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EFFECTIVE COMPLIANCE IN THE DSU:

THE MECHANICS OF MONETARY COMPENSATION AS A FORM OF REPARATION

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Executive Summary

This Memorandum focuses on improving the limitations of the World Trade Organization's (WTO) dispute settlement mechanism through development of the remedy of monetary compensation into the Dispute Settlement Understanding (DSU). It explores possible approaches for applying monetary compensation in the WTO framework and inspects different substantive and procedural aspects of its implementation. The basis for the remedy of monetary compensation is the concept of "reparation" in general international law. Comparison between existing WTO remedies and the remedies accepted in general international law indicates that there is no analogue of "reparation" under the prevailing view of WTO law. The prevailing view is critically examined, and options for introducing or improving monetary compensation in the DSU are considered. This remedy may make a form of either "full" reparation or "partial" reparation into the DSU, and provide a solution for cases when the current remedial structure is not effective for certain WTO Members. This is especially true in the cases of "ineffective retaliation" and the "remedy gap." In the former problem, the small size of the complaining Member's economy relative to the violating Member's economy may make the suspension of concessions ineffective to induce compliance by the violating Member, but still harmful to the complaining Member's economy. In the latter problem, the prolongation of the dispute settlement process or a "hit-and-run" measure cause damage during WTO litigation that cannot be adequately addressed by trade compensation or suspension of concessions.

These two problems can be remedied by any of multiple options for partial or full reparation. Partial reparation is distinguished from full reparation by reference either to the differences in amount of monetary compensation awarded, or alternatively, by reference to the two relevant dates in repairing the injury of an internationally wrongful act: 1) the date on which the obligation of reparation arises, and 2) the date from which the calculation of the level of injury begins. For full reparation, these two dates are one and the same—namely, the original date of the act that gave rise to the breach of the international wrong (or, when the WTO-inconsistent measure was imposed). In cases of partial reparation, as understood in this Memorandum, the two dates are separated. The date on which the obligation arises is after the completion of the dispute resolution process (in the case of the WTO, that date is one day following the end of the reasonable period of time for implementation, or RPT). The date from

which the calculation of the level of injury (or, in the WTO context, the level of nullification or impairment) begins can be found earlier than the date the obligation arises. Partial reparation also can refer to situations where the two dates are not separated, but do not go all the way back to the date the measure was imposed. This distinction in dates creates a system of remedies that can be either full or partial reparation. This Memorandum provides the theoretical and practical foundation for a remedy of monetary compensation that can be designed either as partial reparation or as full reparation.

To introduce or improve the remedy of monetary compensation, this Memorandum addresses a number of relevant substantive and procedural aspects. To provide an efficient solution to current limitations in a form of the monetary compensation, the calculation of monetary compensation is proposed to be dependent on three criteria. Effective combination of 1) the date of calculation, 2) the applicable level of monetary compensation, and 3) adjustments made over the course of time (i.e. interest rates and periodic review) provides the basis of a solution the limitations to the current WTO remedial system. The effective combination of these three criteria provides the solution for the ineffective retaliation and remedy gap because the procedures to calculate the level of monetary compensation would be closely related to the calculation of the amount of concessions that could be suspended.

In addition to the important question of amount or level of monetary compensation, the Memorandum analyzes the technical questions of implementation such as procedural access to the remedy and enforcement challenges. Considering the current structure of remedies under the DSU, monetary compensation could be an aspect of "compensation" or a replacement for retaliation or an additional option available under certain circumstances. This Memorandum considers procedural mechanisms to make monetary compensation available to those Members that would be denied an effective remedy while simultaneously making this remedy an exceptional one. This could be accomplished by certain procedural limitations on a generally available remedy, or by making it available only as an aspect of Special and Differential (S&D) Treatment.

Enforcement issues provide another level of implementation challenges for the remedy of monetary compensation. While many suggestions have been made by Members and commentators, this Memorandum compiles and analyzes those proposals as well as providing some additional possibilities. Regarding enforcement generally, this Memorandum discusses a

number of potential options available to both WTO Members and private parties. It concludes that a system of negotiable rights to monetary compensation, whether sold to and ultimately enforced by other Members or private parties, may provide a useful way forward to ensure the payment of monetary compensation when coupled with the recognition and enforcement of those monetary compensation awards in Members' domestic courts. Members can enforce these awards in a manner analogous to that provided by the 1958 New York Convention, just as is currently allowed under the ICSID.

The introduction of monetary compensation must be aimed at inducing compliance with WTO obligations, the ultimate goal of the WTO dispute settlement system. To provide some oversight and avoid unfounded claims to monetary compensation, the Dispute Settlement Body should provide monitoring of this system. The issues of who would be entitled to monetary compensation and how it would be determined or distributed would essentially be matters for the sovereign discretion of the complaining Member. However, rules and monitoring mechanisms from the Dispute Settlement Body (DSB) can ensure that the Member provides the monetary compensation to the parties that should receive it. A balance between sovereignty and oversight must be struck.

A related issue is whether monetary compensation would have similar effects to those of actionable subsidies. This Memorandum concludes that, from both legal and economic standpoints, monetary compensation can be designed and implemented so as to avoid such subsidy-like effects. Finally, all of the sections of this Memorandum are enhanced by reference to other areas of international law, especially practice under Free Trade Agreements (FTAs) and in the field of investment arbitration.

Although the Memorandum contains some technical economic and legal discussions, it is meant to be a generally accessible document for a broad audience. This Memorandum provides an introductory discussion of the theoretical and practical implications of the development of monetary compensation in the WTO. It can be used by practitioners, diplomats and interested parties to develop the substantive and procedural mechanisms of monetary compensation to solve the limitations and increase the effectiveness of the WTO dispute settlement system.

