to all. The Philippines relies on the findings of the panels in *Indonesia – Autos* and *Dominican Republic – Import and Sale of Cigarettes* to support its argument that products that do not compete in the same market are perceived differently by consumers and cannot, therefore, be considered "like" within the meaning of Article III:2, first sentence, of the GATT 1994.[31] According to the Philippines, the Panel in this dispute failed properly to construe "likeness" in the context of that provision by failing to recognize this additional element of differentiation in the Philippine market.

22. The Philippines further submits that distribution channels for "sugar-based" and "non-sugar-based" distilled spirits in the Philippine market are distinct, reflecting the different consumer markets they serve. The Philippines relies on the findings of the panel in *Chile – Alcoholic Beverages*, which found that, "if products have quite distinctive channels of distribution that could be a negative indicator with respect to substitutability" and that "if the products were regularly presented separately, it would be *one* piece of evidence that perhaps consumers did not group them together in their perceptions".[32] The Philippines submits that local *sari-sari* stores, which are frequented by all except the most affluent of consumers, account for approximately 85 per cent of off-premise sales of "sugar-based" distilled spirits, but do not carry "non-sugar-based" distilled spirits.[33] Moreover, evidence submitted by the complainants shows that "sugar-based" distilled spirits are sold predominantly (as much as 90 per cent) through off-premise channels, while "non-sugar-based" distilled spirits are sold predominantly (as much as 90 per cent) through on-premise channels.[34]

23. The Philippines claims, in addition, that the Panel failed to make an objective assessment of the matter before it, in accordance with Article 11 of the DSU, because, in concluding that there was no evidence of the existence of two separate markets in the Philippines, and that some consumers from the majority market "may be able to purchase high-priced distilled spirits, at least on special occasions", it disregarded critical evidence produced by the Philippines and ignored the fact that no evidence had been presented to counter that presented by the Philippines.[35] In particular, the Philippines argues that the Panel ignored that: (i) "non-sugar-based" distilled spirits are regularly priced over Philippine pesos ("PHP") 150 a bottle; and (ii) 98.2 per cent of Philippine households

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[31]Philippines' appellant's submission, paras. 72-74 (referring to Panel Report, *Indonesia – Autos*, paras. 14.174-14.177 and 14.181; and Panel Report, *Dominican Republic – Cigarettes*, para. 7.331).

[32]Philippines' appellant's submission, para. 75 (quoting Panel Report, *Chile – Alcoholic Beverages*, para. 7.59 (original emphasis)). (boldface added by the Philippines omitted)

[33]Philippines' appellant's submission, para. 76 and footnote 77 thereto.

[34]Philippines' appellant's submission, para. 76 (referring to 2010 International Wine and Spirits Record, "Philippines – Index" (Panel Exhibits EU-15 and US-15)).

[35]Philippines' appellant's submission, para. 173 (quoting Panel Reports, paras. 7.59 and 7.119).

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have a maximum of PHP 150 per week to spend on alcoholic beverages. Therefore, there are at least two market segments in the Philippines, because only 1.8 per cent of the Filipino population can afford "non-sugar-based" distilled spirits, whereas the rest of the population can afford only "sugar-based" distilled spirits.[36]

24. The Philippines argues that the *Euromonitor International* survey[37], submitted by the complainants, shows that only three brands of imported distilled spirits were priced below PHP 150, and that none of these were priced lower than PHP 130, while the remainder (approximately 195 products) were priced far above this level, but that no evidence was presented showing that imported distilled spirits are regularly priced below or even near the PHP 150 threshold. In respect of market segmentation, the Philippines submits that no evidence was presented by the complainants to show that the majority of the Filipino population could afford distilled spirits over PHP 150. The Philippines argues that, while non-price-related factors (such as quality, taste, and social acceptability) prevented the downward substitution of the products at issue, price-related factors were the most significant reason why consumers could not engage in an upward substitution of the products, thus creating a market segmentation of at least two groups.[38] Therefore, in finding that there was "no evidence of the existence of two separate distilled spirit markets in the Philippines that reflect different levels of purchasing power"[39], the Panel simply rejected or ignored much of the evidence submitted by the Philippines, in violation of Article 11 of the DSU.

25. Regarding tariff classification, the Philippines claims that the Panel erred in finding that the fact that all distilled spirits at issue, irrespective of the raw materials from which they are made, fall under the same four-digit Harmonized System ("HS") tariff heading (2208) provides an indication of similarity. The Philippines relies on the findings of the Appellate Body in *Japan – Alcoholic Beverages II* that, "[i]f sufficiently detailed, tariff classification can be a helpful sign of product similarity", but that "tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product 'likeness' under Article III:2".[40] The Philippines argues that the Panel's use of the four-digit tariff heading in this case was inappropriate, because the range of

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[36]Philippines' appellant's submission, para. 174 (referring to Philippines' first written submission to the Panel, paras. 224-229; and Philippines' responses to Panel Questions 35, 36, 72, and 89).

[37]*Euromonitor International*, "Consumer perceptions regarding substitutability in the Philippines distilled spirits market" (August 2010) (Panel Exhibits EU-41 and US-41).

[38]Philippines' appellant's submission, para. 176 (referring to *Euromonitor International* survey, *supra*, footnote 37, p. 19).

[39]Philippines' appellant's submission, para. 177 (quoting Panel Reports, para. 7.60). (boldface added by the Philippines omitted)

[40]Philippines' appellant's submission, para. 80 (quoting Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 21-22, DSR 1996:I, 97, at 114-115).

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products that fall under HS heading 2208 is very broad; in any event, it is not sufficiently detailed to draw any particular inferences as to whether the distilled spirits at issue are "like".[41]

26. The Philippines further claims that the Panel failed to make an objective assessment of the matter before it, in accordance with Article 11 of the DSU, because it ignored significant and clear evidence regarding the tariff classification of whisky and brandy when it arrived at the conclusion that the evidence on tariff classification was inconclusive. Particularly in respect of whisky and brandy, the Panel found that the HS classification at the six-digit level, and the accompanying explanatory notes, take into account the raw material used for the production of the distilled spirit, so that whiskies and brandies made from sugar cane molasses would not fall under the same HS subheading as whiskies and brandies made from traditional raw materials. The Philippines contends, therefore, that the Panel's conclusion that, "at the six-digit level, the HS classification does not give … conclusive guidance" is unsupported by the very facts that the Panel cited in its Reports.[42]

2. Article III:2, Second Sentence, of the GATT 1994

27. The Philippines claims that the Panel erred in finding that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994, because it applies dissimilar internal taxes on domestic distilled spirits made from designated raw materials and "directly competitive or substitutable" imported distilled spirits made from non-designated raw materials, "so as to afford protection to domestic production" of distilled spirits in the Philippines. More specifically, the Philippines claims that the Panel erred in finding that domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994. The Philippines also claims that the Panel erred in finding that the Philippines' excise tax is applied "so as to afford protection to domestic production" of distilled spirits within the meaning of that provision.[43]

(a) Directly Competitive or Substitutable Products

28. The Philippines claims that the Panel erred in finding that domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the

[41] Philippines' appellant's submission, para. 81.

[42] Philippines' appellant's submission, para. 159 (quoting Panel Reports, para. 7.71).

[43] The Philippines does not appeal the Panel's finding at paragraph 7.167 of the Panel Reports that imported spirits and directly competitive or substitutable domestic distilled spirits are not similarly taxed within the meaning of Article III:2, second sentence, of the GATT 1994.

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GATT 1994. The Philippines requests the Appellate Body to reverse this finding for the following reasons.

29. First, the Philippines argues that the Panel erred in finding that the relevant inquiry under Article III:2, second sentence, is not the "degree of competition" between the products at issue but, rather, the "nature or quality" of their competitive relationship.[44] Referring to the Appellate Body reports in *Korea – Alcoholic Beverages* and *US – Cotton Yarn*, the Philippines submits that the degree of competition between the products at issue is the "central" inquiry under Article III:2, second sentence.[45] In examining simply the "nature or quality" of competition, the Panel insufficiently addressed the "degree of proximity" of competition between the products at issue.[46] The Philippines acknowledges that both quantitative and qualitative evidence are relevant in determining the degree of competition between "non-sugar-based" and "sugar-based" distilled spirits under Article III:2. However, the Philippines emphasizes that the evidence that was before the Panel shows "a great disparity in the accessibility of these products, how [they] are perceived by the consumers, and how they are treated by suppliers" in the market.[47] Therefore, had the Panel applied the correct legal standard, it would have come to the conclusion that there was "insufficient proximity in the degree of competition" between the products at issue to permit their characterization as "directly competitive or substitutable".[48]

30. Second, the Philippines maintains that the Panel erred in finding "direct" competition between domestic and imported distilled spirits because "many [consumers] may be able to purchase high-priced distilled spirits, at least on special occasions."[49] The Panel impermissibly lowered the "direct competition" standard of Article III:2, which requires "close proximity in the process of purchasing a product, including its frequency, and the nature and frequency of purchasing another product".[50] The Philippines stresses that "special occasion" purchases are, by nature, "exceptional", likely requiring consumers to alter their usual consumption patterns.[51] Recalling the Appellate Body's interpretation that "directly competitive or substitutable" products are those that offer an "alternative way[] of satisfying a particular need or taste", the Philippines posits that two products that are not

[44]Philippines' appellant's submission, paras. 88 and 89 (quoting Panel Reports, para. 7.101).
[45]Philippines' appellant's submission, paras. 90 and 91 (referring to Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 129, 130, 133, and 134; and Appellate Body Report, *US – Cotton Yarn*, paras. 97 and 98).
[46]Philippines' appellant's submission, para. 93.
[47]Philippines' appellant's submission, para. 94.
[48]Philippines' appellant's submission, para. 95.
[49]Philippines' appellant's submission, para. 96 (quoting Panel Reports, para. 7.119).
[50]Philippines' appellant's submission, para. 97.
[51]Philippines' appellant's submission, para. 98.

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purchased with the same frequency, and that satisfy a dissimilar set of needs, cannot be considered "directly" competitive.[52]

31. Third, the Philippines submits that the Panel incorrectly considered that it was sufficient for a small portion of the market to have "access"[53] to both domestic and imported distilled spirits for them to be "directly competitive or substitutable".[54] The Philippines agrees that access to both imported and domestic distilled spirits is "an important part" of the inquiry and constitutes a "threshold issue" for whether further examination of the degree of competition is required.[55] However, access alone is not sufficient to demonstrate that consumers in an affluent income bracket actually view those products as directly competitive or substitutable. In equating "access" to "direct competition", the Panel failed to give meaning to the term "directly". Moreover, evidence showing a "vast and consistent" price difference between domestic and imported distilled spirits indicates a lack of competition in that portion of the market, because it demonstrates that the pricing behaviour of suppliers of imported distilled spirits is not constrained by the pricing behaviour of suppliers of domestic distilled spirits.[56]

32. Fourth, the Philippines contends that the Panel erred in finding direct competition between domestic and imported distilled spirits on the basis of competition in a "negligible, unrepresentative portion of the market".[57] For the Philippines, evidence of substitutability for the purposes of Article III:2, second sentence, "must emanate from a segment of the population that is genuinely and realistically representative of the whole market in which the products are consumed".[58] The Philippines emphasizes that 98.2 per cent of Filipino households cannot afford imported distilled spirits, and that the Panel erroneously found that these products are "directly competitive or substitutable" with domestic distilled spirits on the basis of "some degree of substitutability" in relation to 1.8 per cent of the market.[59]

33. Fifth, the Philippines submits that the Panel erred in finding that instances of price overlap between domestic and imported distilled spirits demonstrate that these products are "*capable* of being

[52]Philippines' appellant's submission, para. 99 (quoting Appellate Body Report, *Korea – Alcoholic Beverages*, para. 115).
[53]Philippines' appellant's submission, para. 101 (quoting Panel Reports, para. 7.120).
[54]Philippines' appellant's submission, para. 103.
[55]Philippines' appellant's submission, para. 104.
[56]Philippines' appellant's submission, para. 105.
[57]Philippines' appellant's submission, para. 118.
[58]Philippines' appellant's submission, para. 120.
[59]Philippines' appellant's submission, paras. 119.

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directly competitive or substitutable in the future".[60] The Philippines dismisses this finding as "speculative"[61], and considers that the limited price overlap falls short of demonstrating "actual competition" between domestic and imported distilled spirits. The Philippines adds that an inquiry into potential competition is only relevant to determine "whether competition would otherwise occur if the measures were not in place".[62] According to the Philippines, the "massive price differential" between domestic and imported distilled spirits and the actual purchasing power of the "great majority" of Filipinos demonstrate that these products are not capable of being "directly competitive or substitutable in the near future" in the absence of the excise tax.[63] In addition, the Panel's reference to the "future" is too indefinite and therefore insufficient to support a finding of violation of Article III:2, second sentence. The Philippines also maintains that the Panel acted inconsistently with its duties under Article 11 of the DSU in finding, without sufficient evidentiary basis, that the products at issue are capable of competing in the future.

34. Finally, in addition to its claims of error in the application of Article III:2, second sentence, to the facts of the present dispute, the Philippines claims that the Panel acted inconsistently with Article 11 of the DSU in its assessment of the *Euromonitor International*[64] and Abrenica & Ducanes[65] studies, which evaluate the substitutability between domestic and imported distilled spirits in the Philippine market. The Panel's conclusion that both studies showed "a significant degree of competitiveness or substitutability"[66] between domestic and imported distilled spirits in the Philippine market is directly contradicted by the Abrenica & Ducanes study, which showed "negligible levels of substitutability".[67] In addition, the Panel mischaracterized the methodology of the Abrenica & Ducanes study, which held the prices of other distilled spirits unchanged when the price of the selected spirit increased.[68] The *Euromonitor International* survey is, in turn, an insufficient basis on which to find substitutability, because it neither estimated the cross-price elasticity, nor isolated the effects of an increase in domestic prices on quantities of imported distilled spirits. Furthermore, the sample used in the *Euromonitor International* survey represented only the top percentage of income

[60]Philippines' appellant's submission, para. 107 (quoting Panel Reports, para. 7.121 (original emphasis)).
[61]Philippines' appellant's submission, para. 108.
[62]Philippines' appellant's submission, para. 111.
[63]Philippines' appellant's submission, paras. 112 and 113.
[64]*Supra*, footnote 37.
[65]M.J. Abrenica and J. Ducanes, "On Substitutability between Imported and Local Distilled Spirits" (University of Philippines School of Economics Foundation, 10 October 2010) (Panel Exhibit PH-49).
[66]Philippines' appellant's submission, para. 163 (quoting Panel Reports, paras. 7.62 and 7.113).
[67]Philippines' appellant's submission, para. 164.
[68]Philippines' appellant's submission, para. 167 (referring to Panel Reports, para. 7.56).

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distribution in the Philippines, and therefore was not representative of the entire market.[69] The Philippines adds that the *Euromonitor International* survey suggests that non-price-related factors, such as consumer tastes and habits, prevented both the downward and upward substitution of the products.[70] According to the Philippines, the Panel unjustifiably disregarded these shortcomings in its examination of the studies, and thereby failed to make an objective assessment of the matter as required under Article 11 of the DSU.

(b) "So as to afford protection to domestic production"

35. The Philippines claims that the Panel erred in finding that the dissimilar taxes imposed on imported distilled spirits and on directly competitive or substitutable domestic distilled spirits are applied "so as to afford protection to domestic production" of distilled spirits. The Philippines requests the Appellate Body to reverse this finding for the following reasons.

36. The Philippines argues that the Panel's conclusion that "the vast majority of [the] imported spirits are subject to higher taxes" is not supported by the evidence submitted to the Panel.[71] The Panel's conclusion that "*de facto* the measure results in all domestic distilled spirits enjoying the favourable low tax, while the vast majority of the imported spirits are subject to higher taxes"[72] is contradicted by the fact that approximately 50 per cent of Philippine distilled spirits production is made from imported ethyl alcohol, which is subject to the lower tax rate.[73]

37. The Philippines adds that the Panel erroneously inferred protectionism from the high tax rates applicable to some imported distilled spirits. In the Philippines' view, such inference is unwarranted in a case where 98.2 per cent of Filipino households cannot afford imported distilled spirits. The Panel erroneously dismissed the Philippines' argument on the basis of the reasoning articulated by the Appellate Body in *Korea – Alcoholic Beverages*.[74] While such reasoning may have been appropriate in the context of the competitive conditions of the Korean market, it does not preclude consideration of the Philippines' argument concerning income gaps in the present case. Moreover, in merely "transferring the reasoning" applied by the Appellate Body in the context of the factual circumstances

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[69]Philippines' appellant's submission, para. 169 (referring to *Euromonitor International* survey, *supra*, footnote 37, pp. 7 and 13).

[70]Philippines' appellant's submission, para. 170 (referring to *Euromonitor International* survey, *supra*, footnote 37, p. 19).

[71]Philippines' appellant's submission, para. 128 (quoting Panel Reports, para. 7.182).

[72]Philippines' appellant's submission, para. 127 (quoting Panel Reports, para. 7.182).

[73]Philippines' appellant's submission, para. 128 (referring to letter from the Republic of the Philippines Department of Finance, Bureau of Internal Revenue, dated 3 February 2011 (Panel Exhibit PH-82); and Philippines' response to Panel Question 68(a)).

[74]Philippines' appellant's submission, para. 129 (referring to Panel Reports, para. 7.185).

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of *Korea – Alcoholic Beverages*, the Panel fell short of the "case-by-case, comprehensive" analysis that was required to assess whether there is protective application under Article III:2, second sentence, in this dispute.[75]

B. *Arguments of the European Union – Appellee*

38. The European Union takes issue with the Philippines' reference to its excise tax regime as a measure that distinguishes between "sugar-based" distilled spirits and "non-sugar-based" distilled spirits. In the European Union's view, this distinction is false and misleading, because Section 141(a) of the NIRC covers not only distilled spirits made from sugar cane molasses, but also distilled spirits produced from the sap of the *nipa*, coconut, cassava, *camote*, or *buri* palm. Indeed, the European Union notes that some domestic distilled spirits are made from designated raw materials other than sugar cane molasses.

39. The European Union argues that the Philippines overemphasizes the alleged neutrality of the measure at issue, and disagrees with the contentions that the excise tax regime makes no distinction between the products' countries of origin and that "any distilled spirit from any country in the world produced from [sugar cane] is entitled to the lower specific tax."[76] The European Union notes that several imported distilled spirits, albeit produced from sugar cane, do not enjoy the lower flat tax rate for designated raw materials.[77] Moreover, Section 141(a) of the NIRC sets forth the additional requirement that the raw materials be produced commercially in the country where they are processed into distilled spirits. In the European Union's view, this further condition implies that two products that may be essentially identical might be treated differently *solely* on the basis of whether or not climate or agronomic conditions allow for commercial production of the relevant designated raw material in the country of origin.

40. The European Union submits that the Philippines' assertion that the excise tax regime pursues the aim of progressive taxation is "manifestly unfounded" and conceals a protectionist intent, given that the level of taxation does not depend on prices but, rather, on the raw materials from which

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[75]Philippines' appellant's submission, paras. 133-135 (quoting Panel Reports, paras. 7.179 and 7.186, in turn quoting Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:I, 97, at 120).

[76]European Union's appellee's submission, para. 10 (quoting Philippines' appellant's submission, para. 10).

[77]European Union's appellee's submission, para. 12. The European Union mentions seven brands of imported distilled spirits that are excluded from the lower tax rate under Section 141(a) of the NIRC, namely "Havana Club Anejo Reserva", "Lemon Hart Jamaica Rum", "Lemon Hart White Rum", "Malibu Caribbean White Rum w/ coco", "Malibu Rum", "Myers Rum", and "Myers Rum Planters Punch". (*Ibid*., referring to Republic of the Philippines Department of Finance, Bureau of Internal Revenue Regulation 23-2003 (Panel Exhibit PH-64), pp. 9, 11, and 12)

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distilled spirits are produced.[78] The European Union contends that, if the Philippines had really wanted to develop a progressive taxation system, it could have adopted a pure *ad valorem* system, where all products would always be taxed according to their net retail price ("NRP").

41. The European Union also contests the Philippines' argument that there is a "clear-cut distinction" between high-priced imported distilled spirits and low-priced domestic distilled spirits[79], and that price overlaps are "exceptions and aberrations".[80] The European Union agrees with the Panel's findings that "there are a number of high-priced domestic spirits, as well as less expensive imports"[81], and that the overlap in prices "is not exceptional" and "occurs for both high-priced and low-priced products".[82] Moreover, the European Union emphasizes that the measure at issue has a profound impact even on the pre-tax prices of imported distilled spirits by, *inter alia*, preventing producers of imported distilled spirits from enjoying the benefits of economies of scale.

1. Article III:2, First Sentence, of the GATT 1994

42. The European Union requests the Appellate Body to reject the Philippines' claim that the Panel erred in interpreting and applying the concept of "like products" within the meaning of Article III:2, first sentence, of the GATT 1994.

43. With regard to physical characteristics, the European Union takes issue with the Philippines' contention that the narrow scope of the term "like products" implies that "any significant physical difference, even those that may not be perceptible to the consumer, will be considered sufficient to disqualify a product from being considered 'like' another product."[83] The European Union argues that the Philippines' contention is based on the "factually wrong" premise that all domestic products have similar characteristics and all imported distilled spirits have other characteristics.[84] In fact, apart from the raw materials used in the production of distilled spirits, the Panel found no proof that all domestic distilled spirits have a similar chemical composition, or that this composition would, in turn, be any different from that of all imported distilled spirits.

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[78]European Union's appellee's submission, paras. 19 and 20.
[79]European Union's appellee's submission, para. 33.
[80]European Union's appellee's submission, para. 37 (quoting Philippines' second written submission to the Panel, para. 56).
[81]European Union's appellee's submission, para. 35 (quoting Panel Reports, paras. 2.36, 7.51, 7.59, and 7.118).
[82]European Union's appellee's submission, para. 37 (quoting Panel Reports, para. 7.118).
[83]European Union's appellee's submission, para. 45 (quoting Philippines' appellant's submission, para. 30).
[84]European Union's appellee's submission, para. 47.

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44. According to the European Union, the Philippines' assertion is also "legally flawed" and based on an incorrect reading of relevant case law, in that it accords "undue" importance to physical characteristics in the analysis of likeness.[85] The European Union remarks that the likeness analysis is a "holistic exercise" in which physical characteristics have to be examined together with other criteria[86], and in which "no criteri[on] is, on its own, determinative".[87] Moreover, the European Union argues that the relevant case law indicates that some differences in physical characteristics are not *per se* sufficient to render the products "unlike". For instance, the panel in *Japan – Alcoholic Beverages II* found that two of the distilled spirits at issue—vodka and shochu—were "like products" since they shared "*most* physical characteristics", and stated that differences in name, traditional origin, filtration, alcohol strength, and raw materials did not prevent a finding of "likeness". In addition, that panel concluded that shochu and other distilled spirits at issue in that case were not "like products" under Article III:2, first sentence, "only insofar as there existed '*substantial noticeable differences*'" between them.[88] Similarly, the panel in *Mexico – Taxes on Soft Drinks* found that a difference in the raw materials used to sweeten the products at issue did not constitute a "substantial noticeable difference", and accordingly concluded that the products at issue were "like".[89]

45. The European Union disagrees with the Philippines' assertion that the Panel erred in considering as irrelevant for its analysis the European Union's and the United States' regulations, which allegedly prohibit the marketing of whisky and brandy made from the designated raw materials as whisky or brandy in their respective markets.[90] The European Union takes the view that, in a case-by-case analysis, which takes into account all relevant factors, certain facts alleged by the parties may be deemed *irrelevant* or *of little relevance* by a panel, and that the Philippines is merely complaining about the weighing of evidence and the assessment of facts made by the Panel in this case. Since the Philippines has not raised a specific claim of error under Article 11 of the DSU in this respect, the European Union contends that the Appellate Body need not address the Philippines' argument on this issue.

46. The European Union takes issue with the Philippines' claim that the Panel acted inconsistently with Article 11 of the DSU because it disregarded portions of the expert evidence submitted by the

[85]European Union's appellee's submission, para. 50.
[86]European Union's appellee's submission, para. 51.
[87]European Union's appellee's submission, para. 52 (quoting Appellate Body Report, *EC – Asbestos*, para. 111).
[88]European Union's appellee's submission, para. 54 (quoting Panel Report, *Japan – Alcoholic Beverages II*, para. 6.23). (emphasis added by the European Union)
[89]European Union's appellee's submission, para. 55 (quoting Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.136).
[90]European Union's appellee's submission, para. 59 (referring to Philippines' appellant's submission, para. 52).

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Philippines with respect to the chemical composition and the organoleptic properties of the products at issue. The European Union contends that, although the Panel did not explicitly mention the expert evidence in question, it did take it into account. In this respect, the European Union recalls that, in *Australia – Apples*, the Appellate Body found that a panel that does not expressly reproduce certain statements may still act consistently with Article 11 when the panel's reasoning "reveals that it has nevertheless assessed the significance of the[se] statements".[91] Moreover, the Panel "went to great lengths" to discuss the arguments of the Philippines on this point, and simply disagreed on the relevance and weight of those elements.[92]

47. With regard to consumer tastes and habits, the European Union contests the Philippines' claim that the Panel erred in disregarding the fact that 98.2 per cent of Filipino consumers are unable to purchase high-priced imported distilled spirits, and can buy only low-priced domestic distilled spirits, and that a large part of domestic distilled spirits are sold through *sari-sari* stores[93], whereas a substantial part of imported distilled spirits are sold through larger off-premise outlets. The European Union reiterates that the Philippines' distinction between high-priced imported distilled spirits and low-priced domestic distilled spirits is "incorrect", since both domestic and imported distilled spirits cover a relatively wide spectrum of prices.[94] Moreover, the large overlap in the distribution channels of domestic and imported distilled spirits is evidenced by the fact that many supermarkets, restaurants, bars, pubs, and catering companies "offer both domestic and imported spirits side-by-side"[95], and some *sari-sari* stores do sell some imported brands.[96] Finally, the European Union contends that the Panel ultimately was not convinced that the figures provided by the Philippines proved the existence of two separate population groups with distinctive consumption patterns.[97]

48. The European Union also takes issue with the Philippines' view that the Panel wrongly considered, as part of its analysis of the competitive relationship between the products at issue, the fact that even customers who cannot regularly afford high-priced distilled spirits can purchase them "at least" on "special occasions". The European Union asserts that: (i) having already found that

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[91]European Union's appellee's submission, para. 154 (quoting Appellate Body Report, *Australia – Apples*, para. 275).