I. Introduction

The Dispute Settlement Understanding (DSU) of the World Trade Organization (WTO), which was introduced at the 1994 conclusion of the Uruguay Round of trade negotiations, is a part of the single-package of WTO Agreements.[2] A major breakthrough for the international trading system,[3] this mandatory dispute settlement system introduced specific remedial measures aimed at ensuring compliance with WTO obligations.[4] While the DSU provided an important step forward to resolve trade disputes, effective compliance of WTO Members with their obligations under the WTO Agreements has been a matter of concern for many years. Therefore, more work needs to be done to improve this system. The Members recognized this fact by including procedures for a four-year process of “DSU review” beginning at the time of its introduction in 1994.[5] The deadlines for this review process have been postponed multiple times, and the Members have not yet agreed on common grounds.[6] Additionally, the sheer number of issues under discussion and proposals offered by various Members complicates the process of

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[2] WTO, Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 354 (1999), 1869 U.N.T.S. 401, 33 I.L.M. 1226 (1994) [hereinafter DSU].

[3] Steve Charnovitz, *Rethinking WTO Trade Sanctions*, 95 AM. J. OF INT’L L. 792, 803 (2001) (“Another important alteration to the GATT was the change in paradigm from rebalancing to trade sanction.”).

[4] In this Memorandum, the term “WTO obligations” refers to all mandatory rules under the system of WTO Agreements. Thus, it includes primary obligations under the GATT and other covered agreements, obligations undertaken by Members in their Schedules of Concessions (goods) and Commitments (services), obligations imposed on new Members in their Protocols of Accession (where applicable), and the recommendations and rulings of the Dispute Settlement Body.

[5] WTO, “Application and Review of the Understanding on Rules and Procedures Governing the Settlement of Disputes”, Ministerial Decision, at page 419, 14 April 1994.

[6] Thomas A. Zimmerman, “The DSU Review (1998-2004): Negotiations, Problems and Perspectives”, *in* Dencho Georgiev and Kim Van der Borght, eds., REFORM AND DEVELOPMENT OF THE WTO DISPUTE SETTLEMENT SYSTEM (2006), at p. 444.

improving the WTO's dispute settlement system.[7] In spite of setbacks and delays, many Members remain committed to DSU review and reform.

This Memorandum outlines the theory and mechanics of a system of monetary compensation in the DSU. Before that discussion, this Introduction outlines two issues that form the backdrop to this Memorandum. First, it reviews the current state of proposals for monetary compensation from Members during the DSU review negotiations. Second, it analyses the competing perspectives on the goals of the WTO remedial system—that is, whether WTO remedies should simply rebalance the system of negotiated rights that are upset by a Member's WTO-inconsistent measure, or whether remedies should induce compliance *ex ante* as well as *ex post*.

A. *Proposals for Review of DSU Compliance*

One key area, especially for developing country Members, is effective compliance with WTO obligations through an enhanced and well-functioning system of WTO remedies.[8] Proposals by Mexico, Ecuador, the African Group and the Least Developed Countries (LDC) Group have proposed an effective remedy of monetary compensation.[9] These proposals aim to make recourse to the WTO dispute settlement system more accessible to those countries, which

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[7] *See* WTO, Chairman's Remarks: Summary of Recent Work (week of 5 March 2012), WTO Doc. JOB/DS/8, 19 March 2012. The Institute of International Economic Law at Georgetown University Law Center has compiled the publicly available proposals for "DSU Review" on their website. *See* http://www.law.georgetown.edu/iiel/research/projects/dsureview/synopsis.html.

[8] *See* Articles 21 and 22, DSU (providing for surveillance of implementation of panel recommendations and the consequences of failure to implement).

[9] *See, e.g.*, WTO, *Negotiations on the Dispute Settlement Understanding – Proposal by the LDC Group*, WTO Doc. TN/DS/W/17, 9 October 2002; WTO, *Negotiations on Improvements and Clarifications of the Dispute Settlement Understanding – Proposal by Mexico*, WTO Doc. TN/DS/W/23, 4 November 2002 [hereinafter WTO, *Mexico's 2002 Proposal*]; WTO, *Negotiations on Improvements and Clarifications of the Dispute Settlement Understanding – Proposal by Ecuador*, WTO Doc. TN/DS/W/33 23 January 2003; WTO, *Text for the African Group Proposals on Dispute Settlement Understanding Negotiations – Communication from Kenya*, WTO Doc. TN/DS/W/42, 24 January 2003 [hereinafter WTO, *African Group's 2003 Proposal*]. *See also* WTO, *Special Session of the Dispute Settlement Body, Report by the Chairman, Ambassador Ronald Saborío Soto, to the Trade Negotiations Committee*, WTO Doc. TN/DS/25, 21 April 2011 [hereinafter WTO, *Chair's 2011 Summary*].

are currently lacking incentives to bring WTO complaints. Two aspects of the various proposals relate to possible recipients of monetary compensation and the timing of its calculation.

Regarding recipients, some proposals would operate on a basis of Special and Differential (S&D) treatment for developing countries, while others would apply generally to the WTO membership. For example, the LDC Group proposed that monetary compensation be available in successful cases by developing or LDC Members against developed Members.[10] The African Group has proposed the introduction of monetary compensation as a general feature,[11] or on an S&D basis.[12] Mexico further suggested that monetary compensation should be the default remedy for developing Members, but it did so without prejudice to the possibility of developed Members receiving monetary compensation if so agreed.[13] Because this question remains undecided,[14] this Memorandum proposes options regarding the implementation of monetary compensation on both a general and an S&D basis.

A second important aspect of these proposals relates to the time periods included in the calculation. The African Group proposed that the calculation of monetary compensation include the time from the implementation of the offending measure until its withdrawal.[15] Mexico has presented three potential starting points of the calculation: the date of the measure's imposition, the date of request for consultation, or the date of the establishment of the panel.[16] Additionally, Mexico has proposed some retroactivity of the remedies of compensation and the suspension of concessions.[17] The DSB Chairman's April 2011 report noted that the discussion of calculating the level of nullification or impairment prior to the end of the reasonable period of time for

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[10] WTO, *Text for LDC Proposal on Dispute Settlement Understanding Negotiations – Communication from Haiti*, WTO Doc. TN/DS/W/37, 22 January 2003.

[11] WTO, *Negotiations on the Dispute Settlement Understanding – Proposal by the African* Group, WTO Doc. TN/DS/W/15, 25 September 2002.

[12] WTO, *African Group's 2003 Proposal*, *supra* note 9.

[13] WTO, *Improvements and Clarifications of the Dispute Settlement Understanding – Proposal by Mexico*, WTO Doc. TN/DS/W/91, 16 July 2007 [hereinafter WTO, *Mexico's 2007 Proposal*].

[14] WTO, *Chair's 2011 Summary*, *supra* note 9, at B-3, para. 11.

[15] WTO, *African Group's 2003 Proposal*, *supra* note 9, at 3.

[16] WTO, *Amendments to the Understanding on Rules and Procedures Governing the Settlement of Disputes, Proposed Text by Mexico – Communication from Mexico*, WTO Doc. TN/DS/W/40, 27 January 2003, p. 5

[17] WTO, *Mexico's 2002 Proposal*, *supra* note 9.

implementation of recommendations needs further discussion.[18] This aspect of timing is a key point of discussion in this Memorandum to develop effective WTO remedies, especially as it relates to incentives for compliance within the RPT and the remedy gap. These elements of the current state of the debate on monetary compensation form the backdrop of this Memorandum.

B. Rebalancing Negotiated Rights and Inducing Compliance in the DSU

A recurring debate in the WTO dispute settlement system is the purpose or goal of awarding remedies for WTO-inconsistent conduct.[19] Some argue that the goal is rebalancing the negotiated rights between differentiated Members,[20] while others state that inducing compliance with WTO obligations as such is the purpose.[21] The text of the DSU itself does not provide any conclusive determination, yet the question impacts WTO remedies, and thus, proposals for reform of WTO remedies.

If the goal is simply to rebalance rights, then the nature and calculation of remedies should be designed along the lines of liability (as opposed to property) rules.[22] Under this model, compliance with WTO obligations is secondary to the tit-for-tat of the complaining Member applying trade-restrictive measures (trade compensation or suspension of concessions) in return for the violating Member's measures. This would allow a role in WTO law for the concept of "efficient breach," whereby a Member can choose to violate its WTO obligations as long as it is

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[18] WTO, *Chair's 2011 Summary*, *supra* note 9, at B-3, para. 12.

[19] *See generally* Joost Pauwelyn, *The Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?*, in CHAD P. BOWN AND JOOST PAUWELYN, EDS., THE LAW, ECONOMICS AND POLITICS OF RETALIATION IN WTO DISPUTE SETTLEMENT 2010 (hereinafter, BOWN AND PAUWELYN, RETALIATION).

[20] Alan Sykes, *Optimal Sanctions in the WTO: The Case for Decoupling (and the Uneasy Case for the Status Quo)*, in BOWN AND PAUWELYN, RETALIATION, *supra* note 19 [hereinafter Sykes, *Optimal Sanctions*] (arguing for rebalancing of rights only)

[21] William J. Davey, *Sanctions in the WTO: problems and solutions*, in BOWN AND PAUWELYN, RETALIATION, *supra* note 19 [hereinafter Davey, *Sanctions*] (highlighting the goal of inducing compliance); *see also* Gregory Shaffer and Daniel Ganin, *Extrapolating Purpose from Practice: Rebalancing or Inducing Compliance*, in BOWN AND PAUWELYN, RETALIATION, *supra* note 19 [hereinafter Shaffer and Ganin, *Purpose from Practice*] (providing empirical evidence that WTO remedies in practice are designed to induce compliance).

[22] Joel P. Trachtman, *The WTO Cathedral*, 43 STAN. J. INT'L L. REV. 127, 145–52 (2007) [hereinafter Trachtman, *WTO Cathedral*] (discussing property rules and liability rules in the WTO context).

willing to pay for it. The calculation of the amount of impairment or nullification provides a straight-forward level to realign the balance between the violating and the complaining Members. A remedy structure that is solely prospective in application poses no difficulties within the international trade system under this model.

If, however, the goal is to induce compliance with international treaty obligations (the WTO agreements), then the remedy structure should be more akin to property rules. While acknowledging the need to rebalance rights, the focus is ensuring compliance, which could include remedies such as specific performance but excludes efficient breach. To induce compliance, remedies must include a more expansive level calculation of impairment and a broader time period. This is true whether as an *ex post* remedy to a violation, or as an *ex ante* deterrent to a breach. While this goal of WTO remedies is currently at work within the prospective system of trade-related remedies, it can also justify broader forms of compensation. For example, punitive levels of compensation or suspension of concessions could be justified if the goal is ensuring compliance.[23] This Memorandum, then, recognizes the role of rebalancing negotiated rights, yet it considers the role that monetary compensation can play in the current system of WTO remedies to induce compliance with WTO obligations.

The remainder of this Memo covers the theory and mechanics of monetary compensation in the WTO. Part II covers the theoretical dimensions based on general international law and WTO law. This discussion reveals some of the limitations in the WTO dispute settlement system that monetary compensation can address. These are specifically "ineffective retaliation", which refers to situations in which a Member with a small or developing economy cannot effectively suspend concessions even when authorized, and the "remedy gap,"[24] which refers to the increased level of negative trade impact that results from a prolongation of the dispute settlement process or "hit-and-run" measures. These latter measures are short-term WTO-inconsistent measures that are removed before remedies can be applied (i.e. immediately after the DSB

[23] *See* Petros C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place*, 11 EUROPEAN J. INT'L L. 763, 770–71 (2000) [hereinafter Marvoidis, *Remedies*] (noting that punitive damages provide a credible threat to deter breaches *ex ante*, though they are currently not accepted in international law).