[92]European Union's appellee's submission, para. 150.

[93]We note that, before the Panel, the Philippines defined "*sari-sari*" stores as "small, neighborhood, over-the-counter stores that carry basic grocery and household items". (Philippines' first written submission to the Panel, para. 253)

[94]European Union's appellee's submission, para. 68.

[95]European Union's appellee's submission, para. 69 (referring to Panel Reports, para. 2.41).

[96]European Union's appellee's submission, para. 69 (referring to the Report of the Philippine Survey and Research Center, "Sari-Sari Store Survey" (13 September 2010) A(QN)011510-120 (Panel Exhibit PH-55), pp. 12-14).

[97]European Union's appellee's submission, para. 73 (referring to Panel Reports, paras. 2.31, 2.32 and 7.59).

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there are significant price overlaps between domestic and imported distilled spirits, the Panel's mention of "special occasions" was made only "*ad abundantiam*"; (ii) the term "at least" clearly indicates that the Panel found that, for many customers, the products are "usually" in competition and that, only for those with lower income, these products may perhaps be in competition only on those special occasions; and (iii) as noted by the Panel, the marketing campaigns run by producers of both domestic and imported distilled spirits specifically associate consumption of their products with the celebration of important events.[98]

49. The European Union contests the Philippines' assertion that the Panel acted inconsistently with Article 11 of the DSU because it disregarded the evidence on the current price of distilled spirits and on the average income of the population. The European Union submits that the Panel duly took into account the documents concerned and discussed the arguments put forward by the Philippines. Ultimately, according to the European Union, the Panel simply disagreed with the merits of the Philippines' position, and thus it did not commit error under Article 11 of the DSU.

50. Lastly, with regard to tariff classification, the European Union disagrees with the Philippines' claim that the Panel erred in its analysis when it referred to the four-digit HS heading for distilled spirits, which, according to the Philippines, is not sufficiently specific. It also takes issue with the Philippines' assertion that the Panel acted inconsistently with Article 11 of the DSU when it disregarded the fact that raw materials are crucial in determining the six-digit HS subheadings of some distilled spirits, which would prove that those distilled spirits, when made from different raw materials, are "unlike". The European Union argues that the Panel simply found that "a six-digit heading was 'not conclusive'" and that the four-digit level could "provide an *indication* of similarity".[99] Thus, the Panel appreciated the tariff classification in the context of other facts and evidence and did not give any unwarranted weight to this aspect. In addition, the European Union argues that the evidence was not unequivocal. For instance, although the Philippines argued that a Philippine whisky (being made from sugar cane) would not fall under HS subheading 2208.30, export statistics show that, in recent years, there were exports of Philippine whiskies under that HS subheading to several countries worldwide.[100] Finally, the Panel's conclusions on this issue are in conformity with those reached in past disputes.[101] Therefore, the European Union concludes, the

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[98]European Union's appellee's submission, para. 71.

[99]European Union's appellee's submission, para. 77 (quoting Panel Reports, para. 7.63). (emphasis added by the European Union)

[100]European Union's appellee's submission, para. 78 (referring to Panel Exhibit EU-54, containing tables on volume and value of Philippine exports of distilled spirits, 2000-2008).

[101]European Union's appellee's submission, para. 79 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 23, DSR 1996:I, 97, at 115).

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Panel properly applied the criterion of tariff classification in its analysis under Article III:2, first sentence, of the GATT 1994, and did not err under Article 11 of the DSU.

2. Article III:2, Second Sentence, of the GATT 1994

51. The European Union submits that the Panel did not err in finding that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994 by applying dissimilar internal taxes on domestic distilled spirits made from designated raw materials and "directly competitive or substitutable" imported distilled spirits made from non-designated raw materials, "so as to afford protection to domestic production" of distilled spirits. More specifically, the European Union argues that the Panel correctly held that domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994. The European Union also argues that the Panel correctly found that the Philippines' excise tax is applied "so as to afford protection to domestic production" of distilled spirits within the meaning of Article III:2, second sentence, of the GATT 1994.

(a) Directly Competitive or Substitutable Products

52. The European Union requests the Appellate Body to dismiss the Philippines' appeal and uphold the Panel's finding that domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994.

53. First, the European Union dismisses as "purely terminological"[102] the Philippines' argument that the Panel insufficiently addressed the "degree of competition"[103] between domestic and imported distilled spirits in the Philippine market. In rejecting the Philippines' argument that Article III:2, second sentence, requires "complete, absolute or exact" substitutability, the Panel did not exclude the degree of competition from its analysis.[104] Rather, the Panel simply stated that the issue was "not so much" the degree of competition because it was necessary to take into account both current and potential competition.[105] According to the European Union, this interpretation is consistent with *Korea – Alcoholic Beverages*, where the Appellate Body found that Article III:2, second sentence, requires panels to take into account "latent demand, especially in markets where there are regulatory

[102]European Union's appellee's submission, para. 83.
[103]European Union's appellee's submission, para. 85. (emphasis omitted)
[104]European Union's appellee's submission, para. 84.
[105]European Union's appellee's submission, para. 85.

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barriers to trade or to competition".[106] The Panel's interpretation of Article III:2, second sentence, also finds support in *US – Cotton Yarn*, where the Appellate Body held that the term "competitive" has "a wider connotation than 'actually competing' and includes also the notion of a potential to compete".[107] The European Union adds that the Panel's finding on the extent of competition between domestic and imported distilled spirits in the Philippines is an issue of fact that is not amenable to review on appeal, except under Article 11 of the DSU.

54. Second, the European Union argues that the Philippines misreads the Panel Reports when it argues that the Panel found direct competition between the products at issue on the basis of "special occasion" consumption. The Panel rejected the Philippines' arguments regarding the existence of two separate markets for distilled spirits based on price overlaps between imported and domestic distilled spirits, and because there was no evidence of the existence of two separate population groups in terms of consumption patterns and income. Therefore, the Panel dismissed the Philippines' argument because it was "factually unfounded and unproven", and not because it considered that partial competitive overlap was sufficient to establish the requisite level of substitutability.[108] Moreover, the European Union stresses that Article III:2, second sentence, does not require the same frequency in consumption, and that substitutability on "certain occasions" can be relevant under that provision. For the European Union, if potential competition must be taken into account, *a fortiori*, actual competition, even if only partial, should not be disregarded.

55. Third, the European Union challenges the Philippines' assertion that the Panel wrongly assumed that "access" to imported distilled spirits by a narrow segment of the market is equivalent to "direct competition".[109] The Panel's findings under Article III:2, second sentence, were based on "different aspects of similarity" between the products, including their competitive relationship, channels of distribution, properties, nature and quality, common end-uses and marketing, tariff classification, and internal regulations.[110] The Panel simply reasoned that the Philippines' argument concerning market segmentation implies that some part of the Filipino population has access to both groups of distilled spirits. Thus, the Panel rightly concluded that potential competition cannot be ruled out *a priori*. The European Union also submits that the weight to be given to the price studies, which allegedly demonstrate that producers of domestic distilled spirits are not constrained by the

[106]European Union's appellee's submission, para. 86 (quoting Appellate Body Report, *Korea – Alcoholic Beverages*, para. 115).
[107]European Union's appellee's submission, para. 89 (quoting Appellate Body Report, *US – Cotton Yarn*, para. 96). (emphasis omitted)
[108]European Union's appellee's submission, para. 97.
[109]European Union's appellee's submission, para. 99.
[110]European Union's appellee's submission, para. 101.

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pricing behaviour of producers of foreign distilled spirits, is a matter falling within the Panel's discretion as trier of facts, and cannot be reviewed by the Appellate Body except under Article 11 of the DSU.[111]

56. Fourth, the European Union disagrees with the Philippines that the Panel found the requisite level of substitutability on the basis of direct competition only in a "negligible or unrepresentative" portion of the market. The European Union reiterates that the Panel found no evidence that all imported distilled spirits are high-priced and all domestic distilled spirits are low-priced, and that the Filipino population can be divided into two separate groups, in terms of consumption patterns and income. Therefore, the Panel did not decide that competition exists only in a portion of the market. Rather, in the European Union's view, the Panel assessed and made findings in relation to competition in the whole Philippine market for distilled spirits.

57. Fifth, the European Union rejects the Philippines' allegation that the Panel's findings concerning potential competition are "speculative".[112] The Philippines' allegation that the Panel disregarded evidence to the effect that price overlaps between domestic and imported distilled spirits are "exceptional" concerns an issue of fact and, as such, should not be reviewed by the Appellate Body.[113] Nonetheless, the Panel's finding that domestic and imported distilled spirits "are *currently* competitive and substitutable" is supported by evidence demonstrating overlap in the prices of both high- and low-priced distilled spirits.[114] In addition, the Panel was also required to take into account potential competition, because current conditions of competition may be distorted by the effects of the challenged measure. Therefore, the Panel correctly noted that instances of actual competition "are a clear indication that the imported and domestic products at issue in this dispute are indeed capable of being directly competitive or substitutable in the future."[115] The European Union adds that the Panel acted consistently with its duties under Article 11 of the DSU in reaching its finding. According to the European Union, instances of actual competition and studies demonstrating that consumers are willing or might be willing to use imported and domestic distilled spirits to satisfy the same needs support the Panel's finding that there is also potential competition between these products.

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[111]European Union's appellee's submission, para. 103 (referring to Appellate Body Report, *US – Upland Cotton*, para. 441).

[112]European Union's appellee's submission, para. 105 (referring to Philippine's appellant's submission, paras. 107-115).

[113]European Union's appellee's submission, para. 107.

[114]European Union's appellee's submission, para. 110 (referring to Panel Reports, para. 7.118 (original emphasis)).

[115]European Union's appellee's submission, para. 113 (quoting Panel Reports, para. 7.121).

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58. Finally, the European Union argues that the Panel did not act inconsistently with its duties under Article 11 of the DSU in its assessment of the economic studies presented by the parties. The fact that the *Euromonitor International* survey is not an econometric study does not undermine its probative value with respect to consumer preferences in the Philippines. To the contrary, the survey is "very pertinent" to the extent that it shows that consumers regard local and imported distilled spirits as "largely substitutable" and that they would react to price movements by switching between these categories.[116] The European Union also stresses that the sample used in the *Euromonitor International* survey was adjusted and "cross-compared" with published demographic information to allow closer alignment with the overall Filipino population.[117] The European Union adds that the Panel correctly described the methodology of the Abrenica & Ducanes study, because that study did not attempt to examine consumer response to a rise in prices of all domestic distilled spirits, or a reduction in prices of all imported distilled spirits. In any event, it is not clear to the European Union why an alleged imprecise description of the methodology employed in the Abrenica & Ducanes study would amount to a violation of Article 11 of the DSU.[118] The European Union adds that the Abrenica & Ducanes study estimates that, in a tax-neutral environment, the market share of imported distilled spirits would increase by between 13 and 24.5 per cent, thus lending support to the Panel's conclusion regarding significant substitutability.[119]

(b) "So as to afford protection to domestic production"

59. The European Union argues that the Panel did not err in finding that the dissimilar taxes imposed on imported distilled spirits and on directly competitive or substitutable domestic distilled spirits are applied "so as to afford protection to domestic production" of distilled spirits. The European Union requests the Appellate Body to dismiss the Philippines' appeal in this respect, and to uphold the Panel's finding.

60. The European Union rejects the Philippines' argument that the measure at issue has no protective effect because a significant quantity of domestic distilled spirits is produced from imported ethyl alcohol that is taxed at the lower rate. For the European Union, ethyl alcohol is not a distilled spirit, but merely an input in the production of distilled spirits, and therefore is of no relevance to the

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[116]European Union's appellee's submission, para. 172.
[117]European Union's appellee's submission, para. 173.
[118]European Union's appellee's submission, para. 177. According to the European Union, the authors of the Abrenica & Ducanes study (*supra*, footnote 65) expressed their personal opinion when characterizing a cross-price elasticity ranging from -0.01 and 0.07 as "low", but the Panel was entitled to consider that this coefficient was not "insignificant or immaterial" given that the excise tax "squeezed" imported spirits into a "marginal" 2-3 per cent market share. (*Ibid.*, para. 180)
[119]European Union's appellee's submission, paras. 181 and 182 (quoting Panel Reports, para. 7.55).

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current proceedings. The European Union emphasizes that "[a] brandy or whisky or vodka produced in the Philippines, by a Filipino company, and sold in the Philippines, does not become an *imported* spirit even if it were to be produced, in part or wholly, with imported ethyl alcohol."[120]

61. The European Union submits that the Panel correctly eschewed revisiting the question of whether domestic and imported distilled spirits are "directly competitive or substitutable" in determining whether the measure at issue is applied "so as to afford protection to domestic production". The question of whether competition between domestic and imported distilled spirits could exist pertains to the analysis of whether these products are "directly competitive or substitutable" under Article III:2, second sentence. In contrast, the examination of whether the measure is applied "so as to afford protection to domestic production" is a separate and different issue that must be examined individually, and must focus on the structure and application of the measure at issue, not on the competitive relationship between the products. For the European Union, the Philippines' argument regarding market segmentation relates to competition in the Philippine distilled spirits market, and not the structure and application of the measure at issue.

C. *Arguments of the United States – Appellee*

62. The United States takes issue with the Philippines' assertion that this dispute essentially concerns the Philippines' fiscal policy objectives and its commitment to a policy of progressive taxation, as this raises systemic issues regarding the autonomy of WTO Members. The United States takes no position on the fiscal priorities of the Philippine Government, and argues that the issue in dispute is whether the excise tax regime discriminates against imported products, in breach of Article III:2 of the GATT 1994. Moreover, the United States contends that the Philippines' claim that its excise tax regime is origin-neutral because it distinguishes on the basis of raw materials constitutes a "distorted" presentation of the measure at issue[121], and that the Philippines' distinction between "sugar-based" and "non-sugar-based" distilled spirits provides "no practical information" about the products sold in its market.[122] The distinction drawn by the excise tax regime ensures that the lowest tax rate is applied to all distilled spirits produced from designated raw materials in the Philippines, and that imported distilled spirits made from non-designated raw materials face much higher taxes.

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[120]European Union's appellee's submission, para. 124. (original emphasis)
[121]United States' appellee's submission, para. 3.
[122]United States' appellee's submission, para. 4 (referring to Philippines' appellant's submission, para. 5).

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1. Article III:2, First Sentence, of the GATT 1994

63. The United States submits that the Panel correctly interpreted and applied Article III:2, first sentence, of the GATT 1994 and that it conducted an objective assessment of the matter, as required by Article 11 of the DSU. It notes that past panels and the Appellate Body have employed a case-by-case approach to determining whether products are "like", which takes into account all relevant factors. The United States argues that, while the Panel analyzed evidence under each factor before reaching its conclusions, the Philippines largely ignores the overall analysis of the Panel and focuses entirely on physical differences between imported and domestic products and the alleged inability of most Filipino consumers to purchase imported distilled spirits on a weekly basis.

64. With regard to physical characteristics, the United States disagrees with the Philippines' claim that any "significant" physical differences between domestic and imported distilled spirits, even those that may not be perceptible to the consumer, should be sufficient to prevent a finding of "likeness". In the United States' view, the Philippines improperly reads the term "like" to mean "identical" and makes two fundamental errors. First, it overstates the importance of physical characteristics in the analysis of "likeness". Second, it overstates the importance of certain physical differences and ignores "key" physical similarities that consumers rely on when choosing brands of spirits.[123]

65. The United States further notes that the Philippines' arguments on physical characteristics focus entirely on the physical differences that result from the use of different raw materials, particularly congeners present in the chemical composition of the products at issue and flavourings added to domestic distilled spirits. The United States submits that this emphasis on differences in additives and congeners is "unduly narrow" for a proper assessment of physical characteristics.[124] First, some physical characteristics, such as physiological effects, are similar across all types of products, while, for other characteristics, both imported products and domestic products vary from type to type. Second, domestic producers "take great pains" to make their distilled spirits similar to imported distilled spirits of the same type, so much so that they are virtually indistinguishable on the shelf for the consumer.[125] In this context, the United States agrees with the Panel's focus on the characteristics of the final products as sold to consumers, rather than on the raw materials used, and asserts that this approach is consistent with that adopted by the panel in *Mexico – Taxes on Soft Drinks*.[126] Third, the Philippines' view is at odds with the panel's findings in *Japan – Alcoholic*

[123]United States' appellee's submission, para. 25.
[124]United States' appellee's submission, para. 31.
[125]United States' appellee's submission, para. 28 (referring to Panel Reports, para. 2.25)
[126]United States' appellee's submission, para. 28 (referring to Panel Report, *Mexico – Taxes on Soft Drinks*, paras. 8.30, 8.31, and 8.131).

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Beverages II, where the distilled spirits that were found to be "like"—vodka and shochu—shared most physical characteristics, were not necessarily made from the same raw materials, and presented possible differences in alcoholic strength.[127] In any event, the United States stresses that, with respect to organoleptic properties, there is no evidence that these differences among different types of distilled spirits indicate two separate and identifiable product groups between Philippine domestic distilled spirits and their imported counterparts.

66. The United States argues that, while physical characteristics constitute an important criterion for determining whether products are "like", they are not dispositive; rather, they are simply part of the list of factors to be considered. According to the United States, the Philippines "entirely ignores" other relevant evidence cited by the Panel—such as marketing and end-uses—that supports the Panel's finding of "likeness".

67. The United States also contests the Philippines' claim that the Panel erred in considering as irrelevant for its analysis of "likeness" the fact that, under the European Union's and the United States' internal regulations, distilled spirits labelled and marketed as whisky and brandy must be produced from specific raw materials. The United States stresses, and all parties agree, that the "relevant market" for the determination of "likeness" is the Philippines. Accordingly, the Panel correctly reviewed the Philippines' counterparts to the United States' and the European Union's regulations, which permit the sale of products labelled as brandy, whisky, and vodka, even when they are made from raw materials not traditionally associated with those types of distilled spirits.[128]

68. The United States disagrees with the Philippines' claim that the Panel acted inconsistently with Article 11 of the DSU by disregarding expert evidence submitted by the Philippines with regard to the organoleptic properties and chemical composition of distilled spirits. The United States argues that, although the Panel did not directly quote or reproduce the entirety of the expert evidence proffered by the Philippines, it did summarize and consider it along with other relevant evidence, and concluded that the expert evidence was not probative of whether the products are "like".[129]

69. With respect to consumer tastes and habits, the United States takes issue with the Philippines' arguments that: (i) since most domestic consumers do not have the economic means to

[127]United States' appellee's submission, para. 32 (referring to Panel Report, *Japan – Alcoholic Beverages II*, para. 6.23).

[128]United States' appellee's submission, para. 38. The United States cites to evidence it submitted to the Panel in Exhibits US-22 to US-25 and US-27, which contain, *inter alia*, Republic of the Philippines Department of Trade, Bureau of Standards Administrative Orders Nos. 257, 258, 259, and 358.

[129]United States' appellee's submission, para. 104 (referring to Panel Reports, footnotes 397-400 to para. 7.40).

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purchase imported distilled spirits on a weekly basis, the Panel erroneously found that there was competition between domestic and imported distilled spirits; and (ii) purchases of imported distilled spirits on "special occasions" are not sufficient evidence of competition. The United States observes that the Panel drew its conclusions on consumer tastes and habits from a variety of factual elements, including that the same outlets in the Philippines that sell imported distilled spirits also sell domestic distilled spirits, the similarity in marketing campaigns of domestic and imported distilled spirits, and the overlap in price among domestic and imported distilled spirits.[130]

70. The United States submits that the Appellate Body report in *Japan – Alcoholic Beverages II* does not support the Philippines' assertion that a certain quantity or volume of current competition is necessary to find "likeness". In fact, the Appellate Body in that dispute did not suggest that competition must be presently occurring in order for there to be a competitive relationship between two products. Rather, it confirmed that the analysis of "likeness" will vary from case to case and should not be interpreted inflexibly.[131] Moreover, the Philippines' approach would entail that imported products could never be "like" domestic products if a measure entirely excluded them from competition in a given market. Finally, the Philippines' reference to the financial constraints of domestic consumers is based on the "false" premise that the distinguishing feature of domestic and imported distilled spirits is price. Instead, as the Panel correctly found, the excise tax regime distinguishes between distilled spirits based on the raw materials they are made from, and not on the basis of price.

71. The United States also argues that there is no support for the Philippines' proposition that a product consumed on special occasions cannot be in competition with a routinely purchased product. In fact, relevant case law indicates that, since distilled spirits are consumer goods that are purchased frequently, even a purchaser of lesser means can afford to buy a more expensive bottle "at least occasionally".[132] Furthermore, the Panel noted that the Filipino population is not divided into two separate income groups, but is rather distributed along a continuum of income brackets.

72. The United States objects to the Philippines' contention that the Panel erred under Article 11 of the DSU by disregarding the evidence proffered by the Philippines with respect to the low income

[130]United States' appellee's submission, para. 40 (referring to Panel Reports, paras. 2.36, 2.41, 2.42, 7.51, and 7.59).

[131]United States' appellee's submission, para. 43 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 20-21, DSR 1996:I, 97, at 113-114).

[132]United States' appellee's submission, para. 47 (quoting Panel Report, *Korea – Alcoholic Beverages*, para. 10.74). The United States notes that the case law mentioned refers to "directly competitive or substitutable" products under Article III:2, second sentence, of the GATT 1994. However, it argues that there is nothing to suggest that the same reasoning cannot apply to the analysis of "likeness". (*Ibid.*, para. 48)

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of the vast majority of the Filipino population, which allegedly showed the existence of two separate distilled spirits markets. The United States stresses that neither the complainants nor the Panel contested the assertion that most Filipinos are low-income consumers, but adds that such evidence does not necessarily lead to the conclusion that the market is fragmented. According to the United States, the Panel's failure to draw the conclusion suggested by the Philippines from the evidence in question demonstrates that it considered other evidence more probative and relevant to the issue before it.

73. Lastly, with respect to tariff classification, the United States contests the Philippines' claim that the Panel erred in its analysis of this "likeness" criterion because the range of products falling under the four-digit HS heading is not sufficiently detailed to draw any particular inferences on whether the products are "like". The United States also disagrees with the Philippines' contention that the Panel erred under Article 11 of the DSU when it found that the six-digit HS subheadings were inconclusive despite the fact that raw materials may be relevant for the six-digit level classification of brandy and whisky. The United States stresses that the Appellate Body in *Japan – Alcoholic Beverages II* stated that tariff classification can be relevant in determining likeness, but it does not oblige panels to draw conclusions from it in all circumstances.[133] The United States contends that the Panel simply reviewed evidence on four-digit HS classification and found some indications of similarity, thereby making an appropriate application of the criterion to the specific facts of this dispute. Moreover, the Panel thoroughly examined the six-digit HS subheadings and found that the totality of the evidence on this point was inconclusive, thereby fulfilling its duties under Article 11 of the DSU.

2. Article III:2, Second Sentence, of the GATT 1994

74. The United States submits that the Panel did not err in finding that the Philippines has acted inconsistently with the requirements of Article III:2, second sentence, of the GATT 1994 because the Philippines applies dissimilar internal taxes on domestic distilled spirits made from designated raw materials and "directly competitive or substitutable" imported distilled spirits made from non-designated raw materials, "so as to afford protection to domestic production" of distilled spirits. More specifically, the United States argues that the Panel correctly held that domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials are "directly competitive or substitutable" within the meaning of that provision. The United States also argues that the Panel correctly found that the Philippines' excise tax is applied "so as to

[133] United States' appellee's submission, para. 51 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:I, 97, at 114).

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afford protection to domestic production" of distilled spirits within the meaning of Article III:2, second sentence, of the GATT 1994.

(a) Directly Competitive or Substitutable Products

75. The United States argues that the Panel did not err in finding that domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994. The United States requests the Appellate Body to uphold the Panel's finding for the following reasons.

76. First, the United States argues that the Panel's analysis sufficiently addresses the "'degree' of proximity" in competition between domestic and imported distilled spirits, as required by the legal standard of Article III:2, second sentence.[134] For the United States, the Philippines seeks to minimize the significance of other types of evidence relied on by the Panel, such as evidence suggesting that consumers may purchase imported distilled spirits on special occasions, the lack of differentiation in marketing and labelling, and identity in channels of distribution.[135] The Appellate Body's statement in *US – Cotton Yarn* that "[l]ike products are necessarily in the highest degree of competitive relationship in the marketplace" is not relevant, because it compares the term "like product" to the term "directly competitive" in Article 6.2 of the *Agreement on Textiles and Clothing*.[136] According to the United States, the Panel's conclusion that there is a "significant degree of competitiveness or substitutability" between domestic and imported distilled spirits in the Philippine market disproves the Philippines' argument that the Panel did not evaluate the "degree of proximity" of competition.[137]

77. Second, the United States rejects the Philippines' argument that the Panel found direct competition because some consumers may be able to buy imported distilled spirits on "special occasions". The United States contends that there is no "frequency" requirement for direct competition under Article III:2.[138] The United States adds that Philippine producers present their products as appropriate for special occasions. According to the United States, there is no evidence that the "need or taste" that distilled spirits satisfy on special occasions, including relaxation and

[134]United States' appellee's submission, para. 70.
[135]United States' appellee's submission, para. 66 (referring to Panel Reports, paras. 7.119, 7.123, and 7.131).
[136]United States' appellee's submission, para. 68 (quoting Appellate Body Report, *US – Cotton Yarn*, para. 97).
[137]United States' appellee's submission, para. 69 (quoting Panel Reports, para. 7.113).
[138]United States' appellee's submission, para. 73.

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socialization, are different such that "special occasion" products do not compete directly with other products.