[24] This concept, and the origin of the term, comes from the comprehensive discussion of this problem by Rachel Brewster, *The Remedy Gap: Institutional Design, Retaliation, and Trade Law Enforcement*, 80 GEO. WASH. L. REV. 102 (2011) [hereinafter Brewster, *Remedy Gap*]. It has also been referred to as a "free ride." Trachtman, *WTO Cathedral*, *supra* note 22, at 134.

adopts the report, or before the end of the reasonable period of time to implemented DSB recommendations).[25] Responding to the various challenges these limitations present, Part II ends with a discussion of full reparation and partial reparation as these general concepts relate to WTO law.

Part III develops the operational considerations of the mechanism of monetary compensation. It responds to questions and challenges to the implementation of monetary compensation in the DSU. Where relevant, these responses refer to general international law and other specific regimes of international law (e.g. international investment law) to compare to WTO law. It considers various options to implement monetary compensation, and proposes recommendations for solutions to the problems of ineffective retaliation and the remedy gap. This Memorandum considers the mechanics of monetary compensation under a system of either full or partial reparation, and it provides a foundation to develop proposals for monetary compensation under a variety of possible options.

[25] Mavroidis, *Remedies*, *supra* note 23, at 783; JOOST PAUWELYN, CONFLICT OF NORMS IN PUBLIC INTERNATIONAL LAW 226 (2003).

II. Remedies in General International Law and the WTO

This Part outlines the theoretical foundation for a system of monetary compensation in four sections. First, it compares remedies in general international law and WTO law. It then analyses the limitations of the current WTO remedial system. Next, it proposes monetary compensation as a form of reparation, either full or partial. Finally, it concludes that monetary compensation as a form of reparation can begin to solve the problems of access and lack of effective remedies for many WTO Members.

A. Two Systems of Remedies

General international law provides for a range of remedies (or secondary obligations) that flow from a violation of a treaty, customary, or other primary obligation of international law. The goal of these remedies in general international law is full reparation—that is, to fully repair all damage and place the injured State in the position it would have been had no violation occurred.[26] As discussed below, this Memorandum makes a distinction between "full" reparation and "partial" reparation, either of which may be used to develop the system of monetary compensation in response to certain remedial limitations.

Under general international law, States in breach of an international rule are first obligated to cease the offending conduct, and then to provide full reparation for the injury to the other party.[27] The leading statement on the concept of reparation comes from the Permanent Court of International Justice (PCIJ) in the 1928 *Chorzów Factory* case.[28] The PCIJ elaborated a standard of reparation designed to restore the *status quo ante* through restitution-in-kind or monetary compensation:

> *The essential principle contained in the actual notion of an illegal act-a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals-is that reparation must, as far as possible, wipe out al1 the consequences of the illegal act and reestablish the situation which would,*

[26] *See* International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, November 2001, Supplement No. 10 (A/56/10), chp.IV.E.1, art. 31 [hereinafter ILC, *Draft Articles*]

[27] *See* ILC, *Draft Articles*, *supra* note 26, at arts. 41-42; *see generally* Mavroidis, *Remedies*, *supra* note 23 (discussing remedies in general international law, GATT law, and WTO law)

[28] *Chorzów Factory* case, (Germany v. Poland), Indemnity, 1928 PCIJ (ser. A) No. 17 (13 September).

> *in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it-such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.*[29]

This customary international law formula has been codified in the International Law Commission's Draft Articles. First, Draft Article 30 requires "cessation and non-repetition" by the State. Then, Draft Article 30 provides for "full reparation" or *restitution in integrum*, which is defined in Article 34 to include restitution, compensation, and satisfaction.[30] Additionally, Draft Article 49 allows for "countermeasures" but only for the purpose of inducing compliance with the primary obligation.[31] To the extent that the WTO Agreements have not "contracted out" of general international law with specific regime rules (*lex specialis*),[32] these general remedies and the *Chorzów Factory* formula may be relevant.[33]

The DSU provides for an overlapping but different set of remedies than this customary set. A violating Member is required to comply with the obligation, provide compensation on a voluntary and most-favored-nation (MFN) basis, or suffer suspension of concessions by the complaining Member.[34] These WTO remedies of compliance, compensation, and suspension of concessions (commonly referred to as retaliation) are not perfectly analogous to the general international law remedies of cessation, reparation (i.e. restitution, compensation, and satisfaction), and countermeasures. With respect to compliance with WTO obligations, the general requirement of cessation of the internationally wrongful act is analogous. Retaliation in

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[29] *Chorzów Factory* case, at 47 (emphasis added).

[30] ILC, *Draft Articles*, *supra* note 26, at art. 34.

[31] ILC, *Draft Articles*, supra note26, at art. 49.

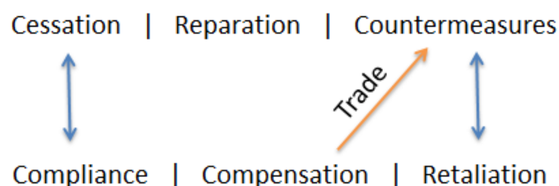
[32] The AB held that WTO is not a self-contained regime of law. *United States – Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/AB/R (1996), at 17; *see also Korea – Measures Affecting Government Procurement*, WTO Doc. WT/DS163/R (2000), at para. 7.96 note 753 ("Customary international law applies generally to the economic relations between the WTO Members. Such international law applies to the extent that the WTO treaty agreements do not 'contract out' from it.")

[33] *See* Mavroidis, *Remedies*, *supra* note 23, at 764–65.

[34] Article 22.1, DSU.