78. Third, the United States posits that the Panel did not err in assessing the competitive relationship between domestic and imported distilled spirits on the basis of evidence demonstrating actual competition "within a subset" of the Philippine market.[139] For the United States, the Panel's findings simply acknowledge that, notwithstanding the relatively low income of the average Filipino consumer, a "subset" of the market may purchase imported distilled spirits even though they are generally more expensive. This is only "logical" because "the existence of current competition certainly does not show *less* likelihood of a competitive relationship."[140] The United States also considers that the Philippines' challenge is directed at the weighing of the evidence by the Panel. For the United States, the Panel was correct in observing that instances of "actual competition" are a clear indication that the imported and domestic distilled spirits are "*capable*" of being directly competitive or substitutable in the future.[141]

79. Fourth, the United States disagrees with the Philippines that the Panel was required to assess competition in a portion of the market that is representative of the "market as a whole".[142] In the United States' view, the Philippines takes out of context the Panel's statements concerning the reliability of the methodological sample used in the cross-price elasticity studies. In addition, the Panel expressly found that the Philippine market is not segmented in the manner suggested by the Philippines, and that many consumers can purchase imported distilled spirits on special occasions.[143] For the United States, the Panel correctly held that Article III:2, second sentence, "does not protect just *some* instances or *most* instances, but rather, it protects *all* instances of direct competition".[144]

80. Fifth, the United States posits that the Panel correctly held that there is potential competition between domestic and imported distilled spirits in the Philippine market. The United States maintains that direct competition under Article III:2, second sentence, does not require "some minimum threshold amount of actual competition", because two products may be "directly competitive or substitutable" even if direct competition is only potential and is not occurring at the present time.[145]

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[139]United States' appellee's submission, para. 76.

[140]United States' appellee's submission, para. 78. (original emphasis)

[141]United States' appellee's submission, para. 81 (quoting Panel Reports, para. 7.121). (original emphasis)

[142]United States' appellee's submission, para. 87 (quoting Philippines' appellant's submission, para. 117).

[143]United States' appellee's submission, para. 88 (referring to Panel Reports, paras. 7.118 and 7.119).

[144]United States' appellee's submission, para. 88 (quoting Panel Reports, para. 7.120 (original emphasis)).

[145]United States' appellee's submission, paras. 83 and 84.

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The assessment of potential competition is particularly important in situations like the present case, where the challenged measure has the effect of "freezing consumer preferences" by imposing significant costs on the purchase of imported distilled spirits.[146] The United States further submits that the observed price overlaps for both low- and high-priced products undermine the Philippines' allegation that the market is divided into two distinct segments.[147] According to the United States, the Panel properly relied on evidence of similarity in product characteristics, marketing, and end-uses in finding that domestic and imported distilled spirits have the potential to be directly competitive or substitutable.[148] Therefore, the Panel did not exceed its discretion under Article 11 of the DSU in reaching its finding.

81. Finally, the United States argues that the Panel did not act inconsistently with Article 11 of the DSU, because it adequately examined the economic studies on substitutability and drew appropriate conclusions on the basis of that evidence. The Panel's conclusion that there was a significant degree of competitiveness or substitutability between domestic and imported distilled spirits in the Philippine market was based on a variety of evidence, including market studies, similarity of marketing campaigns, labelling, and sales locations.[149] Moreover, the Panel "thoroughly weighed" both the *Euromonitor International* and Abrenica & Ducanes studies, including concerns with their methodologies.[150] The United States also notes that the sample used in the *Euromonitor International* survey was adjusted in a manner that allowed for closer alignment with the overall Filipino population, and that respondents indicated that they would be more likely to purchase an imported brand if the price differential were smaller.[151] Moreover, the Abrenica & Ducanes study supports the Panel's findings on substitutability, because it does show substitutability in spite of persistent price gaps between imported and domestic products, and other factors such as brand loyalty.

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[146]United States' appellee's submission, para. 85 (quoting Panel Reports, para. 7.106, in turn quoting Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 119 and 120; and Panel Report, *Chile – Alcoholic Beverages*, para. 7.25).

[147]United States' appellee's submission, para. 86.

[148]United States' appellee's submission, para. 137 (referring to Panel Reports, paras. 7.127, 7.129, and 7.131).

[149]United States' appellee's submission, para. 118 (referring to Panel Reports, para. 7.51; and quoting para. 7.61).

[150]United States' appellee's submission, para. 120.

[151]United States' appellee's submission, paras. 121 and 122 (referring to *Euromonitor International* survey, *supra*, footnote 37, pp. 6 and 30).

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(b) "So as to afford protection to domestic production"

82. The United States argues that the Panel did not err in finding that the dissimilar taxes imposed on imported distilled spirits and on directly competitive or substitutable domestic distilled spirits are applied "so as to afford protection to domestic production" of distilled spirits. The United States requests the Appellate Body to dismiss the Philippines' appeal in this respect, and to uphold the Panel's finding.

83. The United States submits that the Panel correctly focused on the "magnitude of the difference in taxation between domestic and imported goods, and also the design, structure and application" of the measure at issue.[152] The Panel rightly observed that the design, architecture, and structure of the measure are such that the designated raw materials from which a distilled spirit must be made in order to enjoy the lower tax are all grown in the Philippines, and that the vast majority of imported distilled spirits are not made from designated raw materials. Thus, the Panel was correct in finding that "*de facto* the measure results in all domestic distilled spirits enjoying the favourable low tax, while the vast majority of the imported spirits are subject to higher taxes."[153] The United States stresses that the magnitude of the tax differential applied to imported products, which is ten to forty times higher than taxes on domestic products, is sufficient to show that the measure protects Philippine production of distilled spirits.

84. Furthermore, the United States argues that the Panel correctly focused on the measure itself, which differentiates products according to their raw material base. The fact that Philippine producers import ethyl alcohol as an input does not undermine the Panel's conclusion that the structure of the measure favours Philippine producers of distilled spirits, which are the products at issue in the present dispute, not ethyl alcohol. In addition, although it was not necessary for the Panel to inquire into the motivation for the measure, the United States stresses that the Panel had before it statements from Philippine Government officials stating that the purpose of the measure was to protect domestic production.[154]

D. *Claim of Error by the European Union – Other Appellant*

85. The European Union claims that the Panel erred in characterizing its claims under Article III:2, second sentence, of the GATT 1994 as made in the "alternative" to its claims under the

[152] United States' appellee's submission, para. 93.

[153] United States' appellee's submission, para. 93 (quoting Panel Reports, para. 7.182 (original emphasis)).

[154] United States' appellee's submission, paras. 97 and 98 (referring to, for example, a letter from the Philippines Department of Trade and Industry, dated 11 May 2009 (Panel Exhibit US-11)).

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first sentence of that provision. According to the European Union, in failing to make findings in relation to the European Union's claims under Article III:2, second sentence, of the GATT 1994, the Panel acted inconsistently with Articles 7.1, 7.2, and 11 of the DSU, and exercised false judicial economy, thereby acting inconsistently with Articles 3.7 and 21.1 of the DSU. Accordingly, the European Union requests the Appellate Body to reverse the Panel's characterization of its claim under Article III:2, second sentence, as "alternative", to complete the legal analysis with respect to the European Union's claims under that provision, and to find that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994.

86. Referring to the specific language used in its request for the establishment of a panel[155], its first written submission to the Panel[156], and its responses to Panel questions[157], the European Union maintains that it made "two *separate and independent*" claims under the first and second sentences of Article III:2, which it characterized as "main" claims.[158] The European Union's statement that, the Panel "would not necessarily need to analyse a breach of the second sentence" if it were to find a breach of the first sentence of Article III:2, referred to the "consequential" nature of the European Union's claims under these provisions, insofar as "directly competitive or substitutable" products are a subset of "like products".[159] Thus, a finding of breach under Article III:2, first sentence, would "almost automatically" lead to a finding of breach of the second sentence of the same provision.[160]

87. According to the European Union, in failing to address its claims under Article III:2, second sentence, of the GATT 1994, the Panel acted inconsistently with Articles 7.1 and 7.2 of the DSU, which requires panels to "respect their terms of reference and to address all the relevant provisions of the WTO Agreements cited by the parties".[161] In addition, the Panel acted inconsistently with Article 11 of the DSU because it failed to make an objective assessment of the matter before it and declined to make findings that would have assisted the DSB in making the recommendations or

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[155]European Union's other appellant's submission, paras. 8 and 9 (referring to Request for the Establishment of a Panel by the European Union, WT/DS396/4, p. 3).

[156]European Union's other appellant's submission, paras. 10-18 (referring to European Union's first written submission to the Panel, paras. 48-52 and 192).

[157]European Union's other appellant's submission, paras. 19-23 (referring to European Union's response to Panel Question 18, paras. 11 and 12; and referring to European Union's response to Panel Question 64).

[158]European Union's other appellant's submission, para. 20. (original emphasis)

[159]European Union's other appellant's submission, para. 17 (referring to European Union's first written submission to the Panel, para. 52).

[160]European Union's other appellant's submission, para. 17. The European Union also made a "subordinate claim" that each type of imported and domestic distilled spirit (gin, brandy, rum, whisky, tequila and tequila-flavoured spirits) was "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994. (European Union's response to Panel Question 18, para. 12)

[161]European Union's other appellant's submission, para. 31.

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rulings required.[162] Finally, the European Union suggests that the Panel's analysis of the United States' claim under Article III:2, second sentence, of the GATT 1994, which considers arguments made by the European Union and is an integral part of the Panel Reports in this dispute, provide the Appellate Body with sufficient "factual findings of the Panel and/or undisputed facts in the record" to enable it to complete the legal analysis in relation to the European Union's claims under Article III:2, second sentence, of the GATT 1994.[163]

E. *Arguments of the Philippines – Appellee*

88. The Philippines considers that the European Union's claim on appeal "does not contribute to the substantive adjudication of the legal matter" before the Appellate Body in this dispute.[164] In light of the Philippines' appeal of the Panel's findings on the United States' substantive claim under Article III:2, second sentence, of the GATT 1994, the Philippines contends that the merits of the European Union's other appeal will be fully addressed by the Appellate Body regardless of how the Appellate Body considers the European Union's claim on appeal. Accordingly, the Philippines "does not submit any particular arguments for or against" the European Union's other appeal.[165]

F. *Arguments of the Third Participants*

1. Australia

89. Australia agrees with the Philippines that the term "like" under Article III:2, first sentence, of the GATT 1994 should be construed narrowly. However, in Australia's view, this does not mean that any physical difference would necessarily disqualify a product from being considered "like" another product. The panel in *Japan – Alcoholic Beverages II* identified the appropriate standard in that case to be "*[s]ubstantial noticeable differences* in physical characteristics".[166] Moreover, assessing the significance of differences in physical characteristics between products should not be limited to consideration of a single characteristic, but should be an assessment based on all the physical characteristics of the products at issue, such as, appearance, ingredients, flavour, and smell. According to Australia, the facts in this dispute indicate that the raw materials used in the products do

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[162]The European Union also suggests that, to the extent that the Panel's failure to address the European Union's claim under Article III:2, second sentence, constituted an application of the principle of judicial economy, the European Union submits that this would amount to "false application of that principle", inconsistent with Articles 3.7 and 21.1 of the DSU. (European Union's other appellant's submission, para. 35)

[163]European Union's other appellant's submission, paras. 40-49 (quoting Appellate Body Report, *Australia – Salmon*, para. 118).

[164]Philippines' appellee's submission, para. 2.

[165]Philippines' appellee's submission, para. 3.

[166]Australia's third participant's submission, para. 6 (quoting Panel Report, *Japan – Alcoholic Beverages II*, para. 6.23). (emphasis added by Australia)

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not materially alter consumer perception of the product. Rather, consumer perception appears to be affected by the appearance, taste, and smell of the product, as well as its marketing as a particular type of spirit, such as, brandy, gin, etc.

90. With regard to the Philippines' appeal of the Panel's finding under Article III:2, second sentence, of the GATT 1994, Australia notes that the panel in *Japan – Alcoholic Beverages II* found that "the decisive criterion" in determining whether products are "directly competitive or substitutable" "is whether they have common end uses, *inter alia*, as shown by elasticity of substitution".[167] In this regard, the facts in this dispute indicate that domestically produced and imported distilled spirits are marketed as the same "type" of spirit, often using similar packaging and branding, and that the nature and content of the products' marketing strategies seem to indicate that they are competing in a similar market segment.

91. Australia disagrees with the Philippines' contention that products purchased on "special occasions" cannot directly compete with more frequently purchased "everyday" products, and notes that previous panels have found that products with different NRPs can be "directly competitive" even if the products are not purchased with the same frequency.[168] With regard to the Philippines' contention that the Panel erred by relying on speculation as to potential future competitive relationships between the products at issue, Australia observes that previous panels have taken into account evidence of both the existing market competition as well as evidence of future potential market competition between products.[169]

92. With regard to the relationship between the first and second sentences of Article III:2 of the GATT 1994, Australia agrees with the Appellate Body's finding in *Korea – Alcoholic Beverages* that "like products" are a subset of directly competitive or substitutable products and, therefore, all "like products" are, by definition, directly competitive or substitutable.[170] Australia, however, disagrees with the European Union's assertion that, if a panel makes a finding that there has been a violation of Article III:2, first sentence, then this would "almost automatically lead to a finding of a breach of the

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[167]Australia's third participant's submission, para. 12 (quoting Panel Report, *Japan – Alcoholic Beverages II*, para. 6.22). The Appellate Body endorsed this view of the panel. (Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 25, DSR 1996:I, 97, at 117)

[168]Australia's third participant's submission, para. 14 (referring to Panel Report, *Korea – Alcoholic Beverages*, para. 10.74; Panel Report, *Chile – Alcoholic Beverages*, para. 7.37).

[169]Australia's third participant's submission, para. 15 (referring to, for example, Panel Report, *Chile – Alcoholic Beverages*, para. 7.47).

[170]Australia's third participant's submission, para. 16 (quoting Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118).

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second sentence of the same provision".[171] In Australia's view, the panel would still need to give full and separate consideration to all the elements of a claim under Article III:2, second sentence, as stated by the Appellate Body in *Japan – Alcoholic Beverages II*.[172]

93. Australia observes that the Philippines has made five separate allegations under Article 11 of the DSU in respect of its claim that the Panel failed to make an objective assessment of the facts. In this regard, Australia notes that, from a systemic perspective, it would be of concern if claims under Article 11 were, in effect, requiring the Appellate Body to "second-guess a panel's conclusions".[173]

2. Mexico

94. Mexico considers that the Panel's analysis of "likeness" was adequate with regard to its finding that the imported and domestic distilled spirits at issue in this dispute are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994. Mexico notes, however, that the Panel's analysis was made in the context of the facts of this dispute and in the context of the Philippines' distilled spirits market in particular. According to Mexico, a "like product" analysis in any other context has to take into account the specific circumstances of each case.[174] Mexico cites, as an example, tequila produced in Mexico, which is made from agave and is combined with up to 49 per cent of other sugars, and is protected by a recognized appellation of origin in many countries. Mexico contends that such a situation could be decisive when analyzing the properties, nature, and quality of the product as well as its end-uses and consumer tastes and habits in the context of a market other than the one at issue in this dispute, or with regard to different provisions of the *WTO Agreement*.[175]

95. With regard to the Philippines' appeal of the Panel's finding under Article III:2, second sentence, of the GATT 1994, Mexico considers that the Panel's analysis of "directly competitive and substitutable products" was adequate, and submits that the Appellate Body should confirm the Panel's conclusion that the Philippines has acted inconsistently with this provision.[176]

[171] Australia's third participant's submission, para. 17 (quoting European Union's other appellant's submission, para. 17).

[172] Australia's third participant's submission, para. 19 (quoting Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 24, DSR 1996:I, 97, at 116).

[173] Australia's third participant's submission, para. 22.

[174] Mexico's third participant's submission, para. 10.

[175] Mexico's third participant's submission, para. 9.

[176] Mexico's third participant's submission, para. 14.

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III. Issues Raised in This Appeal

96. The following issues are raised in this appeal:

(a) whether the Panel erred in finding that the Philippines has acted inconsistently with Article III:2, first sentence, of the GATT 1994 by applying to imported distilled spirits made from raw materials other than those designated in its legislation internal taxes in excess of those applied to "like" domestic distilled spirits made from designated raw materials, and in particular:

(i) whether the Panel erred in finding that each type of imported distilled spirit at issue in this dispute—gin, brandy, vodka, whisky, and tequila—made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials[177] within the meaning of Article III:2, first sentence, of the GATT 1994;

(ii) whether the Panel erred in finding that all the distilled spirits at issue, whether imported or domestic, and irrespective of the raw materials from which they are made, are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994; and

(iii) whether the Panel, in finding that the products at issue are "like" within the meaning of Article III:2, first sentence, of the GATT 1994, acted inconsistently with its duties under Article 11 of the DSU in its assessment of: (1) the products' physical characteristics; (2) the Philippine market for distilled spirits; and (3) tariff classification;

(b) whether the Panel erred in characterizing the European Union's claim under Article III:2, second sentence, of the GATT 1994 as made in the "alternative" to its claim under the first sentence of Article III:2, and consequently acted inconsistently with Articles 7.1, 7.2, and 11 of the DSU in abstaining from making findings in relation to the European Union's claim under Article III:2, second sentence, of the GATT 1994; and

[177] Domestic distilled spirits made from designated raw materials include also tequila-flavoured spirits.

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(c) whether the Panel erred in finding that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994 by applying dissimilar taxation to imported distilled spirits made from non-designated raw materials and to "directly competitive or substitutable" domestic distilled spirits made from designated raw materials, so as to afford protection to domestic production, and in particular:

(i) whether the Panel erred in finding that all the distilled spirits at issue, whether imported or domestic, and irrespective of the raw materials from which they are made, are "directly competitive or substitutable" products within the meaning of Article III:2, second sentence, of the GATT 1994;

(ii) whether the Panel acted inconsistently with its duties under Article 11 of the DSU in reaching its finding that the imported and domestic distilled spirits at issue, irrespective of the raw material from which they are made, are "directly competitive or substitutable" products within the meaning of Article III:2, second sentence, of the GATT 1994; and

(iii) whether the Panel erred in finding that dissimilar taxation imposed by the Philippines on imported distilled spirits and on "directly competitive or substitutable" domestic distilled spirits is applied "so as to afford protection" to Philippine domestic production of distilled spirits.

IV. Background

A. *The Measure at Issue*

97. The measure at issue in this dispute is the excise tax regime in force in the Philippines as it applies to distilled spirits. The Panel referred to it as the "excise tax".[178] Under the measure at issue,

[178]Panel Reports, para. 2.1.

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taxes are collected on distilled spirits in accordance with the criteria set out in Section 141 of the Philippines' National Internal Revenue Code of 1997 (the "NIRC"), as amended.[179]

98. Under Section 141(a) of the NIRC, distilled spirits are subject to a specific flat tax rate if two requirements are met: (i) the distilled spirits are produced from one of the following raw materials—sap of the *nipa*, coconut, cassava, *camote*, *buri* palm, or from juice, syrup, or sugar of the cane (collectively referred to as "designated raw materials"[180]); and (ii) the designated raw materials are produced commercially in the country where they are processed into distilled spirits. As from 1 January 2011, the flat rate set out in Section 141(a) is 14.68 Philippine pesos ("PHP") per proof litre ("ppl").[181]

99. Under Section 141(b) of the NIRC, all distilled spirits that do not meet either of the requirements set forth above are subject to three different tax rates that apply depending on the net retail price ("NRP") of a 750 millilitre ("ml") bottle of the spirit.[182] As from 1 January 2011, distilled spirits falling under Section 141(b) are subject to a tax of: (i) PHP 158.73 ppl[183], if their NRP is less than PHP 250; (ii) PHP 317.44 ppl[184], if their NRP is between PHP 250 and PHP 675; or (iii) PHP 634.90 ppl[185], if their NRP is more than PHP 675.[186]

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[179]Panel Reports, para. 2.2. Amendments to the NIRC and other relevant regulations to this dispute include: Section 1 of Republic Act No. 9334; Republic Act No. 8240; *Revenue Regulations No. 02-97 Governing Excise Taxation on Distilled Spirits, Wines and Fermented Liquors*; *Revenue Regulations No. 17-99 Implementing Sections 141, 142, 143 and 145(A) and (C)(1), (2), (3) and (4) of the National Internal Revenue Code of 1997*; *Revenue Regulations No. 9-2003 Amending Certain Provisions of Revenue Regulations No. 1-97 and Revenue Regulations No. 2-97*; *Revenue Regulations No. 23-2003 Implementing the Revised Tax Classification of New Brands of Alcohol Products and Variants Thereof*; *Revenue Regulations No. 12-2004 Providing for the Revised Tax Rates on Alcohol and Tobacco Products*; and *Revenue Regulations No. 3-2006 Prescribing the Implementing Guidelines on the Revised Tax Rates on Alcohol and Tobacco Products*. (Panel Reports, para. 2.1)

[180]Panel Reports, para. 2.3.

[181]Equivalent to approximately US$0.34 ppl. All the tax rates under Section 141 of the NIRC are set in "proof litres". Since distilled spirits have different alcohol contents (proof) and bottle volumes, the specific excise tax applicable to a particular spirit will vary depending on these factors. Under Philippine law, a "proof litre" is defined as a "liquor containing one-half (½) of its volume of alcohol of a specific gravity of seven thousand nine hundred and thirty-nine ten thousandths (0.7939) at fifteen degrees centigrade (15°C)". (See Republic Act 9334, p. 3, submitted as Panel Exhibits EU-2, US-2, and PH-4. See also European Union's first written submission to the Panel, footnote 18 to para. 15) The "proof" of an alcoholic beverage is equal to twice its alcohol content by volume.

[182]Panel Reports, para. 2.4.

[183]Equivalent to approximately US$3.68 ppl.

[184]Equivalent to approximately US$7.36 ppl.

[185]Equivalent to approximately US$14.72 ppl.

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100. According to the evidence before the Panel, all distilled spirits produced in the Philippines are made from designated raw materials—more precisely, from one designated raw material: sugar cane—and based on ethyl alcohol processed either in the Philippines or in other countries where sugar cane is produced commercially. Accordingly, all distilled spirits produced domestically are subject to the flat tax rate under Section 141(a) (PHP 14.68 ppl). In contrast, the vast majority of distilled spirits imported into the Philippines are processed from raw materials other than those designated, and are therefore subject to one of the three tax rates set out in Section 141(b) (PHP 158.73 ppl, PHP 317.44 ppl, or PHP 634.90 ppl, depending on their NRP).

101. The classification and applicable tax of brands of distilled spirits is generally indicated in annexes to relevant acts and regulations, and is overseen by the Philippines' Bureau of Internal Revenue ("BIR"). Once a specific brand has been classified as falling under Section 141(a) or Section 141(b), a reclassification of that brand may not occur except through an Act of Congress. However, if a taxpayer considers that the classification has not been made correctly, that taxpayer may request a ruling from the Commissioner of Internal Revenue and, in case of an adverse decision, seek review by the Secretary of Finance.[187]

B. *The Products at Issue*

102. All products at issue in the present dispute are distilled spirits, and in particular the following types: gin, brandy, rum, vodka, whisky, tequila, and tequila-flavoured spirits. Distilled spirits are defined as concentrated forms of potable alcohol obtained through the process of distillation.[188] Combined, ethyl alcohol and water account for more than 99 per cent of the content of all distilled spirits. The average alcohol content ranges from 25 to 40 per cent by volume (or 50 to 80 proof). Spirits of the same type tend to have similar alcohol content.[189] The distillation process starts with the fermentation of feedstock—that is, any raw material that contains natural sugar or other carbohydrates that can be converted into sugar, such as, sugar cane molasses, sugar beet, roots, juice of grapes, or mash of grains or cereals. Different chemical compounds, called "congeners", are formed during the process of fermentation. These congeners confer the typical organoleptic properties—flavour, aroma,

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[186]In order to illustrate how the Philippines' excise tax system operates concretely, the Panel provided the following two examples: (i) under Section 141(a) of the NIRC, a 750 ml bottle of 80 per cent proof whisky made from a designated raw material would be subject to a tax of PHP 8.81; and (ii) under Section 141(b) of the NIRC, a 750 ml bottle of 86 per cent proof whisky made from a non-designated raw material and sold at an NRP of between PHP 250 and PHP 675 would be subject to a tax of PHP 204.75. (Panel Reports, footnote 33 to para. 2.5)

[187]Panel Reports, paras. 2.15 and 2.16.

[188]Panel Reports, para. 2.22.

[189]Panel Reports, para. 2.22 (referring to European Union's first written submission to the Panel, para. 84).

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and colour—upon a specific distilled spirit. Levels and combinations of various congeners differ according to the type of spirit. The typical organoleptic properties of certain distilled spirits—such as brandy, rum, whisky, or tequila—depend on the raw materials used in their production, as well as on post-distillation processes such as ageing, blending, filtering, diluting with water, and incorporating additional flavourings. For other types of distilled spirits—such as gin and vodka—the ethyl alcohol is normally stripped of its congeners so as to obtain a neutral spirit.

103. It was not disputed before the Panel that all distilled spirits, irrespective of their origin or of the raw materials used in their production, have the same end-uses in the Philippines, which the Panel described as "thirst quenching, socialization, relaxation, pleasant intoxication".[190] They can be drunk straight or with ice, diluted with soft drinks or fruit juices or used in the preparation of cocktails. In the Philippines, premium distilled spirits are largely consumed in restaurants, bars, pubs, clubs, and discotheques, whereas less expensive distilled spirits are mostly consumed in private homes.[191]

104. The Panel found that the vast majority of the distilled spirits imported into the Philippines are produced by distilling different raw materials, none of which is a "designated raw material" under Section 141(a) of the NIRC, with the exception of rum, which is processed from the fermentation of sugar cane. More specifically, gin is produced "by redistilling a high proof neutral spirit with juniper berries and other botanicals"[192]; brandy is produced "from the fermentation of grapes" or "the distillation of wine or fortified wine"[193]; vodka is a "neutral spirit" that can be produced "from the distillation of many different products, such as wheat, beets, corn, rye, potatoes, grapes or sugar cane"[194]; whisky is produced "from the distillation of a mash of cereals or grains"[195]; and tequila is "traditionally produced in Mexico from the fermentation of the agave plant".[196]

105. In contrast, all the distilled spirits produced in the Philippines are made from sugar cane, one of the "designated raw materials" under Section 141(a). The ethyl alcohol distilled from sugar cane molasses is normally stripped of its natural congeners so as to obtain a neutral spirit. Subsequently, flavouring, essences, and other ingredients are added to the neutral spirit in order to give it the organoleptic properties typically associated with the specific distilled spirit concerned. The only exception is rum, whose production process, as outlined above, is identical in the Philippines and

[190]Panel Reports, para. 2.38 (quoting European Union's first written submission to the Panel, para. 64).
[191]Panel Reports, para. 2.40 (referring to Philippines' first written submission to the Panel, paras. 263-266).
[192]Panel Reports, para. 2.55.
[193]Panel Reports, para. 2.62.
[194]Panel Reports, para. 2.75.
[195]Panel Reports, para. 2.81.
[196]Panel Reports, para. 2.87.

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elsewhere. For this reason, the parties agree, and the Panel found, that rum produced in the Philippines and imported rum are "like products".[197]

106. All the distilled spirits relevant to this dispute fall under heading 2208 of the Harmonized Commodity Description and Coding System of the World Customs Organization ("HS"). This four-digit heading refers to "undenatured ethyl alcohol of an alcoholic strength by volume of less than 80% vol; spirits, liqueurs and other spirituous beverages".[198] At the six-digit level, the HS classifies distilled spirits under different subheadings:

Heading	HS 6-digit Code	Description
22.08		Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80% vol; spirits, liqueurs and other spirituous beverages
	2208.20	- Spirits obtained by distilling grape wine or grape marc
	2208.30	- Whiskies
	2208.40	- Rum and other spirits obtained by distilling fermented sugarcane products
	2208.50	- Gin and Geneva
	2208.60	- Vodka
	2208.70	- Liqueurs and cordials
	2208.80	- Other

107. The content of the six-digit HS subheadings in question is clarified in the Explanatory Note accompanying the HS ("HSEN") to HS heading 2208 as follows:

> [Heading 2208] includes, *inter alia*:
>
> (1) Spirits obtained by distilling grape wine or grape marc (Cognac, Armagnac, brandy, grappa, pisco, singani, etc.).
>
> (2) Whiskies and other spirits obtained by distilling fermented mash of cereal grains (barley, oats, rye, wheat, corn, etc.).

[197]Panel Reports, para. 2.69 (referring to European Union's first written submission to the Panel, para. 97; United States' first written submission to the Panel, para. 30; and Philippines' first written submission to the Panel, para. 171). While the Panel noted that the parties agree that all rums at issue in the present dispute are "like products", it observed that some brands of imported rum, albeit made from sugar cane—one of the designated raw materials—are subject to the higher excise tax rates provided for in Section 141(b) of the NIRC. (*Ibid*., para. 2.74)

[198]Panel Reports, para. 2.49. (footnote omitted)

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> (3) Spirits obtained exclusively by distilling fermented products of the sugar cane (sugar-cane juice, sugar-cane syrup, sugar-cane molasses), e.g., rum, tafia, cachaça.
>
> (4) Spirituous beverages known as gin or Geneva, containing the aromatic principles of juniper berries.
>
> (5) Vodka obtained by distilling fermented mash of agricultural origin (e.g., cereals, potatoes) and sometimes further treated with activated charcoal or carbon.[199]

108. Based on the HSEN to HS heading 2208, brandy and whisky are classified at the HS six-digit level depending on the raw materials from which they are made. Brandy is one of the "[s]pirits obtained by distilling grape wine or grape marc" (HSEN to subheading 2208.20), while whisky is defined as a "spirit[] obtained by distilling fermented mash of cereal grains" (HSEN to subheading 2208.30). Rum is defined in HS subheading 2208.40 and in the relevant HSEN as a "[s]pirit[] obtained by distilling fermented sugarcane products" and, specifically, sugar cane molasses.[200] Vodka is described as a spirit obtained by distilling "fermented mash of agricultural origin", with "cereals" and "potatoes" indicated as examples (HSEN to subheading 2208.50), thus not excluding vodka made from other raw materials. Gin is described as a spirituous beverage "containing the aromatic principles of juniper berries", but with no reference to its raw material base (HSEN to subheading 2208.60). There is no six-digit HS subheading for "tequila" or "tequila-flavoured spirits".

V. Article III:2, First Sentence, of the GATT 1994

109. We begin with the Philippines' appeal of the Panel's findings that imported distilled spirits made from non-designated raw materials and domestic distilled spirits made from designated raw materials are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994 and that, as a consequence, by subjecting imported distilled spirits made from non-designated raw materials to internal taxes in excess of those applied to "like" domestic distilled spirits made from designated raw materials, the Philippines acts in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

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[199]Panel Reports, para. 2.53 (referring to Harmonized Commodity Description and Coding System, Explanatory Notes, 4th edn (WCO, 2007), p. IV-2208-1 (Panel Exhibit PH-46)).

[200]Panel Reports, para. 7.67.

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110. Specifically, the Philippines challenges the Panel's findings that: (i) all distilled spirits at issue in this dispute are "like products", whether imported or domestic, and irrespective of the raw materials from which they are made; and (ii) each type of imported distilled spirit at issue in this dispute made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials.

111. We address first the Philippines' appeal of the Panel's finding that each type of imported distilled spirit at issue in this dispute made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials. In so doing, we review the Panel's findings on the specific factors it examined in its analysis of "likeness" under Article III:2, first sentence, of the GATT 1994. Second, we consider the Panel's finding that all the distilled spirits at issue in the present dispute, whether imported or domestic, and irrespective of the raw materials from which they are made, are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994.[201]

A. *The Panel's Finding that Each Type of Imported Distilled Spirit Made from Non-Designated Raw Materials is "Like" the Same Type of Domestic Distilled Spirit Made from Designated Raw Materials*

112. The Panel found that each of the types of imported distilled spirit at issue in this dispute made from non-designated raw materials—namely, gin, brandy, vodka, whisky, and tequila—is "like" the same type of domestic distilled spirit made from designated raw materials.[202] In other words, the Panel found that within each different type of distilled spirit there is "likeness", within the meaning of Article III:2 of the GATT 1994, between imported distilled spirits made from non-designated raw materials and domestic distilled spirits made from designated raw materials.

113. The Panel addressed the "likeness" requirement of Article III:2, first sentence, of the GATT 1994 by considering evidence with respect to: (i) the products' properties, nature, and quality, that is, their physical characteristics; (ii) end-uses in the Philippines; (iii) Philippine consumers' tastes and habits; (iv) tariff classification; and (v) relevant Philippine internal regulations. No claims are raised on appeal concerning the Panel's finding that all distilled spirits at issue in this dispute share the same end-uses in the Philippines, namely "thirst quenching, socialization, relaxation, pleasant intoxication".[203]

[201]Panel Reports, para. 7.77.
[202]Panel Reports, para. 7.85. The Panel observed that all parties agreed that both domestic and imported rums were made from the same raw material (sugar cane) and were "like products". (*Ibid*., para. 7.79)
[203]Panel Reports, para. 7.48 (quoting European Union's first written submission to the Panel, para. 64).

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1. The Products' Physical Characteristics

114. We begin by considering the Philippines' claims in respect of the Panel's assessment of the products' physical characteristics. First, we address the Philippines' claim that the Panel erred in its interpretation of the term "like … products" in Article III:2 of the GATT 1994 with respect to the products' physical characteristics. Second, we address the relevance of the raw material base in the determination of whether two products are "like" within the meaning of Article III:2. Third, we address the Philippines' claim that, by applying a "perceptible differences test", the Panel applied the wrong standard to assess the similarity of physical characteristics and thus acted inconsistently with Article III:2, first sentence, of the GATT 1994. Finally, we address the Philippines' claim that the Panel acted inconsistently with Article 11 of the DSU in its assessment of the products' physical characteristics.

Interpretation of the Term "Like Products" with Respect to the Products' Physical Characteristics

115. The Philippines claims that the Panel's statement that the concept of "like products" is not limited to "identical products" is inconsistent with the Appellate Body's narrow definition of "like products" under Article III:2, first sentence, of the GATT 1994. The Philippines argues that the test that should have been applied is whether the products are "sufficiently close" in nature that they can be deemed to fit within the narrow category of "like" within the meaning of Article III:2, as interpreted by the Appellate Body.[204] According to the Philippines, the narrow scope of the category of "like products" means that any significant physical difference will be considered sufficient to disqualify a product from being considered "like" another product.[205]

116. The European Union and the United States disagree with the Philippines' contention that the narrow scope of the term "like products" implies that any significant physical difference will be sufficient to disqualify a product from being considered "like" another product.[206] The European Union and the United States argue that the Philippines overstates the importance of physical characteristics, particularly the differences in chemical composition, in the analysis of "likeness" in relation to other factors.[207]

[204]Philippines' appellant's submission, para. 29 (referring to Panel Reports, para. 7.32).
[205]Philippines' appellant's submission, para. 30.
[206]European Union's appellee's submission, paras. 45 and 52; United States' appellee's submission, para. 25.
[207]European Union's appellee's submission, para. 45; United States' appellee's submission, para. 30.

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117. Article III:2, first sentence, of the GATT 1994 states:

> The products of the territory of any Member imported into the territory of any other Member shall not 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.

118. The Panel recalled that, in *Japan – Alcoholic Beverages II*, the Appellate Body found that the definition of "like products" under Article III:2, first sentence, must be construed narrowly. The Panel understood this statement by the Appellate Body as meaning that likeness under the first sentence of Article III:2, while narrow, is not limited to products that are identical.[208] The Panel reasoned that, "had this sentence intended to cover only identical products, the agreement would have used the word 'identical', instead of using the expression 'like products'" and noted that "[l]ikewise the Appellate Body, in describing like products, has never indicated that the first sentence covers only identical products".[209] In keeping with the case-by-case approach adopted by the Appellate Body in previous disputes, the Panel stated that it would consider whether the products at issue in this dispute are "like", within the meaning of Article III:2, first sentence, of the GATT 1994, by examining all relevant factors[210], including: the products' physical characteristics; their end-uses in the Philippines; Philippine consumers' tastes and habits; the tariff classification of the products; and relevant internal regulations in the Philippines.

119. While in the determination of "likeness" a panel may logically start from the physical characteristics of the products, none of the criteria that a panel considers necessarily has an overarching role in the determination of "likeness" under Article III:2 of the GATT 1994. A panel examines these criteria in order to make a determination about the nature and extent of a competitive relationship between and among the products.[211]

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[208]Panel Reports, para. 7.32.

[209]Panel Reports, para. 7.32.

[210]The 1970 Report of the Working Party on *Border Tax Adjustments* identified the following criteria for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality. (Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18.). Subsequent panels and the Appellate Body found that other criteria, such as tariff classification, may also assist a panel in evaluating whether products are "like" within the meaning of Article III:2, first sentence, of the GATT 1994. See, GATT Panel Report, *Japan – Alcoholic Beverages I*, para. 5.6; and Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 21-22, DSR 1996:I, 97, at 114-115.

[211]In *EC – Asbestos* the Appellate Body found that "a determination of 'likeness' under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products". (Appellate Body Report, *EC – Asbestos*, para. 99)

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120. We understand that products that have very similar physical characteristics may not be "like", within the meaning of Article III:2, if their competitiveness or substitutability is low, while products that present certain physical differences may still be considered "like" if such physical differences have a limited impact on the competitive relationship between and among the products.

121. In this respect, we do not consider, as the Philippines argues, that the Panel committed an error of interpretation when it found that "likeness under the first sentence of Article III:2 is not limited to products that are identical".[212] This statement by the Panel may provide only a partial view of what is entailed in a determination of "likeness" under Article III:2 of the GATT 1994. However, it is consistent with the notion that, while physical characteristics are one of the relevant criteria in the determination of "likeness" under Article III:2, even products that present certain differences may still be considered "like" if the nature and extent of their competitive relationship justifies such a determination.

122. For the reasons explained above, we disagree with the Philippines' arguments that the narrow scope of the category of "like products" means that any significant physical difference will necessarily be considered sufficient to disqualify a product from being considered "like" another product[213] and that, in this case, "the simple fact that sugar-based spirits in the Philippines are physically different from their non-sugar-based counterparts should have been viewed by the Panel as disqualifying these products from being considered physically 'like'".[214]

Relevance of the Raw Material Base in the Determination of "Likeness"

123. Turning to the Panel's assessment of the physical characteristics of the distilled spirits at issue, the Philippines claims that, because of differences in chemical composition, which affect the distilled spirits' taste, flavour and aroma, distilled spirits made from designated raw materials and distilled spirits made from non-designated raw materials are not physically similar.[215] The Panel found that for each type of distilled spirit—gin, brandy, vodka, whisky, tequila and tequila-flavoured spirits—there is similarity in physical characteristics between imported distilled spirits and domestic Philippine distilled spirits, irrespective of the raw materials from which they are made.[216] The Panel emphasized the fact that the production process for each type of distilled spirit made from designated raw materials in the Philippines is designed to ensure, as far as possible, that the final Philippine

[212]Panel Reports, para. 7.32.
[213]Philippines' appellant's submission, para. 30.
[214]Philippines' appellant's submission, para. 39.
[215]Philippines' appellant's submission, para. 31.
[216]Panel Reports, para. 7.80.

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product has similar organoleptic properties (colour, flavour and aroma) as the same type of imported distilled spirit made from non-designated raw materials.[217]

124. The Panel considered that a difference in raw materials used in the production would only be relevant to the extent that it resulted in final products that are not similar. The Panel followed the approach of the panel in *Mexico – Taxes on Soft Drinks*, which had found that soft drinks and syrups sweetened with cane sugar, and soft drinks and syrups sweetened with non-cane sugar sweeteners (high-fructose corn syrup and beet sugar), are "like products" in spite of the differences in raw materials. Thus, the Panel focused on the physical characteristics of distilled spirits as final products, and not on those of the raw materials or production processes used to make the final products.[218]

125. We consider that, in spite of differences in the raw materials used to make the products, if these differences do not affect the final products, these products can still be found to be "like" within the meaning of Article III:2 of the GATT 1994.[219] Article III:2, first sentence, refers to "like products", not to their raw material base. If differences in raw materials leave fundamentally unchanged the competitive relationship among the final products, the existence of these differences would not necessarily negate a finding of "likeness" under Article III:2. As we have explained above, the determination of what are "like products" under Article III:2 is not focused exclusively on the physical characteristics of the products, but is concerned with the nature and the extent of the competitive relationship between and among the products. We consider, therefore, that as long as the differences among the products, including a difference in the raw material base, leave fundamentally unchanged the competitive relationship among the final products, the existence of these differences does not prevent a finding of "likeness" if, by considering all factors, the panel is able to come to the conclusion that the competitive relationship among the products is such as to justify a finding of "likeness" under Article III:2.

126. As noted above, in finding physical similarities between the products at issue, the Panel attached particular importance to the fact that the production process for each type of distilled spirit made from designated raw materials in the Philippines is designed to ensure, as far as possible, that the final product has organoleptic properties similar to those of the same type of imported distilled

[217]Panel Reports, para. 7.80.

[218]Panel Reports, para. 7.37 (referring to Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.131).

[219]The panel in *Japan – Alcoholic Beverages II* found that "the term 'like products' [in Article III:2] suggests that for two products to fall under this category they must share, apart from commonality of end-uses, *essentially* the same physical characteristics" (Panel Report, *Japan – Alcoholic Beverages II*, para. 6.22 (emphasis added)). The GATT panel in *Japan – Alcoholic Beverages I* found that the fact that vodka and shochu were made of *similar* raw materials was an *indication* of the fact that they were "like products". (GATT Panel Report, *Japan – Alcoholic Beverages I*, para. 5.7)

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spirit made from non-designated raw materials.[220] To achieve this result, the ethyl alcohol produced from sugar cane molasses is stripped of its congeners to produce a neutral spirit. Special additives are added to the neutral spirit in order to ensure, as much as possible, that the resulting distilled spirit has the colour, odour, and taste traditionally associated with gin, brandy, vodka, whisky, or tequila.[221]

127. The Panel, in considering consumer perceptions, noted that the names "gin", "brandy", "vodka", "whisky", "tequila" or "tequila-flavoured spirit" are used for domestic Philippine distilled spirits, even though these are made from designated raw materials, such as sugar cane. The Panel also noted that the raw material base is not mentioned on the labels of the bottles in which the domestic distilled spirits are sold. Moreover, the Panel observed that "labels of domestic Philippine distilled spirits made from the designated raw materials tend to mimic or replicate the names of products and designs of the similar imported spirits made from other raw materials".[222]

128. The Philippines claims that domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials are not "like products". Nevertheless, every effort is made, from the production process to the sale of domestic distilled spirits made from designated raw materials, to ensure that they replicate as closely as possible the corresponding type of imported distilled spirit made from non-designated raw materials. While the Panel addressed presentation and labelling under consumers' tastes and habits, we observe that, as distilled spirits are sold in labelled bottles, their presentation and labelling are also concerned with the physical characteristics of the product and not only with the perceptions of the consumer. The fact that domestic Philippine distilled spirits made from designated raw materials closely replicate imported distilled spirits made from non-designated raw materials supports the Panel's overall finding that, within each type, these are "like products". Even where certain differences remain, domestic distilled spirits made from designated raw materials are presented to consumers so as to be indistinguishable from imported distilled spirits made from non-designated raw materials. This suggests, in our view, that even where the products are made from different raw materials and may, as a consequence, present some physical differences that are not completely eliminated in the production process, they can be in a sufficiently close competitive relationship to be considered "like products" within the meaning of Article III:2, first sentence, of the GATT 1994.

[220]Panel Reports, para. 7.80.
[221]Panel Reports, para. 2.25.
[222]Panel Reports, para. 7.61.

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Application of the "Perceptible Differences Test" to Assess the Similarity of Physical Characteristics

129. The Panel found that the differences in chemical composition of distilled spirits shown by the gas chromatography results did not assist it in its "likeness" analysis because the differences in chemical composition between distilled spirits made from the same raw materials were in most cases greater than those between distilled spirits made from different raw materials. This led the Panel to conclude that differences in chemical composition did not show a distinction between distilled spirits made from designated raw materials and those made from non-designated raw materials.[223] For each type of distilled spirit —gin, brandy, vodka, whisky, tequila and tequila-flavoured spirits—the Panel found that there was no evidence of "perceptible differences" between the physical qualities and characteristics of the imported spirit and those of the domestic Philippine spirit, nor between the physical qualities and characteristics of the spirit made from the designated raw materials and those of the spirit made from other raw materials.[224]

130. The Philippines argues that the Panel applied the wrong standard because it relied on a "perceptible differences test" from the perspective of the hypothetical consumer as the sole determinant of whether the products are physically different or not.[225] The Philippines claims that, in a "likeness" analysis, the perception of the consumer is not related to the physical characteristics of the product, which are empirical, physical attributes. Rather, according to the Philippines, the perception of the consumer is relevant to the criterion of consumer tastes and habits. The Philippines thus contends that, having selected the wrong standard, the Panel found physical similarity between "sugar-based" and "non-sugar-based" distilled spirits in spite of "numerous physical differences" between these types of distilled spirits, such as the very different levels of certain key congeners and the use of additives in "sugar-based" distilled spirits.[226]

131. We observe that the criteria to establish "likeness" under Article III:2, first sentence, of the GATT 1994 are not exhaustive and are not set forth in Article III:2, nor in any other provision of the covered agreements. Rather, these criteria are tools available to panels for organizing and assessing the evidence relating to the competitive relationship between and among the products in order to establish "likeness" under Article III:2, first sentence. While distinct, these criteria are not mutually

[223]Panel Reports, para. 7.40.
[224]Panel Reports, paras. 7.42, 7.43, 7.45, 7.46, and 7.47.
[225]Philippines' appellant's submission, para. 44.
[226]Philippines' appellant's submission, para. 38.

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exclusive.[227] Certain evidence, such as that relating to the perceptibility of differences, may well fall under more than one criterion.[228]

132. By finding that there was no evidence of "perceptible differences" in the physical characteristics of the products, the Panel appears to have focused on how the products are perceived by users in its analysis of the products' physical characteristics. While consumer perception of products is highly relevant to the overall determination of "likeness" under Article III:2, we believe that this element may reach beyond the products' properties, nature, and qualities, which concern the objective physical characteristics of the products. Indeed, consumer perception of products may be more concerned with consumers' tastes and habits than with physical characteristics.

133. However, in light of the above, while the Panel refers to "perceptible" differences only in the context of the physical characteristics of the products, we do not consider that the Panel committed an error in its analysis of the products' physical characteristics by finding that, within each type, there is physical similarity between imported and domestic distilled spirits, irrespective of whether they are made from designated raw materials or from non-designated raw materials.[229]

Article 11 of the DSU

134. As noted above, the Philippines claims, in addition, that the Panel acted inconsistently with Article 11 of the DSU, because it disregarded critical portions of the Philippines' evidence and substituted its own judgement for that of the expert testimony presented by the Philippines. Specifically, the Philippines argues that the Panel acted inconsistently with Article 11 of the DSU when it found that there was no evidence that differences in organoleptic properties create a distinction between distilled spirits made from designated raw materials and distilled spirits made from non-designated raw materials, and when it found that the differences in chemical composition that do exist were not of assistance in its analysis of "likeness".[230]

135. Before turning to the issues raised by the Philippines on appeal, we recall that Article 11 of the DSU requires a panel to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case". According to the Appellate Body, Article 11 of the DSU requires a panel to "consider all the evidence presented to it, assess its credibility, determine its

[227]Appellate Body Report, *EC – Asbestos*, para. 111.

[228]For instance, in *EC – Asbestos*, the Appellate Body considered health risks under a "physical characteristics" criterion as well as under the criterion of "consumers' tastes and habits". (Appellate Body Report, *EC – Asbestos*, paras. 114 and 120).

[229]Panel Reports, para. 7.75.

[230]Philippines' appellant's submission, paras. 140 and 141 (referring to Panel Reports, para. 7.40).

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weight, and ensure that its factual findings have a proper basis in that evidence."[231] Within these parameters, "it is generally within the discretion of the panel to decide which evidence it chooses to utilize in making findings"[232], and a panel "is not required to discuss, in its report, each and every piece of evidence."[233] The failure by a panel to reproduce certain material evidence in its report would not be inconsistent with Article 11 if the panel's reasoning reveals that it has nevertheless assessed the significance of this evidence.

136. Panels "are not required to accord to factual evidence of the parties the same meaning and weight as do the parties."[234] In this regard, the Appellate Body will not "interfere lightly" with a panel's fact-finding authority, and will not "base a finding of inconsistency under Article 11 simply on the conclusion that [it] might have reached a different factual finding".[235] Instead, for a claim under Article 11 to succeed, the Appellate Body must be satisfied that the panel has exceeded its authority as the initial trier of facts.[236] As the initial trier of facts, a panel must provide "reasoned and adequate explanations and coherent reasoning"[237], base its finding on a sufficient evidentiary basis[238], and treat evidence with "even-handedness".[239]

137. The Philippines presented to the Panel gas chromatography results as well as an expert study[240] (the "expert study") showing that "sugar-based" and "non-sugar-based" distilled spirits have distinct chemical compositions. This evidence shows, for example, that brandies and whiskies made from grape and grain respectively have generally a higher congener content than brandies and whiskies made from sugar cane molasses. The expert study also contains an expert opinion of the differences in taste and aroma that result from the differences in chemical composition.

138. We note that the differences in congener content are one of several factors the Panel examined in its assessment of the physical characteristics of the products at issue. The Panel did not consider that these chemical differences created a distinction between distilled spirits made from designated and distilled spirits made from non-designated raw materials, because even greater differences in congener content exist among distilled spirits made from non-designated raw

[231] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 185 (referring to Appellate Body Report, *EC – Hormones*, paras. 132 and 133).

[232] Appellate Body Report, *EC – Hormones*, para. 135.

[233] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 202.

[234] Appellate Body Report, *Australia – Salmon*, para. 267.

[235] Appellate Body Report, *US – Wheat Gluten*, para. 151.

[236] Appellate Body Report, *US – Wheat Gluten*, para. 151.

[237] Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, footnote 618 to para. 293.

[238] See Appellate Body Report, *US – Carbon Steel*, para. 148.

[239] Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, para. 292.

[240] T. Allen, "Tasting and Congener Content Analysis of 31 Distilled Spirits" (30 September 2010) (Panel Exhibit PH-30 (BCI)).

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materials.[241] The Panel thus addressed the differences in congener content among "sugar-based" and "non-sugar-based" distilled spirits, although it reached different conclusions than the expert consulted by the Philippines. In light of the above, we consider that, as the trier of facts, the Panel acted within the bounds of its discretion in attributing less weight than the Philippines did to the differences in congener content in the analysis of the physical characteristics of the products.

139. As noted above, the expert study submitted by the Philippines also maintains that the differences in congener content result in important differences in the organoleptic properties of brandies, whiskies, gins, and vodkas made from sugar cane as compared to those made from non-designated raw materials. The Panel, however, having reviewed the evidence concerning the production process of distilled spirits made from designated raw materials and the gas chromatography results, noted in paragraph 2.26 of its Reports that "there is no evidence to suggest that a non-expert consumer would be able to distinguish between imported and domestic spirits of the same type based only on the different raw materials used in their respective production". Furthermore, in paragraphs 7.39 and 7.40, having once again considered the production process of distilled spirits made from designated raw materials, and the fact that these closely replicate those made from non-designated raw materials, the Panel concluded that, in respect of colour, flavour, and aroma, there is no difference between these two categories of distilled spirits.

140. In light of the importance that the Philippines attached to the expert study on the congener content and organoleptic properties of distilled spirits, the Panel could have cited it directly and given it more prominence. However, the Panel did refer to the gas chromatography results on which the expert opinion is based.[242] On the basis of these gas chromatography results, and of the evidence concerning the production process of distilled spirits made from designated raw materials, the Panel reached the conclusion that there are no differences in the organoleptic properties of distilled spirits made from designated raw materials and distilled spirits made from non-designated raw materials. Therefore, we do not consider that the Panel's treatment of the expert study amounts, in the circumstances of this dispute, to disregarding or failing to engage with significant evidence that was relevant to the Philippines' case.

141. In light of the above, we conclude that the Panel did not disregard or fail to engage with the evidence submitted by the Philippines concerning congener content and organoleptic properties of distilled spirits, but that it acted within its discretion as the trier of facts in weighing the evidence. We

[241] Panel Reports, para. 7.40.
[242] Panel Reports, para. 7.40 and footnote 399 thereto.

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therefore consider that the Panel did not fail to make an objective assessment of the facts within the meaning of Article 11 of the DSU.

2. Consumers' Tastes and Habits

142. We now turn to the Philippines' challenge of the Panel's findings on consumers' tastes and habits. First, we address the Philippines' claim that the Panel erred in finding that the degree of competition or substitutability of the products at issue supported its overall finding of "likeness" under Article III:2, first sentence, of the GATT 1994. Second, we address the Philippines' claim that differences in distribution channels reflect the different consumer markets that distilled spirits made from designated raw materials and distilled spirits made from non-designated raw materials serve. Third, we address the Philippines' claim that, in its assessment of the Philippine market for distilled spirits, the Panel acted inconsistently with Article 11 of the DSU.