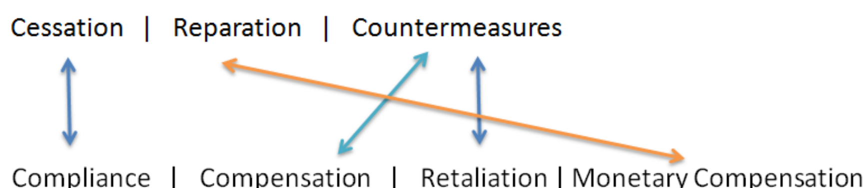
WTO law is a form of countermeasures in international law.[35] Yet the relationship between compensation and reparation is less straightforward. Figure 1 shows the imperfect aligned of remedies in the two legal orders.

Figure 1. Prevailing View of Remedies in General International Law (top) and WTO Law (bottom)



According to one prevailing view of WTO remedies, compensation in the DSU is limited to trade compensation.[36] If compensation is understood solely as increased trade commitments (i.e. liberalized market access) to the extent of the nullification or impairment suffered by the complaining Member,[37] then it is more similar to retaliation as a type of countermeasure. If that is correct, then the general remedy of reparation is simply missing from WTO law. The only way option under this interpretation would be to introduce an entirely new concept of "monetary compensation" into the WTO remedial structure. Figure 2 below shows the alignment of general and WTO remedies if the DSU were amended to introduce monetary compensation into the WTO dispute settlement system.

Figure 2. Monetary Compensation under the Prevailing View of Remedies



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[35] *But see* Trachtman, *WTO Cathedral*, *supra* note 22, at 134 (arguing that WTO retaliation is more similar to compensation under general international law).

[36] Bernard O'Connor and Margareta Djordjevic, *Practical Aspects of Monetary Compensation: The* US – Copyright *Case,* 8 J. OF INT'L ECON. L. 127 (2005) [hereinafter O'Connor and Djordjevic, *Practical Aspects*].

[37] Trachtman, *WTO Cathedral*, *supra* note 22, at 134.

The prevailing view, however, is not mandated by the text of Article 22.1 of the DSU. A strict textual interpretation of the DSU reveals that the term "compensation" could refer to both trade compensation and monetary compensation. Further, the context of WTO Agreements[38] supports the view that Article 22 of the DSU is not strictly limited to trade compensation. In other WTO covered agreements, such as two articles of the GATT and one article of the Agreement on Safeguards, references to compensation clearly envisage it to be solely trade compensation.[39] The DSU drafters knew how to limit the text to trade compensation, yet did not do so. Thus, the failure of Article 22.1 to refer specifically to "monetary" compensation does not mean that the WTO's *lex specialis* has derogated from the general international law system of remedies. Figure 3 below shows how general and WTO remedies align when "compensation" is understood to take the form of either trade compensation or monetary compensation. WTO remedies can include forms of reparation, and "monetary compensation" is not a new concept.[40] The DSU needs no amendment, yet some clarifying language to improve the role of monetary compensation would be beneficial.[41]

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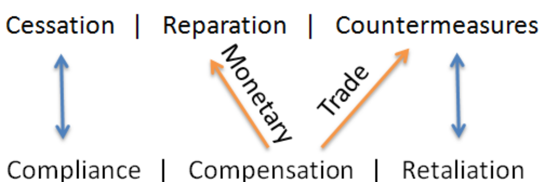
[38] See UN, Vienna Convention on the Law of Treaties, Article 31(1), done at Vienna on 23 May 1969, entered into force on 27 January 1980, United Nations, Treaty Series, vol. 1155, p. 331 (interpreting treaties in light of text and context).

[39] *See* Article XIX(3)(a), GATT ("…the affected contracting parties shall then be free…to suspend… substantially equivalent concessions…."); Article XXVIII(2), GATT on the Modification of Schedules ("In such negotiations and agreement, which may include provision for compensatory adjustment with respect to other products…."); Article 8.1, SCM Agreement ("To achieve this objective, the Members concerned may agree on any adequate means of trade compensation for the adverse effects of the measure on their trade.").

[40] WTO, *Australia—Subsidies Provided to Producers and Exporters of Automotive Leather-Recourse to Article 21.5 of the DSU by the United States*, WTO Doc. WT/DS126/RW, 21 January 2000. *See also* Trachtman, *WTO Cathedral*, *supra* note 22, at 132 note 29 (citing GATT cases where reimbursement of antidumping and countervailing duties was recommended).

[41] For those following the first interpretation—that monetary compensation is currently excluded by the DSU's *lex specialis*—this clarifying language would be seen as a necessary amendment to the DSU to introduce monetary compensation. While this Memorandum disputes that interpretation, such clarifying language would not differ substantially in either case.

Figure 3. Textualist View of Monetary Compensation in WTO Law



The practical implications of these competing interpretations of "compensation" in Article 22 warrant a few comments. The drawback of the prevailing view is that monetary compensation would have to be *introduced* into the WTO dispute settlement system, necessitating an amendment to the DSU. However, the benefit of introducing a brand concept is the complete freedom to design monetary compensation without constraint. Compare these benefits and drawbacks to the textualist interpretation of "compensation." While Article 22 of the DSU provides a textual hook for efforts to *improve* monetary compensation without amending the DSU, that same textual basis provides some constraints which must be addressed. As mentioned above, Article 22 provides that compensation is both voluntary and available on an MFN basis.[42]

The reference in Article 22.1 to consistency "with the covered Agreements" has been interpreted to mean that compensation comport with Article I of the GATT.[43] If compensation is only *trade* compensation, then the liberalization of market access indeed should comply with MFN. However, *monetary* compensation does not fall within the MFN principle. As Bronckers and van den Broek argue, "[W]hen a government pays financial compensation to repair the injury it has caused through a WTO-illegal measure, this can hardly be characterized as an 'advantage, favour, privilege or immunity', within the meaning of the usual MFN language."[44] This is the better interpretation of the GATT. First, monetary compensation as a remedy for WTO-inconsistent measures is not within the scope of Article I of the GATT, first clause.[45]

[42] Article 22.1, DSU ("Compensation is voluntary and, if granted, shall be consistent with the covered Agreements.")

[43] O'Connor and Djordjevic, *Practical Aspects*, *supra* note 36, at 131–36.

[44] Marco Bronckers and Naboth van den Broek, *Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Resolution*, 8 J. OF INT'L ECON. L. 101, 119 (hereinafter Bronckers & van den Broek, *Financial Compensation*) (citing Article 4, TRIPS and Article I, GATT).

[45] Monetary compensation as a remedy of cash damage payments would not be "customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of

Second, as Bronckers and van den Broek point out, recompense for losses that directly result from such a measure cannot be considered an "advantage, favour, privilege or immunity" under the terms of the second clause of Article I of the GATT.[46] In short, the argument that monetary compensation must be applied on an MFN basis is unavailing.

The second condition of Article 22.1 is a stickier point. If monetary compensation must be voluntary, the remedy would be limited. It would not cease to be an option, as the *US – Copyright* case reveals.[47] Yet, to be effective, monetary compensation should be mandatory. One potential solution to this issue would be to find the voluntariness of the remedy in the respondent Member's consent to be bound to the WTO Agreements, including the DSU itself. If Members accept that "compensation" in Article 22 includes monetary compensation, then their consent to an obligation to pay monetary compensation when the DSB recommends it could be found in their acceptance of the WTO's single undertaking which includes the DSU.[48] While such an interpretation may obviate the need for an amendment to the voluntariness condition, it would require assent to an interpretation of "compensation" as containing monetary compensation by WTO Members either through negotiations or as the DSB adopting such an interpretation from a panel or the AB.

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payments for imports or exports", nor a "method of levying such duties and charges", nor "rules and formalities in connection with importation and exportation", not "matters referred to in paragraphs 2 and 4 of Article II." Article I, GATT.

[46] Further, monetary compensation paid to a government or other entity is not granted to "any product." Article I, GATT.

[47] O'Connor and Djordjevic, *Practical Aspects*, *supra* note 36.

[48] This would be analogous to the ICJ basing its consensual jurisdiction for requests for interpretation or revision of judgments (Arts. 60-61) *not* on an actual grant of consent by the Respondent State, but on the Respondent's consent to be bound by the ICJ Statute itself. *See, e.g.*, ICJ, Request for Interpretation of the Judgment of 31 March 2004 in the Case concerning Avena and Other Mexican Nationals (Mexico v. United States of America) (Mexico v. United States of America), Provisional Measures, Order of 16 July 2008, I.C.J. Reports 2008, p. 311, at ¶ 44 (finding jurisdiction under Article 60 of the Statute even where the other alleged basis of jurisdiction was no longer valid).

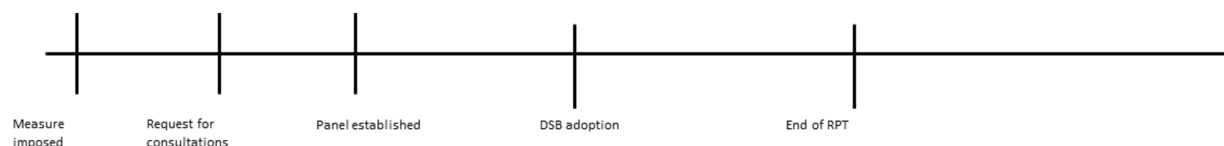
B. Limitations on Effective Compliance in the WTO Remedial System

Two main features of the prevailing view of WTO remedies deny certain states access to an effective remedy. This section reviews, first, the time frames for implementation of remedies in the dispute settlement process and, second, the related requirement that remedies are only authorized prospectively. Then, it considers how these features of the common interpretation of the DSU lead to two limitations on WTO remedies: 1) "ineffective retaliation," and 2) the "remedy gap."

1. Limitations of the Prevailing Interpretation of the DSU

As mentioned above, the three WTO remedies are compliance, compensation, and suspension of concessions. Compliance with the DSB's recommendations or rulings immediately or within a reasonable period of time (RPT) is the first and preferred remedy. If the respondent Member does not do so, the next potential remedy is compensation (trade compensation, in the prevailing view) for the successful complaining Member. If compensation is not afforded the complaining Member, it can request authorization to suspend concessions equivalent to the amount of nullification or impairment. Article 22.3 of the DSU provides a framework for suspension of concessions in the same sector as the violating measure,[49] or under the same WTO Agreement,[50] or under a different WTO Agreement.[51] This procedure makes retaliation the only available option for a complaining Member to induce compliance. Figure 4 shows the important dates and time periods in the dispute resolution process.

Figure 4. Timeline of WTO Dispute Settlement



[49] Article 22.3(a), DSU (stating that this is "the general principle").

[50] Article 22.3(b), DSU (allowing this form when the first is "not practicable or effective").

[51] Article 22.3(c), DSU (allowing such suspension if the first and second are "not practicable or effective" and additionally "the circumstances are serious enough")

Both suspension and compensation are calculated from the date of adoption of the ruling by the DSB and are applied prospectively. If the concerned Member is unable to comply with the recommendations immediately,[52] it may request a "reasonable period of time" for implementation (RPT). The RPT is either agreed by the parties to the dispute or decided by binding arbitration, and should not exceed 15 months from the adoption of the report.[53] These Article 21.3 arbitrators decide only the length of the RPT, and not the means of implementation.[54]

The "right" to RPT[55] leads to the issue of prospective versus retrospective remedies. According to Article 22.6 of the DSU, no compensation is to be provided while the violating Member is exercising its right to RPT. After the RPT expires, the amount of compensation may be provided for the member continuing to suffer the adverse effects of the measure violating WTO obligations. In *US – Section 129(c)(1) URAA*, the panel recognized "that a Member's obligation under the DSU is to provide prospective relief in the form of withdrawing a measure inconsistent with a WTO agreement, or bringing that measure into conformity with the agreement by the end of the reasonable period of time."[56] The current DSU procedures generally provide no relief for the past effects of the inconsistent measure,[57] and no relief for effects of the measure occurring within the RPT. The time period from the implementation of the offending

[52] This may be the case when a Member's internal legislative system makes immediate compliance impossible.