143. The Philippines contends that, in respect of consumers' tastes and habits, the Panel erred in finding that the degree of competition and substitutability among domestically produced "sugar-based" and imported "non-sugar-based" distilled spirits satisfies the higher standard of "likeness" under Article III:2, first sentence. The Philippines argues that the Panel acknowledged that a large proportion of consumers do not have access to high-priced "non-sugar-based" distilled spirits and that the competition and substitutability that exists between the two categories is limited to exceptional "special occasion" purchases.[243]

144. The European Union responds that the Philippines' distinction between high-priced imported distilled spirits and low-priced domestic distilled spirits is "incorrect", since both domestic and imported distilled spirits cover a relatively wide spectrum of prices.[244] The United States observes that the Panel drew its conclusions on consumer tastes and habits from a variety of factual elements, including that the same outlets in the Philippines that sell imported distilled spirits also sell domestic distilled spirits, the similarity in marketing campaigns of domestic and imported distilled spirits, and the overlap in price among domestic and imported distilled spirits.[245]

145. The Panel found that the evidence submitted by the parties suggest a *significant* degree of competitiveness or substitutability for distilled spirits in the Philippine market.[246] The Panel based

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[243]Philippines' appellant's submission, paras. 69-70.
[244]European Union's appellee's submission, para. 68.
[245]United States' appellee's submission, para. 40 (referring to Panel Reports, paras. 2.36, 2.41, 2.42, 7.51, and 7.59).
[246]Panel Reports, para. 7.62. (emphasis added)

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this finding on an analysis of two studies[247] (the "substitutability studies") submitted by the parties regarding consumer perceptions in the Philippine distilled spirits market, and on the analysis of the Philippine market for distilled spirits.

146. The Panel considered that both substitutability studies suggest that a simultaneous increase in the price of domestic Philippine distilled spirits and decrease in the price of imported distilled spirits, such as that which would result from an equalization in the respective levels of the excise tax, could result in the substitution of the consumption of domestic distilled spirits for imported distilled spirits in the Philippine market.[248] Regarding the Philippine distilled spirits market, the Panel noted that: (i) a large proportion of the Philippine population has a limited ability to purchase distilled spirits beyond certain price levels; (ii) there are a number of high-priced domestic Philippine distilled spirits, as well as less expensive imports; and (iii) many consumers may be able to purchase high-priced distilled spirits, at least on special occasions.[249]

147. With respect to each *type* of distilled spirit at issue, the Panel further found that manufacturers' marketing campaigns, which make no distinction between distilled spirits made from designated and non-designated raw materials, suggest a "closer similarity" than the "general similarity" it had already found between all distilled spirits relevant in the present dispute.[250] Moreover, the Panel considered that the labels of domestic Philippine distilled spirits made from designated raw materials do not suggest to the consumer that these products are different from imported distilled spirits made from non-designated raw materials.[251]

148. We observe that both the analysis of "likeness" under Article III:2, first sentence, of the GATT 1994, and the analysis of direct competitiveness and substitutability under Article III:2, second sentence, require consideration of the competitive relationship between imported and domestic products. However, "likeness" is a narrower category than "directly competitive and substitutable". Thus, the degree of competition and substitutability that is required under Article III:2, first sentence, must be higher than that under Article III:2, second sentence. On this point, we recall that, in *Canada – Periodicals*, the Appellate Body considered that a relationship of "imperfect substitutability" would still be consistent with the notion of "directly competitive or substitutable products", under the second sentence of Article III:2 of the GATT 1994, and that "[a] case of perfect

[247]*Euromonitor International* survey, *supra*, footnote 37, submitted by the European Union and the United States; and Abrenica & Ducanes, *supra*, footnote 65, submitted by the Philippines.
[248]Panel Reports, para. 7.57.
[249]Panel Reports, para. 7.59.
[250]Panel Reports, para. 7.82.
[251]Panel Reports, para. 7.82.

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substitutability would fall within Article III:2, first sentence".[252] In *Korea – Alcoholic Beverages*, the Appellate Body observed that "'like products' are a subset of directly competitive or substitutable products", so that "perfectly substitutable products fall within Article III:2, first sentence", while "imperfectly substitutable products can be assessed under Article III:2, second sentence".[253]

149. We do not understand the statements by the Appellate Body in *Canada – Periodicals* and in *Korea – Alcoholic Beverages* to mean that *only* products that are perfectly substitutable can fall within the scope of Article III:2, first sentence. This would be too narrow an interpretation and would reduce the scope of the first sentence essentially to *identical products*. Rather, we consider that, under the first sentence, products that are close to being perfectly substitutable can be "like products", whereas products that compete to a lesser degree would fall within the scope of the second sentence.

150. The Panel found that the degree of substitutability within the *types* of distilled spirits is higher than for *all* distilled spirits, because domestic distilled spirits of a particular type made from designated raw materials are marketed, presented, and labelled so as to resemble as closely as possible imported distilled spirits of the same type made from non-designated raw materials.[254] We have already found, in our discussion of the products' physical characteristics, that the fact that each type of domestic distilled spirit made from designated raw materials is produced and presented in a manner so as to replicate as closely as possible the same type of imported distilled spirit made from non-designated raw materials, supports the conclusion that there is a closer competitive relationship within each type of distilled spirit than there is among all distilled spirits.[255] We consider this to be so, regardless of whether aspects of this replication process pertain to the physical characteristics of the products, or appeal to the tastes and habits of the consumers through labelling and packaging. Thus, in respect of consumers' tastes and habits, we understand the Panel to have found that the competitive relationship between each type of domestic distilled spirit made from designated raw materials and the same type of imported distilled spirit made from non-designated raw materials is that of products that are close to being perfectly substitutable.

151. The Philippines further contends that distribution channels for "sugar-based" and "non-sugar-based" spirits in the Philippine market are distinct, reflecting the different consumer

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[252] Appellate Body Report, *Canada – Periodicals*, p. 28, DSR 1997:I, 449, at 473.

[253] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118. See also Appellate Body Report, *Canada – Periodicals*, p. 19, DSR 1997:I, 449, at 464-465.

[254] Panel Reports, para. 7.82.

[255] *Supra*, section V.A.1.

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markets they serve. The Philippines submits that local *sari-sari* stores (small local stores)[256], which are frequented by all except the most affluent of consumers, account for approximately 85 per cent of off-premise sales of "sugar-based" spirits, but do not carry "non-sugar-based" spirits.[257] Moreover, the Philippines argues that evidence submitted by the European Union and the United States shows that "sugar-based" spirits are sold predominantly through off-premise channels, while "non-sugar-based" spirits are sold predominantly through on-premise channels such as bars, restaurants, and hotels.[258]

152. The Panel addressed distribution channels under Article III:2, second sentence, of the GATT 1994. In that context, the Panel found that some establishments (especially *sari-sari* stores) that offer domestic Philippine distilled spirits do not carry imported distilled spirits, but that all outlets where imported distilled spirits are sold, either for consumption on-premise or off-premise, also offer domestic Philippine distilled spirits. The Panel considered this to be "an indication of similarity between the products at issue."[259]

153. *Sari-sari* stores, which represent an important distribution channel for domestic distilled spirits made from designated raw materials, do not distribute imported distilled spirits made from non-designated raw materials. However, most other on-premise and off-premise outlets carry both domestic and imported distilled spirits. In our view, the fact that domestic and imported distilled spirits in the Philippines do not share all channels of distribution does not establish that the degree of substitutability is such that they are not "like products" within the meaning of Article III:2, first sentence, of the GATT 1994. In particular, the fact that one channel of distribution is used only for domestic spirits (*sari-sari* stores) is not sufficient to establish that the products are not "like".[260]

154. In light of all the above, we do not consider that the Panel committed an error to the extent it found that the degree of competition or substitutability between imported distilled spirits of a

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[256]Before the Panel, the Philippines defined "*sari-sari*" stores as "small, neighborhood, over-the-counter stores that carry basic grocery and household items". (Philippines' first written submission to the Panel, para. 253)

[257]Philippines' appellant's submission, para. 76 and footnote 77 thereto.

[258]Philippines' appellant's submission, para. 76.

[259]Panel Reports, para. 7.123.

[260]The panel in *Korea – Taxes on Alcoholic Beverages* found that "[c]onsiderable evidence of overlap in channels of distribution and points of sale … is supportive of a finding that the identified imported and domestic products are directly competitive or substitutable". (Panel Report, *Korea – Taxes on Alcoholic Beverages*, para. 10.86) Similarly, the panel in *Chile – Alcoholic Beverages* found that "the *consistent* practice of putting these products on adjoining shelf space in similar outlets is *one* piece of evidence supporting a finding of substitutability", but that "if the products were regularly presented separately, it would be *one* piece of evidence that perhaps consumers did not group them together in their perceptions". (Panel Report, *Chile – Alcoholic Beverages*, paras. 7.57 and 7.59 (original emphasis))

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particular type, made from non-designated raw materials, and domestic distilled spirits of the same type, made from designated raw materials, supports its overall finding that these products are "like" within the meaning of Article III:2, first sentence, of the GATT 1994.

155. The Philippines claims, in addition, that, in its analysis of consumers' tastes and habits under Article III:2, first sentence[261], and of competition under the second sentence[262], the Panel acted inconsistently with Article 11 of the DSU. The Philippines contends that, in concluding that there was no evidence of the existence of two separate markets in the Philippines, and that some consumers from the majority market "may be able to purchase high-priced distilled spirits, at least on special occasions", the Panel disregarded critical evidence produced by the Philippines and ignored the fact that no evidence had been presented to counter that presented by the Philippines.[263]

156. The Philippines contends that the evidence it submitted to the Panel demonstrates that imported "non-sugar-based" spirits are priced regularly above PHP 150 per bottle and that, therefore, only 1.8 per cent of its population can afford imported distilled spirits.[264] The European Union argued before the Panel that the group of consumers able to afford imported distilled spirits represents 15 per cent of the population, amounting to 13.7 million people.[265] In weighing the evidence, the Panel found that "a large proportion of the Philippine population has a limited ability to purchase distilled spirits beyond certain price levels", but that the market is not divided into two segments, as there are lower-priced imported distilled spirits that compete with domestic distilled spirits, as well as high-priced domestic spirits that compete with imported distilled spirits. The Panel concluded that, "in terms of income, the population in the Philippines does not appear to be divided into two separate groups, but is rather distributed along a continuum of income brackets".[266] In doing so, the Panel did take into account the evidence submitted by the Philippines regarding the pricing of spirits and the income levels of its population, as well as some contrasting evidence presented by the European Union and the United States. Based on that evidence, the Panel reached conclusions that differ from those of the Philippines, both under Article III:2, first sentence, and Article III:2, second sentence.

157. We have recalled, above, that a panel enjoys a margin of discretion in assessing the value of, and the weight to be ascribed to, the evidence before it, and that panels "are not required to accord to

[261]Panel Reports, para. 7.59.
[262]Panel Reports, para. 7.119.
[263]Philippines' appellant's submission, para. 173 (quoting Panel Reports, paras. 7.59 and 7.119).
[264]Philippines' appellant's submission, para. 174.
[265]Panel Reports, footnote 528 to para. 7.120.
[266]Panel Reports, para. 7.59.

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factual evidence of the parties the same meaning and weight as do the parties."[267] In light of the above, it is our view that the Panel did consider and review the evidence submitted by the Philippines concerning its distilled spirits market and, in particular, evidence of the price levels of distilled spirits and the expendable income of the population. Although the Panel attributed different weight to this evidence than that advocated by the Philippines, it did so, in our view, within its discretion as the trier of facts.

3. Tariff Classification

158. We turn next to the criterion of tariff classification. First, we address the Philippines' claim that the Panel erred in finding that HS heading 2208 provides an indication of similarity between domestic distilled spirits made from designated raw materials and imported distilled spirits made from non-designated raw materials. Second, we address the Philippines' claim that the Panel acted inconsistently with Article 11 of the DSU in its assessment of the HS six-digit subheadings for brandy and whisky.

159. The Panel considered the fact that all distilled spirits at issue in this dispute, irrespective of the raw materials from which they are made, fall under HS heading 2208, as an indication of similarity.[268] The Panel also found that the HS six-digit subheadings for gin and vodka (2208.50 and 2208.60, respectively) make no distinction between distilled spirits on the basis of the raw materials from which they are made, and that no HS six-digit subheadings exist for tequila and tequila-flavoured spirits. In contrast, the HS six-digit subheading for brandy (2208.20) "covers 'brandy' as a '[Spirit] obtained by distilling grape wine or grape marc'"[269] and the HS six-digit subheading for whisky (2208.30) "covers 'Whiskies', as spirits made from a 'mash of cereal grains'".[270] Accordingly, the Panel considered that, at the six-digit level, the HS classification did not provide "conclusive guidance".[271]

160. The Philippines claims that the Panel erred in considering the fact that all distilled spirits at issue, irrespective of the raw materials from which they are made, fall under the same four-digit HS heading (2208), as an indication of similarity. The Philippines argues that the Panel's reliance on

[267] Appellate Body Report, *Australia – Salmon*, para. 267. In *US – Wheat Gluten*, the Appellate Body also stated that "in view of the distinction between the respective roles of the Appellate Body and panels … we will not interfere lightly with the panel's exercise of its discretion". (Appellate Body Report, *US – Wheat Gluten*, para. 151)

[268] Panel Reports, para. 7.63.

[269] Panel Reports, para. 7.66.

[270] Panel Reports, para. 7.69.

[271] Panel Reports, para. 7.71.

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the four-digit tariff heading in this case was inappropriate, because the range of products that fall under heading 2208 is very broad. This tariff heading is not sufficiently detailed to draw any particular inferences as to whether the distilled spirits at issue are "like".[272]

161. In *Japan – Alcoholic Beverages II*, the Appellate Body stated that tariff classification can be a helpful sign of similarity only if it is sufficiently detailed.[273] We do not consider that HS heading 2208, which groups together all distilled spirits, as well as other liquors and unflavoured neutral spirits for human consumption or for industrial purposes, constitutes a tariff classification that is sufficiently detailed to provide an indication of "likeness", within types of distilled spirits, between domestic distilled spirits made from designated materials and imported distilled spirits made from non-designated materials.[274]

162. Turning to the Panel's finding in respect of the HS six-digit subheadings, the Philippines claims that the Panel failed to make an objective assessment of the matter before it, as required by Article 11 of the DSU, because it ignored significant and clear evidence regarding the tariff classification of whisky and brandy when it arrived at the conclusion that the evidence on tariff classification was inconclusive.[275] Particularly in respect of whisky and brandy, the Panel found that the HS classification at the six-digit level, and the accompanying explanatory notes (HSENs), take into account the raw material used for the production of a particular distilled spirit, so that whisky and brandy made from sugar cane molasses would not fall under the same HS subheading as whisky and brandy made from traditional raw materials.

163. We observe that the six-digit HS subheading for brandy refers to spirits obtained by distilling grape wine or grape marc. The six-digit HS subheading for whisky contains no reference to the raw material from which this spirit is produced. However, the HSENs to the six-digit HS codes for both brandy and whisky specify the material from which the spirit is distilled, namely, grape wine or grape marc for brandy and mash of cereal grains for whisky.[276] This, in our view, provides an indication that tariff classification would not suggest that domestic brandies and whiskies made from designated

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[272]Philippines' appellant's submission, para. 81.

[273]Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:1, 97, at 114.

[274]We observe that the HS heading 2208 refers to "undenatured ethyl alcohol of an alcoholic strength by volume of less than 80%; spirits, liqueurs and other spirituous beverages". Gin, brandy, rum, vodka, whisky, tequila and tequila-flavoured spirits are all covered by HS heading 2208, but also covered are chocolate, vanilla, milk, and honey liqueurs or "crèmes" as well as unflavoured neutral spirits for human consumption or for industrial purposes of less than 80 per cent volume. (Panel Reports, paras. 2.51-2.53 (referring to, *inter alia*, the HSEN to heading 2208 (Panel Exhibit PH-46)))

[275]Philippines' appellant's submission, para. 159.

[276]Panel Reports, paras. 2.51-2.53 (referring to, *inter alia*, the HSEN to heading 2208 (Panel Exhibit PH-46)).

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raw materials are "like" imported brandies and whiskies made from non-designated raw materials. Accordingly, we do not agree with the Panel's conclusion that at the six-digit level the HS classification provides no "conclusive guidance" as to the similarity of brandies and whiskies made from designated and non-designated raw materials.

164. We observe, however, that tariff classification is only one of the criteria that the Panel reviewed in its analysis of "likeness" under Article III:2 of the GATT 1994. We have already agreed with the Panel's conclusions that the criteria of products' physical characteristics and consumers' tastes and habits do support a finding that the products at issue are "like" within the meaning of Article III:2. Moreover, we recall that the Panel's finding that the end-uses of the products at issue are similar was not appealed. Thus, the fact that the Panel overlooked the significance of HS six-digit level classification for brandy and whisky does not, in our view, undermine its overall finding that the products at issue are "like". Therefore, we do not consider that this is an error that rises to the level of a failure by the Panel to comply with its duties under Article 11 of the DSU.

165. In light of the above, we do not consider that the Panel committed an error under Article 11 of the DSU, as the Philippines contends, in respect of the six-digit HS subheadings.

4. Regulatory Regimes

166. The Philippines claims that the Panel erred in considering that the regulatory regimes in force in the European Union and in the United States, which prohibit the marketing of whisky and brandy made from sugar cane molasses as "whisky" and "brandy", are "irrelevant".[277] The Philippines contends that the domestic regulatory regimes of both complainants are useful in identifying physical differences between the products that are commonly recognized as important to that particular product's identity.

167. In our view, the fact that, in the European Union and in the United States, whisky and brandy made from sugar cane molasses cannot be marketed and sold as "brandy" and "whisky" may be an indication that consumers in those countries would perceive these products as having quite distinct physical properties. In contrast, in the Philippines, not only can domestically distilled spirits made from designated raw materials be marketed and sold as "brandy" and "whisky", but also, as we have already considered above, every effort is made in the production, marketing, and sale of brandy or whisky made from designated raw materials to ensure that they replicate as closely as possible imported brandy or whisky made from non-designated raw materials.

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[277]Philippines' appellant's submission, para. 51.

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168. The determination of "likeness" under Article III:2, first sentence, of the GATT 1994 should be made on a case-by-case basis. If two spirits are considered to be "like products" in a given market, this does not necessarily mean that they would be considered "like products" in another market. It is thus conceivable that brandy and whisky made from designated raw materials and those made from non-designated raw materials may be considered as "like products" by consumers in the Philippine market, but that they may not be considered as "like products" by consumers in another market. As we have explained above, we consider that, in order to establish whether two products are "like" within the meaning of Article III:2 of the GATT 1994, a panel needs to examine the nature and the extent of the competitive relationship between and among products, which will depend on the market where these products compete.

169. We are, therefore, of the view that the Panel did not err in considering as relevant the regulatory framework of the Philippines, rather than that of the European Union or the United States, in its analysis of the competitive relationship between each type of domestic distilled spirit made from designated raw materials and the same type of imported distilled spirit made from non-designated raw materials in the market where the products compete, that is, the Philippine market.

5. Conclusions

170. As we have explained above, the determination of "likeness" under Article III:2, first sentence, of the GATT 1994 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among imported and domestic products. The Panel reviewed the products' physical characteristics, end-uses, and consumers' tastes and habits, as well as tariff classification and relevant Philippine internal regulations, and concluded that an analysis of these factors shows that each type of imported distilled spirit at issue in this dispute made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials, within the meaning of Article III:2, first sentence, of the GATT 1994.

171. We are of the view that, overall, the Panel did not commit an error in the interpretation and application of Article III:2, first sentence, of the GATT 1994. In particular, we consider that the Panel's analyses of the products' physical characteristics and of consumers' tastes and habits supports the overall conclusion that distilled spirits of a particular type made from designated raw materials and distilled spirits of the same type made from non-designated raw materials are "like products" within the meaning of Article III:2 of the GATT 1994. This finding is, in our view, further supported by the Panel's finding on end-uses, which the Philippines does not challenge on appeal. The Panel found that specific types of distilled spirits share the same end-uses, that is, "thirst quenching,

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socialization, relaxation, pleasant intoxication", irrespective of the raw materials from which they are made.[278]

172. In light of the above, we *uphold* the Panel's finding, in paragraph 7.85 of the Panel Reports, that each type of imported distilled spirit at issue in this dispute—gin, brandy, vodka, whisky, and tequila—made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials, within the meaning of Article III:2, first sentence, of the GATT 1994.

173. Moreover, for the reasons explained above, we consider that the Panel did not act inconsistently with Article 11 of the DSU in its evaluations of the products' physical characteristics, of the Philippine market for distilled spirits, and of tariff classification.

174. As a consequence, we also *uphold* the Panel's finding, in paragraphs 7.90 and 8.2 of the Panel Reports, that, by imposing on each type of imported distilled spirit at issue in this dispute—gin, brandy, rum, vodka, whisky, and tequila—made from non-designated raw materials, internal taxes in excess of those applied to "like" domestic distilled spirits of the same types, made from designated raw materials, the Philippines has acted inconsistently with Article III:2, first sentence, of the GATT 1994.[279]

B. *The Panel's Finding that All Distilled Spirits at Issue in This Dispute, whether Imported or Domestic and Irrespective of Their Raw Material Base, are "Like Products"*

175. We now turn to the Panel's finding at paragraph 7.77 of its Reports that "the distilled spirits at issue in the present dispute, whether imported or domestic, and irrespective of the raw materials from which they are made, are like products within the meaning of the first sentence of Article III:2 of the GATT 1994".[280]

176. The Philippines contends that the Panel's error in assessing the products' physical characteristics also led it to make the "extraordinary" finding that all distilled spirits at issue in this dispute are "like products", such that "non-sugar-based" whiskies are "like" "sugar-based" brandies, etc.[281] The Philippines adds that these types of products are so different that the

[278] Panel Reports, para. 7.81.
[279] Panel Reports, para. 7.90, EU Panel Report, para. 8.2, and US Panel Report, para. 8.2(a).
[280] Panel Reports, para. 7.77.
[281] Philippines' appellant's submission, para. 40.

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complainants themselves did not claim that all "non-sugar-based" distilled spirits are "like" all "sugar-based" distilled spirits for the purposes of Article III:2 of the GATT 1994.[282]

177. It is not immediately clear from paragraph 7.77 of the Panel Reports, when read in isolation, whether the Panel actually concluded that *all* distilled spirits at issue in this dispute are "like products", irrespective of their raw material base and their origin or type (brandy, whisky, rum, gin, vodka, tequila, tequila-flavoured spirits), or whether it simply stated that the distilled spirits at issue in this dispute *may be* "like products", irrespective of raw material base and origin. We observe, however, that before reaching its conclusion in paragraph 7.77, the Panel stated, in the two preceding paragraphs, that *all* distilled spirits at issue in this dispute are similar in respect of physical characteristics and end-uses, and that factors such as marketing campaigns, the significant degree of competition or substitutability, tariff classification, and domestic regulations suggest similarity between *all* distilled spirits at issue in this dispute, irrespective of their raw material base and origin. Moreover, in paragraph 7.78, the Panel stated that, "in addition" to its conclusion in paragraph 7.77, it would then turn "to each type of spirit (gin, brandy, rum, vodka, whisky, tequila and tequila-flavoured spirits), in order to consider whether those spirits, imported or domestic and irrespective of the raw materials from which they are distilled, are 'like products'". These statements by the Panel may be read as suggesting that the conclusion in paragraph 7.77 was in fact that *all* distilled spirits at issue in this dispute are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994.

178. In addition, we note that the Panel later stated that, under Article III:2, second sentence, it considered the issue of "direct competitiveness or substitutability" as if *arguendo* it had found that the products at issue were *not* like.[283] As we consider further below, the Panel addressed, under Article III:2, second sentence, whether *all* distilled spirits at issue in this dispute are directly competitive or substitutable products on an *arguendo* basis. This suggests that, under Article III:2, first sentence, the Panel did find that *all* distilled spirits at issue in this dispute are "like products". Had this not been the case, there would have been no need for the Panel to consider *arguendo* the issue of whether *all* distilled spirits at issue are directly competitive or substitutable under Article III:2, second sentence.

179. To the extent that the Panel found, in paragraph 7.77 of its Reports, that *all* distilled spirits at issue in this dispute, regardless of the different types, are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994, we disagree with this finding by the Panel.

[282]Philippines' appellant's submission, para. 41.
[283]Panel Reports, para. 7.99.

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180. The Panel's own findings suggest that the degree of physical similarity and competition among *all* distilled spirits at issue in this dispute is not such as to fulfil the narrow definition of "likeness" in Article III:2, first sentence, of the GATT 1994. We observe that, in paragraph 7.40 of its Reports, the Panel stated that it had found "evidence that each of the different types of distilled spirits has specific organoleptic properties". It clearly follows from this that, in the Panel's view, all distilled spirits do not have the same organoleptic properties.[284]

181. Moreover, in respect of consumers' tastes and habits, the Panel found that the evidence suggested a *significant* degree of competitiveness or substitutability for distilled spirits in the Philippine market.[285] To the extent that this finding by the Panel refers to *all* distilled spirits in the Philippine market, we do not consider that a *significant* degree of competitiveness or substitutability would support a finding of "likeness" under Article III:2, first sentence, of the GATT 1994. We have considered above that, based on the findings of the Appellate Body in *Canada – Periodicals*[286] and in *Korea – Alcoholic Beverages*[287], under Article III:2, first sentence, products that are close to being perfectly substitutable can be "like products", whereas products that compete to a lesser degree would fall within the scope of the second sentence of Article III:2. This, in our view, suggests that a finding of "likeness" under the first sentence requires a degree of competition that is higher than merely *significant*.

182. Finally, we disagree with the Panel's finding that, the fact that all distilled spirits at issue in this dispute, irrespective of the raw materials from which they are made, fall under HS heading 2208, provides an indication of similarity.[288] We recall that, in *Japan – Alcoholic Beverages II*, the Appellate Body stated that tariff classification can be a helpful sign of similarity only if it is sufficiently detailed.[289] As already noted above, we do not consider that HS heading 2208, which groups together all distilled spirits, as well as other liquors and unflavoured neutral spirits for human consumption or for industrial purposes, constitutes a sufficiently detailed tariff classification to support a finding that *all* distilled spirits at issue in this dispute are "like" within the meaning of Article III:2, first sentence, of the GATT 1994.

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[284]For example, with respect to colour, the Panel found that all gins and all vodkas have a clear (transparent) colour, while all whiskies have a "similar golden" colour, and all brandies have a colour that "goes from golden to mahogany." (Panel Reports, paras. 2.55, 2.62, 2.75, and 2.81)

[285]Panel Reports, para. 7.62.