[53] Article 21.3(a), DSU (determined by the Member concerned with the approval by the DSB); Article 21.3(b), DSU (mutually agreed by the parties within 45 days after adoption of the report); Article 21.3(c), DSU (within 90 days of the adoption of the report). Davey calculated the average period for implementation to be about 9 months. WILLIAM J. DAVEY, ENFORCING WORLD TRADE RULES: ESSAYS ON WTO DISPUTE SETTLEMENT AND GATT OBLIGATIONS 80 (2006) (hereinafter DAVEY, ENFORCING WORLD TRADE RULES).

[54] WTO, EC – Hormones, Arbitration under Art.21.3(c) of the Understanding of Rules and Procedures Governing the Settlement of Disputes (May 29, 1998), WT/DS26/15 and WT/DS48/13, para. 38.

[55] *See, e.g.*, Sykes, *Optimal Sanctions*, *supra* note 19.

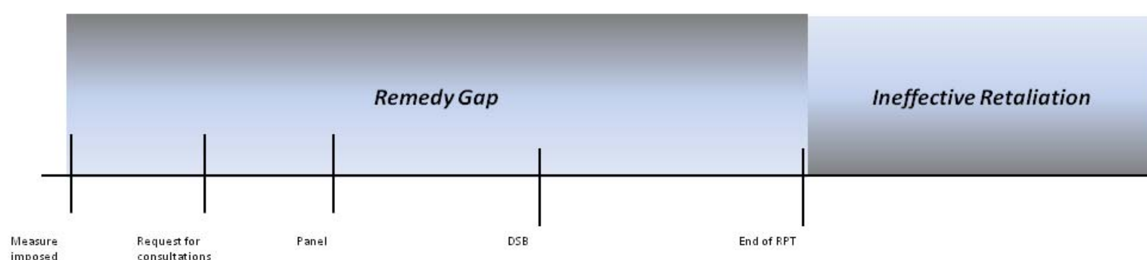
[56] WTO, United States – Section 129(c)(1) of the Uruguay Round Agreements Act, Panel Report (July 15, 2002), WT/DS221/R, (hereinafter *US – Section 129(c)(1) URAA*), para. 3.93.

[57] *See* Panel Report, *United States – Import Measures on Certain Products from the European Communities*, ¶ 6.106, WT/DS165/R (Jul. 17, 2000) (noting that "retroactive remedies are alien to the long established GATT/WTO practice where remedies have traditionally been prospective."). It is noteworthy that this Panel does not rely on any text for this assertion.

measure, through the WTO dispute resolution process, and finally concluding at the end of the RPT can be quite a lengthy period.[58] This leads to a potentially immense amount of unrepaired damage.

However, retroactive remedies have been authorized under the DSU in the *Australia - Automotive Leather* case.[59] Avoiding repayment of subsidies paid or duties collected may have encouraged some Members to oppose retrospective remedies, but such remedies are not forbidden in the WTO remedial system.[60] Like the prevailing view to limit compensation to trade compensation, the limit of remedies to solely prospective remedies is not mandated by the text. Retrospective remedies are useful because prospective remedies may not compensate the loss of the Member. To the extent that lost volume of trade does not necessarily equal the actual loss in economic benefits and the investing or reinvesting of those benefits, a prospective remedy may not counteract all harms from a violation. These timing issues—the right to RPT and the typical use of prospective remedies—lead to the two limitations on effective WTO remedies discussed next (see Figure 5).

Figure 5. Non-compensable Trade Impacts under Prevailing View of WTO Remedies



[58] *See* Brewster, *Remedy Gap*, *supra* note 24, at 117–25 & n. 44 (discussing the lengthening of the process, and citing the six-year gap between request for consultations and authorization to retaliate in *EC – Aircraft*).

[59] *See* WTO, *Australia—Subsidies Provided to Producers and Exporters of Automotive Leather-Recourse to Article 21.5 of the DSU by the United States*, WTO Doc. WT/DS126/RW, 21 January 2000.

[60] *See id.*; *see also* Trachtman, *WTO Cathedral*, *supra* note 22, at 132 note 29 (citing GATT cases where reimbursement of antidumping and countervailing duties was recommended); Kil Won Lee, “Improving Remedies in the WTO Dispute Settlement System”, unpublished Ph.D. dissertation, p. 13, note 22 (same).

2. Ineffective Retaliation

For some Members, the typical remedy of prospective retaliation may be an ineffective means to ensure compliance. In some cases,[61] a complaining Member may sometimes forego suspending concessions when that Member cannot make a meaningful trade impact on the violator. In the *EC – Bananas* dispute, Ecuador was successful in challenging the EC's treatment of banana imports from Latin America.[62] When the EC did not implement the panel's recommendation within the RPT, Ecuador was awarded the right to suspend concessions. While the amount of suspension authorized comprised an important portion of Ecuador's banana exports, it was an insignificant amount of the EC's banana imports.[63] This discrepancy is exacerbated by the fact that trade retaliation forces the retaliator to "shoot itself in the foot." In such cases, the effect of inducing compliance is less since the violating Member may choose to tolerate the countermeasure instead of complying.[64] Therefore, any retaliatory measures by Ecuador against the EC would be ineffective or unnoticeable in the EC while they would be actually damaging to the Ecuadorian economy through their trade-restrictive nature. For countries such as Ecuador, which have small economies or markets for certain goods, retaliation under WTO rules fails to provide an effective remedy.[65]

3. Remedy Gap

The remedy gap covers two types of problems within the DSU: 1) prolongation of the dispute settlement process, and 2) hit-and-run measures. Brewster has termed the "remedy gap" those situations in which a measure does its damage (or from the violator's perspective, achieves

[61] *See, e.g.*, WTO, EC-Bananas III (Ecuador) (Art.22.6 – EC), Arbitration decision, WTO doc. WT/DS27/ARB, 9 April 2008; WTO, United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services, AB Report, WTO doc. WT/DS285/AB, 21 December 2007.