[286]Appellate Body Report, *Canada – Periodicals*, p. 28, DSR 1997:I, 449, at 473.

[287]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118.

[288]Panel Reports, para. 7.63.

[289]Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:1, 97, at 114.

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183. In light of the above, we do not consider that the Panel's conclusions on the products' physical characteristics, consumers' tastes and habits, and tariff classification support a finding that *all* distilled spirits at issue in this dispute are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994. Therefore, to the extent that paragraph 7.77 of the Panel Reports stands for the proposition that *all* distilled spirits at issue in this dispute are "like products", regardless of types, we *reverse* this finding by the Panel.

VI. Article III:2, Second Sentence, of the GATT 1994

184. In this section, we address both the Philippines' appeal and the European Union's other appeal regarding Article III:2, second sentence, of the GATT 1994. We begin with the other appeal of the European Union.

A. *European Union's Other Appeal*

185. The European Union claims that the Panel erred in characterizing its claim under Article III:2, second sentence, of the GATT 1994 as made in the "alternative"[290] to its claim under the first sentence of Article III:2. According to the European Union, by failing to address its claim under Article III:2, second sentence, the Panel acted inconsistently with Articles 7.1, 7.2, and 11 of the DSU.[291] Moreover, to the extent that the Panel's failure to address the European Union's claim under Article III:2, second sentence, constituted application of the principle of judicial economy, the European Union submits that the Panel exercised "false" judicial economy in violation of Articles 3.7 and 21.1 of the DSU.[292] The European Union requests the Appellate Body: to reverse the Panel's characterization of its claim under the second sentence of Article III:2 as "alternative" to its claim under the first sentence thereof; to complete the legal analysis; and to find that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994.[293]

186. The Philippines does not contest the specific claim raised by the European Union in its other appeal. The Philippines essentially considers that the merits of the claim raised by the European Union in its other appeal will be fully addressed by the Appellate Body in any case, because the Philippines has appealed the finding of inconsistency made by the Panel in response to the United States' claim under Article III:2, second sentence, of the GATT 1994.[294]

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[290]Panel Reports, paras. 7.1, 7.5, 7.17, 7.92, 7.93, 7.95; and EU Panel Report, para. 8.3.
[291]European Union's other appellant's submission, para. 29.
[292]European Union's other appellant's submission, para. 35.
[293]European Union's other appellant's submission, para. 50.
[294]Philippines' appellee's submission, para. 3.

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187. The European Union's request for the establishment of a panel describes the specific claims raised by the European Union under Article III:2 of the GATT 1994 in the following terms:

> [T]he Philippines has acted inconsistently with the first sentence of Article III:2 of the GATT 1994, by making distilled spirits imported from other WTO Members, including the [European Union], subject, directly or indirectly, to internal taxes or other internal charges in excess of those applied, directly or indirectly, to like domestic products. Moreover, *separately and in combination* with the first sentence of Article III:2, by applying internal taxes or other internal charges to imported and/or domestic products in a manner contrary to the principles set forth in paragraph 1 of Article III of the GATT 1994, the Philippines has acted inconsistently with the second sentence of Article III:2 of the GATT 1994.[295] (emphasis added)

188. We consider that the European Union's panel request clearly indicates that the European Union made separate and independent claims under the first and second sentences of Article III:2, of the GATT 1994. We further note that, in response to questioning by the Panel, the European Union specified the products at issue in each of its claims under the first and second sentences of Article III:2 and stated:

> In essence, the [European Union's] main claims are as follows:
>
> - Under Article III:2, first sentence, of the GATT [1994]:
>
> (i) the EU claims that for each type of spirit (e.g. gin, vodka, whisky, rum, brandy, tequila etc.) the products distilled from the designated raw materials are "like" those distilled from the non-designated raw materials. Thus, by way of example, a whisky produced from the designated raw materials (e.g. sugar-cane) is like a whisky produced from other raw materials (e.g. malt). …
>
> - Under Article III:2, second sentence, of the GATT [1994]:
>
> (i) the EU submits that all distilled spirits falling under heading HS2208 are "directly competitive and substitutable", irrespective of the raw materials they are distilled from. In other words, by way of example, the EU claims that imported gin is directly competitive and substitutable with Filipino vodka, that imported brandy is directly competitive

[295]WT/DS396/4, p. 3.

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> and substitutable with domestic whisky, etc.[296] (emphasis and footnote omitted)

189. In our view, this response by the European Union demonstrates that its claims under the first and second sentences of Article III:2 were not only separate and independent, but also involved *distinct product groupings*. Before the Panel, the European Union claimed that the Philippines had acted inconsistently with Article III:2, *first sentence*, of the GATT 1994 by applying to *each type* of imported distilled spirit made from non-designated raw materials (gin, brandy, rum, whisky, vodka, tequila) internal taxes in excess of those applied to "like" domestic distilled spirits of the same type made from designated raw materials. In addition, the European Union claimed that the Philippines had acted inconsistently with Article III:2, *second sentence*, of the GATT 1994 by applying dissimilar taxes to *all* imported distilled spirits at issue made from non-designated raw materials and to all "directly competitive or substitutable" domestic distilled spirits made from designated raw materials, so as to afford protection to domestic production.[297]

190. The Panel's incorrect characterization of the European Union's claim under the second sentence of Article III:2 may stem, in part, from the European Union's statement in its first written submission that, "if the Panel were to establish that the Philippines violates Article III:2, first sentence, it would not necessarily need to analyse a breach of the second sentence of the same provision: such a breach would inevitably be covered."[298] This statement is legally incorrect, because the second sentence of Article III:2 requires the European Union to establish *separately*: (i) that imported and domestic distilled spirits are "directly competitive or substitutable"; (ii) that such directly competitive or substitutable products are "not similarly taxed"; and (iii) that dissimilar taxation of the directly competitive or substitutable products is applied "so as to afford protection to domestic production".[299] Moreover, because the European Union's claims under the first and second sentences of Article III:2 involved distinct product groupings, a finding that *each type* of

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[296] European Union's response to Panel Question 18, para. 11. The European Union did "not take a definitive position on 'likeness' between different types of spirits … [and] does not exclude that two or more different types of spirits could be held 'like'." Yet, the European Union did not consider it necessary for the Panel to engage in such analysis, because it would be "long and complex". (*Ibid.*)

[297] The European Union also made a "subordinate claim" that each type of imported and domestic distilled spirit (gin, brandy, rum, whisky, vodka, tequila) were "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994. (European Union's response to Panel Question 18, para. 12)

Having found that *all* the distilled spirits at issue, whether imported or domestic, and irrespective of the raw material from which they are made, are "directly competitive or substitutable" under Article III:2, second sentence, of the GATT 1994, the Panel did not address the European Union's "subordinate claim" (Panel Reports, para. 7.138), and its failure to do so has not been appealed by the European Union.

[298] European Union's first written submission to the Panel, para. 52. (footnote omitted)

[299] See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 24, DSR 1996:1, 97 at 116. (emphasis omitted)

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imported distilled spirit (gin, brandy, rum, whisky, vodka, tequila) is "like" the same type of domestic distilled spirit under the first sentence does not establish, without more, that *all* the imported and domestic distilled spirits at issue are "directly competitive or substitutable" under the second sentence of Article III:2 of the GATT 1994.

191. Thus, we consider that the European Union's claim under the second sentence of Article III:2 could not have been properly understood as having been made in the "alternative", that is, to be addressed only if the Panel were to reject the European Union's claim under the first sentence of that provision.[300] Accordingly, we *reverse* the Panel's findings, in paragraphs 7.1, 7.5, 7.17, 7.92, 7.93, 7.95, and 8.3 of the EU Panel Report, that the European Union's claim under Article III:2, second sentence, of the GATT 1994 was made in the "alternative" to its claim under the first sentence of that provision.

192. Having erroneously concluded that the European Union's claim under Article III:2, second sentence, was made in the "alternative", the Panel examined the consistency of the Philippines' excise tax with the second sentence of Article III:2 *only* with respect to the United States' claim under that provision, though it took into account "all the arguments and evidence on record, including those submitted by the European Union and third parties".[301] In failing to examine the *European Union's* claim under Article III:2, second sentence, the Panel failed to conduct an objective assessment of the matter before it, as required by Article 11 of the DSU, in relation to that specific claim of the European Union. Moreover, the Panel found that the Philippines had acted inconsistently with the second sentence of Article III:2, and made recommendations that the Philippines bring itself into conformity with its obligations under that provision, only in its Report addressing the complaint by the United States (DS403).[302] In erroneously abstaining from making findings under Article III:2, second sentence, and in failing to make recommendations that the Philippines bring itself into conformity with that provision in its Report addressing the complaint by the European Union (DS396), the Panel failed to "make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements" in the dispute in DS396, as required under Article 11 of the DSU.[303] For these reasons, we *find* that the Panel acted inconsistently with its obligations under Article 11 of the DSU, in paragraph 8.3 of the EU Panel

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[300]Without prejudice to the European Union's right under Article 17.6 of the DSU to appeal any issues of law covered in the Panel Reports and legal interpretations developed by the Panel, we consider that this matter could have been raised at the interim review stage of the panel proceedings.

[301]Panel Reports, para. 7.95.

[302]US Panel Report, paras. 8.2(b) and 8.4.

[303]EU Panel Report, para. 8.3.

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Report, in failing to examine, and in abstaining from making findings in relation to, the European Union's separate and independent claim under Article III:2, second sentence, of the GATT 1994.

193. We must now determine whether there are "sufficient factual findings in the panel report or undisputed facts in the panel record"[304] to enable us to complete the legal analysis in relation to the European Union's separate and independent claim under Article III:2, second sentence, of the GATT 1994. We note here and discuss below that the findings made by the Panel under Article III:2, second sentence, of the GATT 1994 provide a sufficient basis for us to complete the legal analysis in relation to the European Union's claim under that provision.[305]

B. *Philippines' Appeal*

194. We examine next the issues raised in the Philippines' appeal regarding the Panel's findings under Article III:2, second sentence, of the GATT 1994, which contains a general prohibition against "internal taxes or other internal charges" applied to "imported or domestic products in a manner contrary to the principles set forth in paragraph 1". Article III:1 of the GATT 1994, in turn, provides that internal taxes and other internal charges "should not be applied to imported or domestic products so as to afford protection to domestic production". The *Ad* Note to Article III:2 clarifies the conditions under which a measure conforming to the first sentence of Article III:2 will be nonetheless inconsistent with the second sentence of that provision as follows:

> A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

195. As noted earlier, the Appellate Body has explained that three separate issues must be addressed when assessing the consistency of an internal tax measure with Article III:2, second sentence, of the GATT 1994. First, whether the imported and domestic products are "*directly competitive or substitutable*"; second, whether such directly competitive or substitutable imported and domestic products are "*not similarly taxed*"; and third, whether dissimilar taxation of the directly

[304] Appellate Body Report, *US – Section 211 Appropriations Act*, para. 343 (referring to Appellate Body Report, *Australia – Salmon*, para. 118).
[305] Panel Reports, paras. 7.95-7.188.

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competitive or substitutable imported products is "*applied ... so as to afford protection to domestic production*".[306]

196. The Philippines appeals the Panel's assessment of two elements of the three-part test of Article III:2, second sentence, of the GATT 1994. First, the Philippines claims that the Panel erred in finding that all distilled spirits at issue in this dispute, whether imported or domestic, and irrespective of the raw material from which they are made, are "directly competitive or substitutable" products within the meaning of Article III:2, second sentence.[307] Second, the Philippines claims that the Panel erred in finding that dissimilar taxation of the imported and domestic distilled spirits at issue is applied "so as to afford protection" to Philippine production of distilled spirits under Article III:2, second sentence.[308] The Philippines does *not* appeal the Panel's finding that imported distilled spirits made from non-designated raw materials and directly competitive or substitutable domestic distilled spirits made from designated raw materials are not "similarly taxed" within the meaning of Article III:2, second sentence, of the GATT 1994.[309]

1. Directly Competitive or Substitutable Products

197. In examining whether the imported and domestic distilled spirits at issue are "directly competitive or substitutable" in the Philippine market, the Panel initially noted that the substitutability studies submitted by the parties suggest "a significant degree of competitiveness or substitutability" in the Philippines between the distilled spirits at issue.[310] The Panel then rejected the Philippines' argument that the price gap between imported and domestic distilled spirits, combined with the income disparity in the Philippines, demonstrates the existence of two distinct segments in the Philippine distilled spirits market. The Panel reasoned that the overlap in prices both for high- and low-priced brands of imported and domestic distilled spirits suggests that the Philippine market is not segmented.[311] Moreover, in terms of purchasing power, many Filipino consumers "may be able to purchase high-priced distilled spirits, at least on special occasions".[312] The Panel added that the Philippines' argument concerning market segmentation implies that "at least a narrow segment of the market has access to both groups of spirits".[313] For the Panel, such instances of actual competition

[306]Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 24, DSR 1996:1, 97, at 116. (original emphasis)
[307]Panel Reports, para. 7.138.
[308]Panel Reports, para. 7.187.
[309]Panel Reports, para. 7.167.
[310]Panel Reports, para. 7.113 (referring to *Euromonitor International* survey, *supra*, footnote 37, and Abrenica & Ducanes, *supra*, footnote 65).
[311]Panel Reports, para. 7.118.
[312]Panel Reports, para. 7.119.
[313]Panel Reports, para. 7.120.

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indicate that imported and domestic distilled spirits are "*capable* of being directly competitive or substitutable in the future".[314]

198. On this basis, the Panel concluded that there is "a direct competitive relationship" between domestic and imported distilled spirits made from different raw materials in the Philippine market.[315] This factor, combined with other similarities in terms of channels of distribution[316], the products' physical characteristics[317], end-uses and marketing[318], tariff classification[319], and internal regulations[320] suggest that the imported and domestic distilled spirits at issue, irrespective of the raw materials from which they are made, are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994.[321]

199. On appeal, the Philippines challenges the Panel's assessment of the *competitive relationship* between imported and domestic distilled spirits in the Philippine market. The Philippines does *not* challenge the other factors taken into account by the Panel in its determination that imported and domestic distilled spirits are "directly competitive or substitutable", such as similarity in channels of distribution, physical characteristics, end-uses and marketing, tariff classification, and internal regulations.[322]

200. The Philippines claims that the Panel made in essence three errors in its assessment of the competitive relationship between imported and domestic distilled spirits in the Philippine market. First, the Philippines argues that the Panel insufficiently addressed the "degree of competition" between imported and domestic distilled spirits in the Philippine market. Second, the Philippines maintains that the Panel erroneously found direct competition or substitutability between imported and domestic spirits on the basis of a "non-representative" segment of the Philippine market having "access" to distilled spirits "at least on special occasions". Third, the Philippines posits that the Panel incorrectly held that there is potential competition between imported and domestic distilled spirits in the Philippines. In addition, the Philippines argues that the Panel acted inconsistently with its duties under Article 11 of the DSU in its assessment of the two studies that purported to evaluate the degree

[314]Panel Reports, para. 7.121. (original emphasis)
[315]Panel Reports, para. 7.137.
[316]Panel Reports, para. 7.123.
[317]Panel Reports, para. 7.127.
[318]Panel Reports, paras. 7.129 and 7.131.
[319]Panel Reports, paras. 7.133 and 7.134.
[320]Panel Reports, para. 7.135.
[321]Panel Reports, para. 7.138.
[322]Panel Reports, paras. 7.122-7.135.

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of substitutability between domestic and imported distilled spirits in the Philippine market. We address each of these arguments in turn.

(a) "Degree" of Competition

201. The Philippines argues that the Panel applied an incorrect standard in finding that the analysis under the second sentence of Article III:2 of the GATT 1994 should focus on the "nature" and "quality" of competition, but not on the "degree of competition" between domestic and imported distilled spirits in the Philippines.[323] Referring to the Appellate Body reports in *Korea – Alcoholic Beverages* and *US – Cotton Yarn*, the Philippines stresses that the degree of competition between imported and domestic products is the "central" inquiry under Article III:2, second sentence.[324] According to the Philippines, had the Panel applied the correct standard, it would have come to the conclusion that there is "insufficient proximity" in the degree of competition between the products at issue to permit their characterization as "directly competitive or substitutable".[325]

202. Both the European Union and the United States respond that the Panel correctly focused its analysis on the degree of competition between imported and domestic distilled spirits in the Philippine market. For the European Union, the Philippines' argument is "purely terminological".[326] In stating that the issue was "not so much" the degree of competition, the Panel simply rejected the Philippines' argument that Article III:2, second sentence, requires "complete, absolute or exact" substitutability.[327] For the United States, the Philippines seeks to minimize the significance of other types of evidence upon which the Panel relied, such as the lack of differentiation between imported and domestic distilled spirits in labelling and marketing.[328] Moreover, the Panel's conclusion that there is a "significant degree of competitiveness or substitutability" between domestic and imported distilled spirits in the Philippine market disproves the Philippines' argument that the Panel did not evaluate the "degree of proximity" of competition.[329]

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[323] Philippines' appellant's submission, para. 88.

[324] Philippines' appellant's submission, paras. 90 and 91 (referring to Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 129, 130, 133, and 134; and Appellate Body Report, *US – Cotton Yarn*, paras. 97 and 98).

[325] Philippines' appellant's submission, para. 95.

[326] European Union's appellee's submission, para. 83.

[327] European Union's appellee's submission, para. 84. (emphasis omitted)

[328] United States' appellee's submission, para. 66 (referring to Panel Reports, para. 7.131).

[329] United States' appellee's submission, para. 69 (quoting Panel Reports, para. 7.113 (emphasis omitted)).

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203. The Philippines' allegation of error is directed at the following statement by the Panel:

> The question before us under Article III of the GATT 1994 is not so much what the "degree of competition" between the products at issue is, but what is the "nature" or "quality" of their "competitive relationship".[330]

204. Although the statement challenged by the Philippines, read in isolation, could be viewed as de-emphasizing the role played by this particular factor in the Panel's assessment, a careful review of the Panel's analysis indicates that the Panel appropriately ascertained the extent of the competitive relationship between imported and domestic distilled spirits in the Philippine market. At the outset of its analysis, the Panel articulated the standard that it would apply to determine whether the products at issue were "directly competitive or substitutable" in the following terms:

> We start by looking at the direct competitive relationship between the relevant products, i.e. the extent to which consumers are willing to use the different products to satisfy the same, or similar, needs ("consumers' tastes and habits"). We will focus our analysis on how those products relate to each other in the market. Although at some level all products may be said to be "at least indirectly competitive," given that consumers have limited disposable income for competing needs, the second sentence of Article III:2 only regulates situations where products compete directly.[331] (footnote omitted)

205. We consider that the standard articulated by the Panel appropriately framed the analysis as one aimed at determining whether competition between imported and domestic distilled spirits in the Philippines is *sufficiently direct* so that these products could be properly characterized as "directly competitive or substitutable". In so doing, the Panel followed the guidance provided by the Appellate Body in *Korea – Alcoholic Beverages*, in which the Appellate Body held that imported and domestic products are "directly competitive or substitutable" when they are "in competition" in the marketplace.[332] The Appellate Body held further that the term "directly" suggests "a degree of proximity in the competitive relationship between the domestic and the imported products."[333] The requisite degree of competition is met where the imported and domestic products are characterized by a high, but imperfect, degree of substitutability.[334] As the Appellate Body found, this will be the case

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[330]Panel Reports, para. 7.101.

[331]Panel Reports, para. 7.104.

[332]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 114.

[333]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 116.

[334]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118; Appellate Body Report, *Canada – Periodicals*, p. 28, DSR 1997:I, 449, at 473. See also Appellate Body Report, *US – Cotton Yarn*, footnote 68 to para. 97.

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where the imported and domestic products are "interchangeable" or offer "alternative ways of satisfying a particular need or taste".[335]

206. Moreover, in applying the standard it articulated to the facts before it, the Panel reviewed the substitutability studies[336], which purport to evaluate the degree of substitutability between imported and domestic distilled spirits in the Philippine market. The Panel found that the substitutability studies indicate that there is "*a significant degree of competitiveness or substitutability*" in the Philippine market between the imported and domestic distilled spirits at issue.[337] For the Panel, these studies, combined with instances of price competition for both high- and low-priced brands of imported and domestic distilled spirits[338], potential for consumption of high-priced spirits on "special occasions"[339], instances of actual competition in a narrow segment of the Philippine consumer market[340], and potential competition between imported and domestic distilled spirits in the Philippine market[341] sufficiently demonstrate that there is "a direct competitive relationship between domestic and imported distilled spirits" in the Philippines.[342] For the Panel, such a direct competitive relationship, combined with similarities between imported and domestic distilled spirits in terms of their properties, nature and quality[343], end-uses and marketing[344], tariff classification[345], and domestic Philippine regulation of distilled spirits[346] sufficiently evidences that these products are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994.[347]

207. In our view, the Panel's analysis sufficiently demonstrates that it appropriately assessed the degree of competition between imported and domestic distilled spirits in the Philippine market. We note, in this respect, that the Panel expressly derived, from its statement that the "question before us … is not so much what the 'degree of competition' between the products at issue is, but what is the 'nature' or 'quality' of their 'competitive relationship'"[348], the conclusion that it "*should not place too*

[335]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 115.
[336]*Euromonitor International* survey, *supra*, footnote 37; Abrenica & Ducanes, *supra*, footnote 65.
[337]Panel Reports, para. 7.113 (referring to *Euromonitor International* survey, *supra*, footnote 37, p. 19; and Abrenica & Ducanes, *supra*, footnote 65). (emphasis added)
[338]Panel Reports, para. 7.118.
[339]Panel Reports, para. 7.119.
[340]Panel Reports, para. 7.120.
[341]Panel Reports, para. 7.121.
[342]Panel Reports, para. 7.137.
[343]Panel Reports, para. 7.127.
[344]Panel Reports, para. 7.131.
[345]Panel Reports, paras. 7.133 and 7.134.
[346]Panel Reports, para. 7.135.
[347]Panel Reports, para. 7.137.
[348]Panel Reports, para. 7.101 (quoting Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 128-134).

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much emphasis on quantitative analyses".[349] Thus, the Panel's reference to the "degree of competition" in the statement challenged by the Philippines related exclusively to a *quantitative* assessment of the competitive relationship between domestic and imported distilled spirits in the marketplace. In de-emphasizing the role played by quantitative analyses of substitutability, the Panel followed the guidance provided by the Appellate Body in previous cases. In *Korea – Alcoholic Beverages*, the Appellate Body expressly found that a particular degree of competition need not be shown in quantitative terms[350], and cautioned panels against placing undue reliance on "quantitative analyses of the competitive relationship", because cross-price elasticity is not "the decisive criterion" in determining whether two products are directly competitive or substitutable.[351]

208. For these reasons, we do not agree with the Philippines that the Panel insufficiently assessed the degree of competition between domestic and imported distilled spirits in the Philippine marketplace. Rather, the Panel appropriately sought to determine the degree or extent to which domestic and imported distilled spirits are in direct competition in the Philippine market.

(b) Market Segmentation

209. The second set of issues raised by the Philippines' appeal of the Panel's assessment of competition relates to the Panel's rejection of its argument that imported and domestic distilled spirits are not "directly competitive or substitutable" in the Philippines because they are sold in two separate and distinct market segments.

210. Before the Panel, the Philippines argued that there is a "huge gap" in its market between the prices of "sugar-based" and "non-sugar-based" distilled spirits. Such a general gap in prices, compounded by the income disparity in the Philippine market, prevents most consumers in the Philippines from purchasing "non-sugar-based" distilled spirits, thus suggesting the existence of two market segments: one for domestic, low-priced distilled spirits made from designated raw materials, and another for imported, high-priced distilled spirits made from non-designated raw materials.[352]

211. Although the Panel recognized that the prices of imported brands of distilled spirits, even before taxes, tend to be higher than the corresponding domestic brands of distilled spirits, the Panel considered that the evidence shows overlap in the prices of imported and domestic distilled spirits

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[349] Panel Reports, para. 7.105. (emphasis added)
[350] Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 130 and 131.
[351] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 134. (emphasis omitted)
[352] Panel Reports, para. 7.114.

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which is "not exceptional" and occurs for both high- and low-priced products.[353] For the Panel, such price overlaps suggest that the Philippine market is not segmented, and that in some cases there is price competition between imported and domestic products.[354]

212. With regard to the purchasing power of Philippine consumers, the Panel found that, while "a large proportion" of Philippine consumers may not have access to high-priced distilled spirits, "many others may be able to purchase high-priced distilled spirits, at least on special occasions."[355] Moreover, for the Panel, the Philippines' argument that distilled spirits made from non-designated raw materials are only available to a "narrow segment" of the population implies that at least that segment of the market has access to both groups of spirits.[356] This was sufficient for the Panel to find a direct competitive relationship between imported and domestic distilled spirits in the Philippines because:

> Article III of GATT 1994 does not protect just *some* instances or *most* instances, but rather, it protects *all* instances of direct competition. It follows that the competitive relationship does not need to occur throughout the *whole* market for a panel to find that a measure is inconsistent with the second sentence of Article III. We thus conclude that, even if the Philippine distilled spirits market were segmented, actual direct competition exists within at least a segment of that market.[357] (original emphasis; footnote omitted)

213. On appeal, the Philippines argues that these findings do not provide a sufficient basis for the Panel to conclude that imported distilled spirits made from non-designated raw materials and domestic distilled spirits made from designated raw materials are "directly competitive or substitutable" in the Philippine market. The Philippines essentially argues that the Panel erred in finding direct competition on the basis of a "non-representative" segment of its population having "access" to both types of spirits "at least on special occasions".

214. Both the European Union and the United States argue that the Panel correctly rejected the Philippines' argument that its distilled spirits market is divided into two distinct segments on the basis of evidence suggesting instances of price overlap between imported and domestic distilled spirits, and of evidence suggesting that, in terms of income, the Philippine population is distributed along a "continuum of income brackets".[358]

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[353]Panel Reports, para. 7.118.
[354]Panel Reports, para. 7.118.
[355]Panel Reports, para. 7.119.
[356]Panel Reports, para. 7.120.
[357]Panel Reports, para. 7.120.
[358]European Union's appellee's submission, para. 96; United States' appellee's submission, para. 88 (referring to Panel Reports, para. 7.59).

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215. At the outset, we note that the Panel rejected the Philippines' argument that imported and domestic distilled spirits are in two distinct market segments in the Philippines primarily on the basis of evidence demonstrating overlaps in the *prices* of imported and domestic distilled spirits, both for high- and low-priced products.[359] We consider that price is very relevant in assessing whether imported and domestic products stand in a sufficiently direct competitive relationship in a given market. This is because evidence of price competition indicates that the imported product exercises competitive constraints on the domestic product, and *vice versa*. In this respect, we agree with the Philippines that evidence of major price differentials could demonstrate that the imported and domestic products are in completely separate markets. However, in this case, the Panel made a factual finding that there is overlap in the prices of imported and domestic distilled spirits in the Philippines, and that such overlap is not "exceptional" but rather occurs for both high- and low-priced products.[360] The Philippines does not challenge this factual finding on appeal, but rather argues that existing price overlaps do not show a sufficiently direct degree of competition. In our view, such instances of price overlap both for high- and low-priced distilled spirits sufficiently support the Panel's conclusion that "the market is not segmented and that in some cases imported and domestic products compete with respect to price."[361]

216. Turning to the purchasing power of the Filipino population, the Panel found that, "in terms of income, the population in the Philippines does not appear to be divided into two separate groups, but is rather distributed along a continuum of income brackets."[362] For the Panel, this suggested that, even though a "large proportion" of Philippine consumers do not have "access" to high-priced distilled spirits, many others "may be able to purchase high-priced distilled spirits, at least on special occasions."[363]

217. The Philippines argues that the Panel's reference to "special occasion" purchases was in error, because the term "directly competitive or substitutable" products in Article III:2, second sentence, requires identity in the "nature and frequency"[364] of the consumers' purchasing behaviour. According to the Philippines, "[i]f a proposed alternative cannot be purchased with the same frequency as the

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[359]Panel Reports, para. 7.118.
[360]Panel Reports, para. 7.118.
[361]Panel Reports, para. 7.118. See, for example, Panel Reports, paras. 2.66, 2.67, 2.72, and 2.73.
[362]Panel Reports, para. 7.59.
[363]Panel Reports, para. 7.119.
[364]Philippines' appellant's submission, para. 97.

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original product and is not purchased according to the same set of needs and wants, the products cannot be considered to be 'directly' competitive."[365]

218. We do not agree with the Philippines that Article III:2, second sentence, of the GATT 1994 requires *identity* in the "nature and frequency" of the consumer's purchasing behaviour. If that were the case, the competitive relationship between the imported and domestic products in a given market would only be assessed with reference to *current* consumer preferences. However, as the Appellate Body expressly held in *Korea – Alcoholic Beverages*, "the requisite relationship *may* exist between products that are not, at a given moment, considered by consumers to be substitutes but which are, nonetheless, *capable* of being substituted for one another."[366] Therefore, requiring identity in frequency and nature of consumers' purchase decisions, as suggested by the Philippines, would not sufficiently account for *latent* demand for imported distilled spirits in the Philippine market.

219. Moreover, in determining whether imported and domestic distilled spirits offer "alternative ways of satisfying a particular need or taste"[367] in the Philippines, the Panel was required to examine both "latent and *extant* demand"[368] for imported distilled spirits in the Philippine market. Viewed in this light, we read the Panel's statement that many consumers may be able to purchase high-priced distilled spirits "at least on special occasions" merely as providing additional support to its conclusion that there is at least some extant demand for imported distilled spirits in the Philippine market.

220. Moreover, the Philippines argues that the Panel incorrectly found direct competition on the basis of a "narrow segment" of the population having "access" to imported distilled spirits. We are not persuaded. To begin with, we note that the Panel did not accept that the Philippine market is divided into two distinct segments in terms of purchasing power, but rather, is distributed "along a continuum of income brackets".[369] In the passage challenged by the Philippines, the Panel engaged with the Philippines' argument concerning segmentation in the Philippines' distilled spirits market simply on an *arguendo* basis. It reasoned that, even assuming that the Philippine market were segmented, at least one segment of the market has "access" to both domestic and imported distilled spirits.[370] In our view, it was reasonable for the Panel to draw, from the Philippines' argument that imported distilled spirits are only available to a "narrow segment" of its population, the inference that there is actual competition between imported and domestic distilled spirits at least in the segment of

[365]Philippines' appellant's submission, para. 99.
[366]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 114. (original emphasis)
[367]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 115.
[368]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 116. (emphasis added)
[369]Panel Reports, para. 7.59.
[370]Panel Reports, para. 7.120.

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the market that the Philippines admitted has access to both imported and domestic distilled spirits. Moreover, we note that the Panel buttressed this conclusion with statements from domestic Philippine companies that their products face competition from imported distilled spirits, and that their marketing strategies convey an image of their products as drinks that compete with imported distilled spirits.[371]

221. More importantly, we do not agree with the Philippines that Article III:2, second sentence, requires that competition be assessed in relation to the market segment that is most representative of the "market as a whole".[372] To the contrary, the Panel was correct in concluding that Article III of the GATT 1994 "does not protect just *some* instances or *most* instances, but rather, it protects *all* instances of direct competition."[373] This reading is consistent with the Appellate Body's finding that the object and purpose of the GATT 1994, as reflected in Article III, is "requiring equality of competitive relationships and protecting expectations of equal competitive relationships".[374] Moreover, current demand for imported spirits in the Philippine market is a function of actual retail prices, which could be distorted by the excise tax system and other related effects, such as higher distribution costs, and lower volumes and economies of scale.[375] In this regard, we recall that under the excise tax system imported distilled spirits are subject to taxes that are 10 to 40 times higher than those applied to domestic distilled spirits. Therefore, current consumer demand for imported distilled spirits in the Philippines is likely to be *understated* by the effects of the excise tax system.

222. For these reasons, it was reasonable for the Panel to conclude that actual competition in a segment of the market further supports its conclusion that imported and domestic distilled spirits are capable of being substituted in the Philippines. This inference, together with other quantitative and qualitative elements relied on by the Panel, such as the substitutability studies[376] and instances of price

[371]Panel Reports, footnote 528 to para. 7.120 (referring to European Union's first written submission to the Panel, paras. 127-136; and Panel Exhibits EU-22, EU-25, EU-29, EU-43, EU-58, EU-59, EU-60, EU-63, EU-64, EU-65, and EU-87). These exhibits essentially consist of printouts of Philippine distilled spirit producers' websites, Philippine distilled spirits' press advertisements, and excerpts from Philippine distilled spirit producers' annual reports.

[372]Philippines' appellant's submission, para. 117.

[373]Panel Reports, para. 7.120 (referring to Panel Report, *Chile – Alcoholic Beverages*, para. 7.43). (original emphasis)

[374]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 120.

[375]See Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 122 and 123. See also Panel Report, *Chile – Alcoholic Beverages*, para. 7.78.

[376]Panel Reports, paras. 7.112 (referring to *Euromonitor International* survey, *supra*, footnote 37, p. 19; and Abrenica & Ducanes, *supra*, footnote 65) and 7.113.

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competition[377], provide support for its finding that there is "a direct competitive relationship between domestic and imported distilled spirits" in the Philippines.[378]

(c) Potential Competition

223. The Philippines further claims that the Panel erred in its application of Article III:2, second sentence, of the GATT 1994 in finding that instances of actual competition indicated *potential* competition between imported and domestic distilled spirits in the Philippine market. The Philippines argues that "aberrational and exceptional" instances of price overlap between imported and domestic distilled spirits fall short of establishing both actual and potential competition in the marketplace.[379] The Philippines adds that the inquiry into *potential* competition is limited to determining "whether competition would otherwise occur if the measures were not in place".[380] The "massive [pre-tax] price differential" between domestic and imported distilled spirits demonstrates that the lack of direct competition or substitution in the Philippine market cannot be attributed to the excise tax at issue.[381] Furthermore, the Philippines maintains that the Panel acted inconsistently with Article 11 of the DSU in finding that the products at issue are capable of competing in the future without a sufficient evidentiary basis.[382]

224. Both the European Union and the United States respond that the Panel correctly concluded that there is potential competition between domestic and imported distilled spirits in the Philippine market. The European Union emphasizes that the Philippines does not challenge the Panel's factual finding that price overlap is not "exceptional".[383] For its part, the United States argues that direct competition under Article III:2 does not require "some minimum threshold amount of actual competition"[384], because two products may be "directly competitive or substitutable" even if direct competition is only potential and is not occurring at the present time.[385] Both the European Union and the United States also argue that the Panel did not exceed its discretion under Article 11 of the DSU in reaching its findings concerning potential competition.

225. The Philippines' challenge is directed at the following statement by the Panel:

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[377]Panel Reports, para. 7.118.
[378]Panel Reports, para. 7.137.
[379]Philippines' appellant's submission, paras. 109 and 110.
[380]Philippine's appellant's submission, para. 111.
[381]Philippine's appellant's submission, para. 112.
[382]Philippines' appellant's submission, paras. 185 and 186.
[383]European Union's appellee's submission, para. 107.
[384]United States' appellee's submission, para. 83.
[385]United States' appellee's submission, para. 84.

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> In our view, an Article III analysis should not depend on predicting income distribution patterns, but rather on whether there is evidence that consumers are willing, or may be willing, to use the different products to satisfy the same or similar needs. In this respect, the instances of actual competition … are a clear indication that the imported and domestic products at issue in this dispute are indeed *capable* of being directly competitive or substitutable in the future.[386] (original emphasis)

226. We do not agree with the Philippines that this statement is in error. As noted earlier, the Philippines does not appeal the Panel's finding that there are overlaps in the prices of imported and domestic distilled spirits, both for high- and low-priced products.[387] We have also agreed with the Panel that such price overlaps support the Panel's finding that "in some cases imported and domestic products compete with respect to price."[388] In our view, such instances of *actual* competition are also highly probative in relation to *potential* competition, particularly in this case where imported distilled spirits are subject to excise taxes that are 10 to 40 times higher than those applicable to domestic distilled spirits. Therefore, the excise tax system could have the effect of "creating and even freezing preferences for domestic goods" in the Philippines.[389] For this reason, instances of *current* substitution are likely to *underestimate* latent demand for imported spirits as a result of distortive effects introduced by the excise tax at issue. This is particularly the case for "experience goods" such as distilled spirits, which consumers "tend to purchase because they are familiar with them and with which consumers experiment only reluctantly".[390]

227. In addition, we do not agree with the Philippines that an analysis of potential competition under Article III:2, second sentence, is limited to an assessment of whether competition would otherwise occur if the challenged taxation were not in place.[391] In our view, such a "but for" test reflects an overly restrictive interpretation of the term "directly competitive or substitutable" products, one which assumes that internal taxation is the *only* factor restricting potential substitutability. On the contrary, as noted by the Appellate Body, "consumer demand may be influenced by measures other than internal taxation", such as "earlier protectionist taxation, previous import prohibitions or quantitative restrictions".[392]

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[386]Panel Reports, para. 7.121.
[387]Panel Reports, para. 7.118.
[388]Panel Reports, para. 7.118.
[389]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 120 (quoting Panel Report, *Japan – Alcoholic Beverages II*, para. 6.28).
[390]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 123.
[391]Philippines' appellant's submission, para. 111.
[392]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 123.

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228. Accordingly, we do not consider that the Panel erred in drawing from instances of current price competition the inference that domestic and imported distilled spirits are capable of being substituted in the Philippine market. Latent demand for imported distilled spirits in the Philippines is likely to be *underestimated* by the effects of the excise tax at issue both on consumer perception and on price levels for imported distilled spirits.

229. In addition to its claim that the Panel erred in its application of Article III:2, second sentence, to the facts of this case, the Philippines also claims that the Panel acted inconsistently with Article 11 of the DSU in finding that imported and domestic distilled spirits are "*capable* of being directly competitive or substitutable in the future"[393] without a sufficient evidentiary basis. We recall that the Appellate Body has emphasized that a claim that a panel failed to comply with its duties under Article 11 of the DSU "must stand by itself and should not be made merely as a subsidiary argument or claim in support of a claim that the panel failed to apply correctly a provision of the covered agreements."[394] The Philippines advances, in support of its claims of violation under Article 11 of the DSU, essentially the same arguments that it puts forward in support of its claims that the Panel erred in its application of Article III:2, second sentence, of the GATT 1994. We have found that the Panel did not err in deriving from instances of actual competition a conclusion with respect to potential competition between imported and domestic distilled spirits in the Philippines market. Therefore, in the absence of additional elements demonstrating that the Panel acted inconsistently with Article 11 of the DSU in reaching this finding, we do not agree that the Panel committed error under that provision. Accordingly, we dismiss the Philippines' claim that the Panel acted inconsistently with its duties under Article 11 of the DSU in finding that imported and domestic distilled spirits are "*capable* of being directly competitive or substitutable in the future".[395]

(d) Substitutability Studies – Article 11 of the DSU

230. Finally, the Philippines claims that the Panel failed to conduct an objective assessment of the facts in its examination of the studies that aimed at evaluating the substitutability between domestic and imported distilled spirits in the Philippine market.[396]

231. According to the Philippines, the Panel's conclusion that *both* substitutability studies show "a significant degree of competitiveness or substitutability" between domestic and imported distilled

[393]Panel Reports, para. 7.121. (original emphasis)
[394]Appellate Body Report, *Chile – Price Band System (Article 21.5 – Argentina)*, para. 238. See also Appellate Body Report, *US – Steel Safeguards*, para. 498.
[395]Panel Reports, para. 7.121. (original emphasis)
[396]Philippines' appellant's submission, para. 162.

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spirits in the Philippine market is directly contradicted by one of those studies (the Abrenica & Ducanes study), which finds "negligible" levels of substitutability.[397] The Philippines adds that the *Euromonitor International* survey is an insufficient basis for a finding of substitutability, because it does not estimate the cross-price elasticity coefficient, does not isolate the effects of an increase in domestic prices on volumes of imported spirits, and is based on a sample that is not representative of the entire market.[398] The Philippines adds that the Panel inaccurately described the methodology of the Abrenica & Ducanes study, because it erroneously observed that this study was based on scenarios where the prices of imported and domestic distilled spirits changed simultaneously.[399]

232. The European Union responds that the Abrenica & Ducanes study estimated that in a tax-neutral environment the market share of imported distilled spirits would increase by between 13 and 24.5 per cent, thus lending support to the Panel's conclusion on substitutability.[400] The *Euromonitor International* survey also supports the Panel's conclusion with respect to substitutability, because it shows, on the basis of a representative sample, that consumers regard local and imported products as "largely substitutable" and that they would react to price movements by switching between those categories.[401] The European Union adds that the Panel correctly described the methodology of the Abrenica & Ducanes study, because that study did not attempt to examine consumer response to a rise in prices of all domestic spirits, or a reduction in prices of all imported spirits.[402]

233. Similarly, the United States posits that the Panel adequately examined the substitutability studies, and drew appropriate conclusions on the basis of that evidence. The Panel's conclusion that there is a "significant degree of competitiveness or substitutability" between domestic and imported distilled spirits in the Philippine market was based on a variety of evidence, including the substitutability studies, similarity of marketing campaigns, labelling, and sales locations.[403] The United States notes that both studies found that, while small, there is substitutability in spite of persistent price gaps between imported and domestic products and other factors such as brand loyalty.

[397]Philippines' appellant's submission, paras. 163 and 164 (quoting Panel Reports, paras. 7.62 and 7.113).
[398]Philippines' appellant's submission, paras. 165 and 169.
[399]Philippines' appellant's submission, paras. 166 and 167 (quoting Panel Reports, para. 7.56).
[400]European Union's appellee's submission, paras. 181 (quoting Panel Reports, para. 7.55) and 182.
[401]European Union's appellee's submission, para. 172.
[402]European Union's appellee's submission, para. 176.
[403]United States' appellee's submission, para. 118 (quoting Panel Reports, para. 7.61).

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According to the United States, the Philippines in essence disagrees with the weight accorded by the Panel to the substitutability studies.[404]

234. For its part, the Panel observed that, while the *Euromonitor International* survey did not attempt to estimate the cross-price elasticity for imported and domestic distilled spirits in the Philippines[405], the Abrenica & Ducanes study estimates it to range between -0.01 and 0.07, which the authors consider "low", therefore demonstrating that "local and imported brands [of distilled spirits] are non-substitutable".[406] The Panel then observed that both studies were based on scenarios where prices of imported and domestic distilled spirits change simultaneously. According to the Panel, the studies' conclusions with respect to substitutability would have been clearer had the studies attempted to "isolate the effects of an increase in the price of domestic spirits on the quantities consumed of imported spirits".[407] Nonetheless, the Panel concluded that:

> … the studies support the proposition that there is a significant degree of competitiveness or substitutability in the Philippines' market between the distilled spirits at issue in the present dispute. This refers both to distilled spirits as a general category, as well as to specific types of distilled spirits such as gin, brandy, vodka and whisky.[408] (footnote omitted)

235. We recall that Article 11 of the DSU requires a panel to "consider all the evidence presented to it, assess its credibility, determine its weight, and ensure that its factual findings have a proper basis in that evidence."[409] Within these parameters, "it is generally within the discretion of the panel to decide which evidence it chooses to utilize in making findings"[410], and panels "are not required to accord to factual evidence of the parties the same meaning and weight as do the parties."[411] For a claim under Article 11 to succeed, the Appellate Body must be satisfied that the panel has exceeded its authority as initial trier of facts, which requires it to provide "reasoned and adequate explanations

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[404]United States' appellee's submission, para. 125.

[405]Panel Reports, para. 7.112 (referring to *Euromonitor International* survey, *supra*, footnote 37, p. 5).

[406]Panel Reports, para. 7.112 (referring to Abrenica & Ducanes, *supra*, footnote 65, pp. 2, 11, 12, and 20).

[407]Panel Reports, para. 7.112.

[408]Panel Reports, para. 7.113.

[409]Appellate Body Report, *Brazil – Retreaded Tyres*, para. 185 (referring to Appellate Body Report, *EC – Hormones*, paras. 132 and 133).

[410]Appellate Body Report, *EC – Hormones*, para. 135.

[411]Appellate Body Report, *Australia – Salmon*, para. 267.

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and coherent reasoning"[412], base its finding on a sufficient evidentiary basis[413], and treat evidence with "even-handedness".[414]

236. Against these parameters, we turn to the specific issues raised by the Philippines on appeal. We begin with the Philippines' argument that the Panel failed to conduct an objective assessment of the matter before it because the Abrenica & Ducanes study directly contradicts the Panel's finding that "the studies support the proposition that there is a significant degree of competitiveness or substitutability" between domestic and imported distilled spirits in the Philippine market.[415] We agree with the Philippines that the Panel could have better explained how the Abrenica & Ducanes study could be viewed as evidence of a "significant degree" of substitutability, particularly in light of the study's conclusion that substitutability between imported and domestic distilled spirits in the Philippine market, estimated to range between -0.01 and 0.07, was "low".[416] However, we consider that the weight and significance to be attributed to that estimated cross-price elasticity coefficient is a matter falling within the Panel's discretion as initial trier of facts. We recall that, under the excise tax system, imported distilled spirits are subject to taxation that is 10 to 40 times higher than that applicable to domestic distilled spirits. Therefore, the excise tax could have the effect of creating or even freezing consumer preferences for domestic distilled spirits in the Philippine market. Viewed in this light, even a "low" cross-price elasticity of between -0.01 and 0.07 could be found "significant", particularly at the higher end of that range. In this respect, we agree with the panel in *Chile – Alcoholic Beverages* that a low coefficient of cross-price elasticity is not "fatal" to a claim of direct competitiveness or substitutability because "the econometric measurement of the degree of substitution may not … always adequately reflect the extent of substitution" by virtue of the effects of the internal taxation on consumer preferences and the foreign suppliers' pricing behaviour.[417]

237. Moreover, despite its conclusion that the cross-price elasticity between domestic and imported distilled spirits in the Philippines is "low", the Abrenica & Ducanes study in fact also concluded that the market share of imported distilled spirits in the Philippines would increase by between 13 and 24.5 per cent in a tax-neutral environment.[418] The assessment of the significance of such market share increases in terms of the degree of competition between domestic and imported

[412]Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, footnote 618 to para. 293.
[413]See Appellate Body Report, *US – Carbon Steel*, para. 148.
[414]Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, para. 292.
[415]Panel Reports, para. 7.113.
[416]A coefficient of cross-price elasticity of -0.01 means that the choice probability for the imported spirit would *decline* by 1 per cent due to a 10 per cent increase in the price of domestic spirits. Conversely, the choice probability for the imported spirit would increase by 7 per cent as a result of a 10 per cent increase in the price of domestic spirits. (See Abrenica & Ducanes, *supra*, footnote 65, p. 12)
[417]Panel Report, *Chile – Alcoholic Beverages*, paras. 7.69 and 7.70.
[418]Panel Reports, para. 7.55 (referring to Abrenica & Ducanes, *supra*, footnote 65, p. 14).

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distilled spirits in the Philippines is similarly a matter falling within the purview of the Panel's fact-finding authority under Article 11 of the DSU.

238. We are also not persuaded by the Philippines' argument that the *Euromonitor International* survey did not provide a sufficient basis to rebut the Abrenica & Ducanes study's conclusion that the cross-price elasticity between imported and domestic distilled spirits in the Philippines was "low". In our view, the fact that the *Euromonitor International* survey did not attempt to estimate the cross-price elasticity or to isolate the effects of increases in domestic spirits' prices on the volume of imported spirits does not undermine the Panel's assessment of its probative value with respect to substitutability in the Philippine market. Moreover, it was for the Panel to determine the credibility of the results of the study, in light of the Philippines' objections concerning the sample upon which it is based. In our view, the Panel's finding that there is a "significant degree" of substitutability between imported and domestic distilled spirits in the Philippine market is borne out by the *Euromonitor International* survey conclusion that:

> [o]n average, at an import price decrease of 25% and domestic increase of 50%, consumers were 4.9% more willing to purchase imports and 4.0% less likely to purchase domestics"; "On average, at an import price decrease of 40% to 60% and domestic increase of 100% to 200%, consumers were 10.1% more willing to purchase imports and 6.5% less likely to purchase domestics"; and, "If price were no issue, on average, consumers were 43% more likely [to] purchase local brands and 86% more likely to purchase imported ones.[419] (footnote omitted)

239. Thus, we consider that the Philippines' challenge is directed at the Panel's weighing of the evidence contained in the *Euromonitor International* survey and in the Abrenica & Ducanes study. Article 11 of the DSU required the Panel to "consider all the evidence presented to it, assess its credibility, determine its weight, and ensure that its factual findings have a proper basis in that evidence".[420] Within these parameters, the Panel did not exceed the bounds of its discretion simply by according to the evidence contained in the two studies a weight that is different than that attributed by the Philippines.[421]

240. Turning to the Philippines' argument concerning the Panel's alleged mischaracterization of the methodology upon which the Abrenica & Ducanes study was based, it is not clear why the Panel's

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[419] Panel Reports, para. 7.54 (quoting *Euromonitor International* survey, *supra*, footnote 37, pp. 30 and 33).

[420] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 185 (referring to Appellate Body Report, *EC – Hormones*, paras. 132 and 133).

[421] See Appellate Body Report, *Australia – Salmon*, para. 267.

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allegedly inaccurate description of such methodology as one based on simultaneous changes in the prices of both imported and domestic spirits would amount to a violation of its duties under Article 11 of the DSU. The Appellate Body has held that "not every error in the appreciation of a particular piece of evidence will rise to the level of a failure by the Panel to comply with its duties under Article 11 of the DSU."[422] According to the Appellate Body, this will only be the case where such error "undermine[s] the objectivity of the Panel's assessment".[423] In this case, the Philippines has not demonstrated that the Panel's alleged mischaracterization of the methodology used in the Abrenica & Ducanes study calls into question the objectivity of the Panel's assessment of the substitutability studies. In any event, the Philippines seems correct in arguing that, in the first part of the Abrenica & Ducanes study, consumer preferences were initially assessed in a scenario where prices of the selected brand increased, while prices for all other brands remained unchanged. However, in the second part of the study, changes in the market share for imported distilled spirits were estimated under three tax-neutral scenarios (uniform excise tax, *ad valorem* tax, and no tax) in which prices of imported brands would fall, while those of their local counterparts simultaneously would increase.[424]

241. Accordingly, we do not consider that the Panel acted inconsistently with its duties under Article 11 of the DSU in its examination of the *Euromonitor International* survey and of the Abrenica & Ducanes study.

(e) Conclusion

242. In light of all of the above, we consider that the Panel did not err in its assessment of the competitive relationship between the imported and domestic distilled spirits at issue in the Philippine market. In our view, studies showing a significant degree of substitutability in the Philippine market between imported and domestic distilled spirits, as well as instances of price competition and evidence of actual and potential competition between imported and domestic distilled spirits in the Philippine market, sufficiently support the Panel's conclusion that there is "a direct competitive relationship [in the Philippines] between domestic and imported distilled spirits, made from different raw materials".[425] This factor, combined with the other elements upon which the Panel relied, such as overlap in the channels of distribution[426], and similarities in the products' physical characteristics[427], end-uses, and marketing[428], sufficiently support the Panel's finding that all imported

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[422]Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1318.
[423]Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1318.
[424]See Panel Reports, para. 7.55 (referring to Abrenica & Ducanes, *supra*, footnote 65, p. 13).
[425]Panel Reports, para. 7.137.
[426]Panel Reports, para. 7.123.
[427]Panel Reports, para. 7.127.

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and domestic distilled spirits at issue are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994.

243. Accordingly, we *uphold* the Panel's finding, at paragraph 7.138 of the Panel Reports, that all the distilled spirits at issue in the present dispute, whether imported or domestic, and irrespective of the raw materials from which they are made, are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994.

2. "So As to Afford Protection to Domestic Production"

244. We now turn to the Philippines' claim that the Panel erred in finding that the Philippines' excise tax is applied in a manner "so as to afford protection to domestic production" within the meaning of Article III:2, second sentence, of the GATT 1994.

245. We recall that, in reviewing the "design, architecture and structure" of the measure at issue, the Panel observed that all designated raw materials listed in Section 141(a) of the NIRC are grown in the Philippines and "*all* domestic distilled spirits are produced from designated raw materials", thus being subject to the lower flat tax rate of PHP 14.68 ppl.[429] By contrast, the vast majority of imported distilled spirits are not made from designated raw materials and are therefore subject to the higher tax rates provided for in Section 141(b), varying from PHP 158.73 to PHP 634.90 ppl. For the Panel, this meant that "*de facto* the measure results in all domestic distilled spirits enjoying the favourable low tax, while the vast majority of the imported spirits" are subject to taxes between 10 and 40 times higher.[430]

246. The Panel rejected the Philippines' argument that the measure at issue has no impact on competitive conditions in its market by virtue of the low purchasing power of the vast majority of the Philippine population and of the pre-tax price differences between domestic and imported distilled spirits. The Panel observed that, in *Korea – Alcoholic Beverages*, the Appellate Body rejected a "very similar argument" and found that, since the products at issue "ha[d] already been found to be directly competitive or substitutable", such argument was "misplaced at this stage of the analysis".[431] The Appellate Body in that dispute further stated that "Article III is not concerned with trade volumes" and

[428]Panel Reports, paras. 7.129 and 7.131.
[429]Panel Reports, para. 7.182. (original emphasis)
[430]Panel Reports, paras. 7.182 and 7.183.
[431]Panel Reports, para. 7.185 (quoting Appellate Body Report, *Korea – Alcoholic Beverages*, para. 152).

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therefore "[i]t is … not incumbent on a complaining party to prove that tax measures are capable of producing any particular trade effect."[432]

247. In light of the above considerations, the Panel concluded that:

> … the design, architecture, and structure of the measure, including the magnitude of the tax differential applicable to imported and domestic products, reveal the protective nature of the measure. … [T]he dissimilar taxation imposed by the Philippine excise tax on imported distilled spirits and on directly competitive or substitutable domestic spirits is applied "so as to afford protection" to Philippine domestic production of distilled spirits.[433]

248. The Philippines claims that the Panel's finding is in error for two reasons. First, the facts "simply do not support" the Panel's conclusion that "the vast majority of imported spirits are subject to higher taxes"[434] because approximately 50 per cent of the domestic production of distilled spirits is made from imported ethyl alcohol, a "significant quantity" of which is, in turn, subject to the lower flat tax rate under Section 141(a) of the NIRC.[435] Second, the Philippines submits that the Panel erroneously rejected its argument that the excise tax could have no protectionist intent given that the vast majority of Philippine households cannot afford imported distilled spirits. In particular, by merely "transferring the reasoning"[436] applied by the Appellate Body to the facts in *Korea – Alcoholic Beverages* and dismissing the Philippines' argument "for the same reasons"[437], the Panel engaged in a "legally deficient" inquiry[438] and fell short of the case-by-case, "comprehensive and objective analysis" that is required under Article III:2, second sentence, of the GATT 1994.[439]

249. The European Union and the United States respond that the Panel was correct in finding that the excise tax is applied "so as to afford protection to domestic production". In particular, the European Union stresses that ethyl alcohol is merely an input used in the production of distilled spirits

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[432]Panel Reports, para. 7.185 (quoting Appellate Body Report, *Korea – Alcoholic Beverages*, para. 153).

[433]Panel Reports, para. 7.187.

[434]Philippines' appellant's submission, para. 128 (quoting Panel Reports, para. 7.182).

[435]Philippines' appellant's submission, para. 128 (referring to Letter from the Commissioner of the Philippines Bureau of Internal Revenue, dated 3 February 2011, to the President of Distilled Spirits Association of the Philippines (Panel Exhibit PH-82; and Philippines' response to Panel Question 68(a)).

[436]Philippines' appellant's submission, para. 134.

[437]Panel Reports, para. 7.186.

[438]Philippines' appellant's submission, para. 132.

[439]Philippines' appellant's submission, paras. 133 (quoting Panel Reports, para. 7.179, in turn quoting Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:1, 97, at 120; and referring to Appellate Body Report, *Korea – Alcoholic Beverages*, para. 137).

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and is therefore of no relevance to the current dispute.[440] It further submits that, at this stage of its analysis, the Panel rightly refrained from re-addressing the question of whether domestic and imported spirits are "directly competitive or substitutable".[441] The United States argues that the Panel correctly focused on the "magnitude of the difference in taxation, … the design, structure and application" of the measure at issue.[442] Likewise, the Panel appropriately focussed on the final products at issue, rather than on inputs used by domestic producers.[443] The United States maintains further that it was not necessary for the Panel to inquire into the motivations for the measure, and emphasizes that the Philippines does not dispute the fact that imported distilled spirits are subject to higher taxes than all domestic distilled spirits.[444]

250. We recall that, in *Japan – Alcoholic Beverages II*, the Appellate Body stated that the question of whether dissimilar taxation affords protection is not one of intent, but rather of application of the measure at issue. This requires a "comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products".[445] The Appellate Body observed that, "[a]lthough it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure."[446] The Appellate Body further stated that dissimilar taxation must be more than *de minimis*, and that in certain cases "[t]he very magnitude of the dissimilar taxation … may be evidence of such a protective application."[447] In *Korea – Alcoholic Beverages*, the Appellate Body added that the protective application of dissimilar taxation can only be determined "on a case-by-case basis, taking account of all relevant facts".[448]

251. Against this background, we now turn to the specific issues raised by this part of the Philippines' appeal. The Philippines claims that the Panel erred in finding that the "vast majority of imported spirits are subject to higher taxes" because approximately 50 per cent of domestic production is made from imported ethyl alcohol, which is taxed at the lower rate.[449]

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[440]European Union's appellee's submission, paras. 122 and 123.
[441]European Union's appellee's submission, paras. 128-130.
[442]United States' appellee's submission, para. 93.
[443]United States' appellee's submission, para. 96.
[444]United States' appellee's submission, para. 97.
[445]Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:1, 97, at 120. See also Appellate Body Report, *Korea – Alcoholic Beverages*, para. 149.
[446]Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:1, 97, at 120.
[447]Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:1, 97, at 120.
[448]Appellate Body Report, *Korea – Alcoholic Beverages*, para. 137.
[449]Philippines' appellant's submission, para. 128.

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252. We do not find merit in the Philippines' argument in this respect. In our view, the question before the Panel at this stage of its analysis was whether the design, architecture, and structure of the excise tax indicates that such measure affords protection to the Philippine production of the "directly competitive or substitutable" distilled spirits at issue in this dispute. Ethyl alcohol, as such, does not fall within the category of the "directly competitive or substitutable" distilled spirits at issue, but, rather, is an input used in the production of these distilled spirits. Therefore, the fact that imported ethyl alcohol is subject to taxation similar to that imposed on domestic distilled spirits had no bearing on the Panel's assessment of whether the excise tax affords protection to domestic production of the directly competitive or substitutable distilled spirits at issue.

253. We now turn to the Philippines' claim that the Panel fell short of the required "case-by-case, comprehensive analysis" when it dismissed its argument that the excise tax could not afford protection to domestic production because of the competitive conditions in the Philippine market, where the majority of the population cannot afford imported distilled spirits.[450]

254. We agree with the Philippines that, read in isolation, the portion of the Panel's reasoning at which the Philippines' claim is directed was too cursory. Had the Panel found that the excise tax regime affords protection to domestic production solely by referring to the reasoning articulated by the Appellate Body in *Korea – Alcoholic Beverages*, it would have fallen short of a comprehensive and objective analysis of the case at hand.

255. However, the Panel's analysis of whether the measure at issue is applied so as to afford protection to Philippine production was not as limited as the Philippines suggests. Indeed, the Panel reviewed "the design, architecture and structure" of the measure in some detail and observed that, while "*[a]ll* designated raw materials are grown in the Philippines and *all* domestic distilled spirits are produced from designated raw materials", the vast majority of imported distilled spirits "are *not* made from designated raw materials".[451] It therefore concluded that, *de facto*, the application of the measure resulted in all domestic spirits enjoying the lower flat tax rate, while the vast majority of imported spirits are subject to higher taxes.[452] The Panel stressed further that the more burdensome tax treatment applied to imported spirits can be quantified in the order of "10 to 40 times that applicable to all domestic spirits", thus making the difference in taxation "nominally large".[453] In our view, these findings by the Panel, taken as a whole, constitute an adequate analysis of the specific

[450] Philippines' appellant's submission, para. 135.
[451] Panel Reports, para. 7.182. (original emphases)
[452] Panel Reports, para. 7.182.
[453] Panel Reports, para. 7.183.

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facts of this dispute, as they relate to the European Union's and the United States' claims under Article III:2, second sentence, of the GATT 1994.

256. Having made the findings above, the Panel went on to dismiss the Philippines' argument regarding the lack of protective application on the basis of market segmentation. We agree with the Panel that the assessment of whether the excise tax could affect the competitive relationship between domestic and imported distilled spirits in the Philippine market pertains to the prong of analysis directed at determining whether the products are "directly competitive or substitutable". Having addressed—and rejected—the Philippines' arguments concerning pre-tax price differentials when determining whether the products at issue are "directly competitive or substitutable" in the Philippine market, it was not necessary for the Panel to revisit this argument in its assessment of whether the dissimilar taxation of such products afforded protection to domestic production. Moreover, the passage of the Appellate Body report in *Korea – Alcoholic Beverages* quoted by the Panel explained that a finding that a tax measure affords protection to domestic production does not depend upon showing "some identifiable trade effect".[454] Thus, the question of whether or not the excise tax negatively impacts trade in imported distilled spirits is not determinative of the question of whether the measure affords protection to domestic production.

257. In light of the above, we do not consider that the Panel erred in its application of the term "so as to afford protection to domestic production" when it found, in paragraph 7.187 of the Panel Reports, that "the design, architecture, and structure of the measure, including the magnitude of the tax differential applicable to imported and domestic products, reveal the protective nature of the measure."[455] Accordingly, we *uphold* the Panel's finding, in paragraph 7.187 of the Panel Reports, that dissimilar taxation imposed by the Philippine excise tax on imported distilled spirits and on directly competitive or substitutable domestic spirits is applied "so as to afford protection" to Philippine production of distilled spirits.

C. *Conclusion*

258. For all the foregoing reasons, we *uphold* the Panel's finding, in paragraph 7.188 of its Reports, that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994 by applying dissimilar internal taxation to all imported distilled spirits made from non-designated raw materials and to all directly competitive or substitutable domestic distilled spirits

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[454]Panel Reports, para. 7.185 (quoting Appellate Body Report, *Korea – Alcoholic Beverages*, para. 153).

[455]Panel Reports, para. 7.187.

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made from designated raw materials, so as to afford protection to Philippine production of distilled spirits.

259. Consequently, we *uphold* the Panel's finding, in paragraphs 7.188 and 8.2(b) of the US Panel Report, that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994 by applying dissimilar internal taxes to all imported spirits made from non-designated raw materials and to all directly competitive or substitutable domestic distilled spirits made from designated raw materials, so as to afford protection to Philippine production of distilled spirits.

260. Having *reversed* the Panel's finding at paragraph 8.3 of the EU Panel Report that the European Union's claim under the second sentence of Article III:2 was made in the "alternative" to its claim under the first sentence thereof, we complete the legal analysis on the basis of factual findings made by the Panel in the context of the complaints by the European Union and the United States, and on the basis of the legal findings that the Panel made under Article III:2, second sentence, in addressing the complaint by the United States, as upheld in this appeal. We consequently *find*, in relation to the European Union's claim, that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994 by applying dissimilar internal taxation to all imported spirits made from non-designated raw materials and to all directly competitive or substitutable domestic distilled spirits made from designated raw materials, so as to afford protection to Philippine production of distilled spirits.

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VII. Findings and Conclusions in the Appellate Body Report WT/DS396/AB/R

261. In the appeal of the Panel Report, *Philippines – Taxes on Distilled Spirits* (complaint by the European Union, WT/DS396/R) (the "EU Panel Report"), for the reasons set out in this Report, the Appellate Body:

(a) with respect to Article III:2, first sentence, of the GATT 1994:

(i) upholds the Panel's finding, in paragraph 7.85 of the EU Panel Report, that each type of imported distilled spirit at issue in this dispute—gin, brandy, vodka, whisky, and tequila—made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials, within the meaning of Article III:2, first sentence, of the GATT 1994;

(ii) finds that the Panel did not act inconsistently with Article 11 of the DSU in its evaluations of the products' physical characteristics, of the Philippine market for distilled spirits, and of tariff classification;

(iii) upholds, as a consequence, the Panel's finding, in paragraphs 7.90 and 8.2 of the EU Panel Report, that the Philippines has acted inconsistently with Article III:2, first sentence, of the GATT 1994 by imposing on each type of imported distilled spirit at issue in this dispute—gin, brandy, rum, vodka, whisky, and tequila—internal taxes in excess of those applied to "like" domestic distilled spirits of the same type made from designated raw materials; and

(iv) reverses the Panel's finding, in paragraph 7.77 of the EU Panel Report, to the extent that it stands for the proposition that *all* distilled spirits at issue in this dispute are "like products", regardless of types, within the meaning of Article III:2, first sentence, of the GATT 1994;

(b) with respect to Article III:2, second sentence, of the GATT 1994:

(i) reverses the Panel's findings, in paragraphs 7.1, 7.5, 7.17, 7.92, 7.93, 7.95, and 8.3 of the EU Panel Report, that the European Union's claim under Article III:2, second sentence, of the GATT 1994 was made in the "alternative" to its claim under the first sentence of that provision;

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(ii) finds that the Panel acted inconsistently with its duties under Article 11 of the DSU, in paragraph 8.3 of the EU Panel Report, by failing to examine, and abstaining from making findings in relation to, the European Union's separate and independent claim under Article III:2, second sentence, of the GATT 1994;

(iii) upholds the Panel's finding, in paragraph 7.138 of the EU Panel Report, that all imported distilled spirits made from non-designated raw materials and all domestic distilled spirits made from designated raw materials at issue in this dispute are "directly competitive or substitutable" within the meaning of Article III:2, second sentence, of the GATT 1994, and finds that the Panel did not act inconsistently with Article 11 of the DSU in reaching this finding;

(iv) upholds the Panel's finding, in paragraph 7.187 of the EU Panel Report, that dissimilar taxation imposed by the Philippine excise tax on imported distilled spirits and on directly competitive or substitutable domestic spirits is applied "so as to afford protection" to Philippine production of distilled spirits; and

(v) on this basis, completes the legal analysis in relation to the European Union's separate and independent claim under Article III:2, second sentence, and finds that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994, by applying dissimilar internal taxation to imported distilled spirits and to directly competitive or substitutable domestic distilled spirits, so as to afford protection to Philippine production of distilled spirits.

262. The Appellate Body recommends that the DSB request the Philippines to bring its measures, found in this Report and in the EU Panel Report, as modified by this Report, to be inconsistent with the GATT 1994, into conformity with its obligations under that Agreement.

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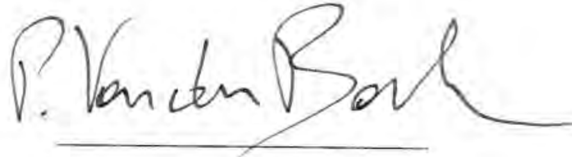
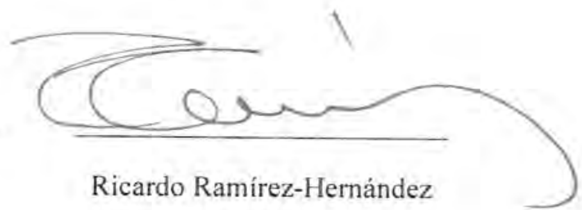
Signed in the original in Geneva this 7th day of December 2011 by:



Peter Van den Bossche
Presiding Member

Jennifer Hillman
Member



Ricardo Ramírez-Hernández
Member

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VII. Findings and Conclusions in the Appellate Body Report WT/DS403/AB/R

261. In the appeal of the Panel Report, *Philippines – Taxes on Distilled Spirits* (complaint by the United States, WT/DS403/R) (the "US Panel Report"), for the reasons set out in this Report, the Appellate Body:

(a) with respect to Article III:2, first sentence, of the GATT 1994:

(i) upholds the Panel's finding, in paragraph 7.85 of the US Panel Report, that each type of imported distilled spirit at issue in this dispute—gin, brandy, vodka, whisky, and tequila—made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials, within the meaning of Article III:2, first sentence, of the GATT 1994;

(ii) finds that the Panel did not act inconsistently with Article 11 of the DSU in its evaluations of the products' physical characteristics, of the Philippine market for distilled spirits, and of tariff classification;

(iii) upholds, as a consequence, the Panel's finding, in paragraphs 7.90 and 8.2(a) of the US Panel Report, that the Philippines has acted inconsistently with Article III:2, first sentence, of the GATT 1994 by imposing on each type of imported distilled spirit at issue in this dispute—gin, brandy, rum, vodka, whisky, and tequila—internal taxes in excess of those applied to "like" domestic distilled spirits of the same type made from designated raw materials; and

(iv) reverses the Panel's finding, in paragraph 7.77 of the US Panel Report, to the extent that it stands for the proposition that *all* distilled spirits at issue in this dispute are "like products", regardless of types, within the meaning of Article III:2, first sentence, of the GATT 1994;

(b) with respect to Article III:2, second sentence, of the GATT 1994:

(i) upholds the Panel's finding, in paragraph 7.138 of the US Panel Report, that all imported distilled spirits made from non-designated raw materials and all domestic distilled spirits made from designated raw materials are "directly competitive or substitutable" within the meaning of Article III:2,

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second sentence, of the GATT 1994, and finds that the Panel did not act inconsistently with Article 11 of the DSU in reaching this finding;

(ii) upholds the Panel's finding, in paragraph 7.187 of the US Panel Report, that dissimilar taxation imposed by the Philippine excise tax on imported distilled spirits and on directly competitive or substitutable domestic spirits is applied "so as to afford protection" to Philippine production of distilled spirits; and

(iii) upholds, as a consequence, the Panel's finding in paragraphs 7.188 and 8.2(b) of the US Panel Report, that the Philippines has acted inconsistently with Article III:2, second sentence, of the GATT 1994 by applying dissimilar internal taxation to all imported distilled spirits made from non-designated raw materials and to all directly competitive or substitutable domestic distilled spirits made from designated raw materials, so as to afford protection to Philippine production of distilled spirits.

262. The Appellate Body recommends that the DSB request the Philippines to bring its measures, found in this Report and in the US Panel Report, as modified by this Report, to be inconsistent with the GATT 1994, into conformity with its obligations under that Agreement.

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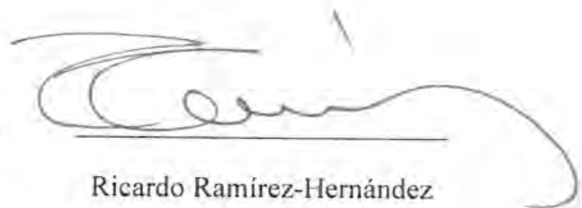
Signed in the original in Geneva this 7th day of December 2011 by:

Peter Van den Bossche
Presiding Member

Jennifer Hillman
Member



Ricardo Ramírez-Hernández
Member

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ANNEX I

WORLD TRADE ORGANIZATION

WT/DS396/7
WT/DS403/7
27 September 2011

(11-4674)

Original: English

PHILIPPINES – TAXES ON DISTILLED SPIRITS

Notification of an Appeal by the Philippines
under Article 16.4 and Article 17 of the Understanding on Rules
and Procedures Governing the Settlement of Disputes (DSU),
and under Rule 20(1) of the *Working Procedures for Appellate Review*

The following notification, dated 23 September 2011, from the Delegation of the Republic of the Philippines, is being circulated to Members.

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1. Pursuant to Articles 16.4 and 17 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the *Working Procedures for Appellate Review* (WT/AB/WP/6, 16 August 2010), the Republic of the Philippines ("the Philippines") hereby notifies the Dispute Settlement Body ("DSB") of its decision to appeal certain issues of law and legal interpretations in *Philippines – Taxes on Distilled Spirits* (WT/DS396, WT/DS403) ("Panel Report"). As set out in this notice of appeal, and pursuant to Article 17.13 of the DSU, the Philippines requests that the Appellate Body reverse or modify various legal findings and conclusions of the Panel, that result from the errors identified below.

2. Pursuant to Rule 20(2)(d)(iii) of the *Working Procedures for Appellate Review*, this notice of appeal includes an indicative list of the paragraphs of the Panel Report containing the alleged errors, without prejudice to the Philippines' ability to refer to other paragraphs of the Panel Report in the context of its appeal.

I. APPEAL OF THE PANEL'S FINDINGS OF A VIOLATION OF ARTICLE III:2, FIRST SENTENCE OF THE GATT 1994

3. The Panel erred in its interpretation and application of the term "like products" under Article III:2, first sentence of the GATT 1994 and failed to apply the appropriate standard when assessing the products' physical characteristics, consumer tastes and habits, and the products' tariff classifications.

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4. The Panel's errors of law and legal application include:

(a) The Panel failed to apply the correct standard when examining the physical characteristics of the products in question, and the manner in which they compete in the Philippine market.

(b) The Panel failed to apply the correct standard when assessing consumers' tastes and habits in the Philippine market.

(c) The Panel failed to apply the appropriate standard when examining whether the tariff classification of non-sugar-based spirits and sugar-based spirits indicated "likeness."

5. As a result of these errors, the Philippines requests that the Appellate Body reverse the Panel's findings in paragraphs 7.39, 7.40, 7.42, 7.43, 7.45, 7.46, 7.47, 7.59, 7.60, 7.62, 7.63, 7.71, 7.74, 7.76, 7.77, 7.80, 7.82, 7.83, 7.85, 7.90, 8.2 (with respect to the claims of the European Union) and 8.2(a) (with respect to the claims of the United States) of the Panel Report.

II. APPEAL OF THE PANEL'S FINDINGS OF A VIOLATION OF ARTICLE III:2, SECOND SENTENCE OF THE GATT 1994

6. The Panel erred in its interpretation and application of the term "directly competitive or substitutable" within the meaning of Article III:2, second sentence of the GATT 1994, as well as the term "so as to afford protection". The Panel consequently also failed to apply the correct standard when assessing competition in the Philippine market.

7. The Panel's errors of law and legal application include:

(a) The Panel failed to properly interpret and apply the term "directly" when it found that competition existed in the market due to the possibility that some consumer could purchase non-sugar-based spirits on "special occasions."

(b) The Panel failed to apply the correct standard when it found that it was sufficient for a certain market segment to have access to both types of products.

(c) The Panel failed to apply the correct standard when it found that potential competition existed in the Philippine market.

(d) The Panel misinterpreted the application of the term "directly competitive or substitutable" by finding that some degree of substitutability in a non-representative sample of the market in question was sufficient to show direct competition.

(e) The Panel erred in its interpretation of the treaty term "so as to afford protection to domestic production", and misapplied this provision in the instant case.

8. As a result of these errors, the Philippines requests that the Appellate Body reverse the Panel's findings in paragraphs 7.118, 7.119, 7.120, 7.121, 7.137, 7.138, 7.187, 7.188, and 8.2(b) (with respect to the claims of the United States) of the Panel Report.

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III. APPEAL OF THE PANEL'S FAILURE TO MAKE AN OBJECTIVE ASSESSMENT OF THE MATTER AS REQUIRED BY ARTICLE 11 OF THE DSU

9. The Panel acted inconsistently with Article 11 of the DSU by failing to conduct an objective assessment of the matter when examining the evidence relating to physical characteristics of the products at issue, their tariff classification, the result of the econometric study and the Euromonitor International study and the segmentation of the market.

10. The Panel's errors of law and legal application under Article 11 include:

(a) The Panel erroneously substituted its own judgment for that of the experts in relation to the organoleptic properties of the products and the congener results.

(b) The Panel erred when it found that the evidence on tariff classification was inconclusive.

(c) The Panel misinterpreted the results of the econometric study and the Euromonitor International survey, and substituted its own judgment for that of the experts in violation of Article 11.

(d) The Panel erred when it found that the Philippine market is not segmented and that "many consumers may be able to purchase high-priced spirits" on "special occasions".

(e) The Panel erred when it concluded that there is evidence that the products are capable of being directly competitive or substitutable in the near future.

11. As a result of these errors, the Philippines requests that the Appellate Body reverse the Panel's findings in paragraphs 7.39, 7.40, 7.42, 7.43, 7.45, 7.46, 7.56, 7.57, 7.59, 7.60, 7.62, 7.76, 7.77, 7.80, 7.82, 7.90, 7.113, 7.119, 7.121, 7.127, 7.137, 7.138, 7.188, 8.2 (with respect to the claims of the European Union) and 8.2(a) and (b) (with respect to the claims of the United States) of the Panel Report.

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ANNEX II

WORLD TRADE ORGANIZATION

WT/DS396/8
WT/DS403/8
30 September 2011

(11-4741)

Original: English

PHILIPPINES – TAXES ON DISTILLED SPIRITS

Notification of an Other Appeal by the European Union
under Article 16.4 and Article 17 of the Understanding on Rules
and Procedures Governing the Settlement of Disputes (DSU),
and under Rule 23(1) of the *Working Procedures for Appellate Review*

The following notification, dated 28 September 2011, from the Delegation of the European Union, is being circulated to Members.

Pursuant to Articles 16.4 and 17 of the *DSU*, the European Union hereby notifies to the Dispute Settlement Body its decision to appeal to the Appellate Body certain issues of law covered and certain legal interpretations developed by the Panel in *Philippines — Taxes on Distilled Spirits* (WT/DS396, WT/DS403) ("Panel Report"). Pursuant to Rule 23(1) of the *Working Procedures for Appellate Review*, the European Union simultaneously files this Notice of Other Appeal with the Appellate Body Secretariat.

For the reasons further elaborated in its submissions to the Appellate Body, the European Union appeals, and requests the Appellate Body to reverse, modify or declare moot and of no legal effect the findings and conclusions of the Panel, with respect to the following errors of law and legal interpretations contained in the Panel Report, and to complete the analysis[1]:

I. MISCHARACTERISATION OF THE EUROPEAN UNION CLAIM UNDER ARTICLE III:2, SECOND SENTENCE, OF THE GATT

The Panel erred in its interpretation and application of Article 7, paragraphs 1 and 2, of the *DSU*, and/or failed to make an objective assessment pursuant to Article 11 of the *DSU*, and/or falsely exercised judicial economy, thereby violating Articles 3.7 and 21.1 of the *DSU*, when it wrongly characterised the claim put forward by the European Union under Article III:2, second sentence, of the GATT as "alternative"[2], and consequently failed to make any findings in relation to it.[3] The European Union requests the Appellate Body to complete the analysis.

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[1]Pursuant to Rule 20(2)(d)(iii) of the *Working Procedures for Appellate Review* this Notice of Appeal includes an indicative list of the paragraphs of the Panel Report containing the alleged errors, without prejudice to the ability of the European Union to refer to other paragraphs of the Panel Report in the context of its appeal.
[2]Panel Report, paras. 7.1, 7.5, 7.17, 7.92, 7.93, 7.95 and 8.3.
[3]Panel Report, paras. 7.95 and 8.3.

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