[62] WTO, EC-Bananas III (Ecuador) (Art.22.6 – EC), Arbitration decision, WTO doc. WT/DS27/ARB, 9 April 2008.

[63] *See* Bronckers & van den Broek, *Financial Compensation*, *supra* note 44, at 105.

[64] *See* Trachtman, *WTO Cathedral*, *supra* note 22, at 129 n. 7.

[65] *See* Trachtman, *WTO Cathedral*, *supra* note 22, at 146, and Bronckers & van den Broek, *Financial Compensation*, *supra* note 44, at 105 (discussing the relevance of the maxim *ubi ius ibi remedium*). But note that "[i]t is rumored that Ecuador was granted certain non-WTO benefits in order to settle this case informally." *Id.* at 139.

the desired level of protection) during the overly long dispute settlement process at the WTO.[66] This problem comes from the prevailing view that the WTO lacks retrospective remedies. Brewster's concept of the remedy gap uses that lacking as it is a prolongation of the dispute settlement process. Note that prolongation can also be present alongside the problem of ineffective retaliation.

The second problem exploits the remedy gap. A "hit-and-run" measure, which causes harm during the DSU procedures but is withdraw prior to the end of the RPT. The damage caused by this type of measure can never be remedied, even though in theory the violation is remedied by compliance immediately or within the RPT—the supposedly preferred solution to WTO violations. The remedy gap issues are especially problematic in trade remedy measures that are undertaken by a Member. These measures are unilateral actions that Members may take that are specifically designed to have an impact on trade or imports. While any measure or conduct by a Member that is ultimately found to be WTO-inconsistent is unilateral in a general sense, trade remedies are by design trade distortive (though they ostensibly respond to the trade-distortive effects of other Members' conduct). In the case of safeguards, a country can achieve its desired level of protection for domestic industry by a short-term measure that it removes after the dispute resolution process is completed.[67] Davey referred to this as a "three year free pass" in the context of safeguard cases.[68] The remedy gap—because of the timeframes for trade remedies, especially the right to a reasonable period of time to implement recommendations in conjunction with the solely prospective nature of remedies—incentivizes delay tactics.[69]

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[66] *See generally* Brewster, *Remedy Gap*, *supra* note 24.

[67] For two recent examples in the trade remedies area, *see* WTO, Dominican Republic - Safeguard Measures on Imports of Polypropylene Bags and Tubular Fabric, Panel Report, WTO Docs. WT/DS415, 416, 417, 418/R, 31 January 2012, *and* WTO, United States – Subsidies on Upland Cotton, Decision of Arbitrator WTO Doc. WT/DS267/ARB/2, 31 August 2009.

[68] Davey, *Sanctions*, *supra* note 21, at 361.

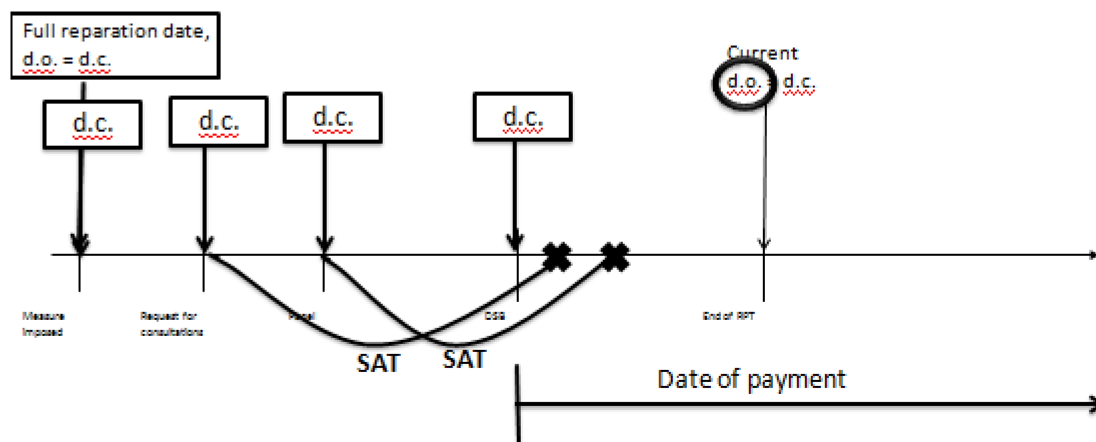
[69] This has been described as the "chocolate cake scenario", in which a violating Member wants to have its cake (maintain a violating measure) and eat it too (enjoy greater benefits in spite of retaliation). Jorge A. Huerta-Goldman, *Is retaliation useful? Observations and analysis of Mexico's Experience*, (hereinafter Huerta-Goldman, *Mexico's Experience*), in BOWN AND PAUWELYN, RETALIATION, *supra* note 19, at 281.

C. Monetary Compensation as Full Reparation or Partial Reparation

Monetary compensation counteracts the problems of ineffective retaliation and the remedy gap. Yet the design of such a remedy may be full or partial reparation, depending on the problem being addressed. Figures 6 and 7 graphically represent these concepts. Full and partial reparation can be distinguished by two different criteria. First, the amount of monetary compensation may cover the total damages suffered (full) or some lesser amount (partial). Second, the two concepts may be distinguished by to relevant timing aspects: 1) the date on which the obligation to compensate arises ("date of obligation" or "d.o."), and 2) the date from which the calculation of the level of compensation begins ("date of calculation" or "d.c."). Under current WTO remedies, the date of obligation and date of calculation are the same—at the end of the RPT (see "current" in Figures 6 and 7). For full reparation, while the two dates also are the same, the relevant date is the date that the WTO-inconsistent measure was originally imposed (shown in purple in Figures 6 and 7).

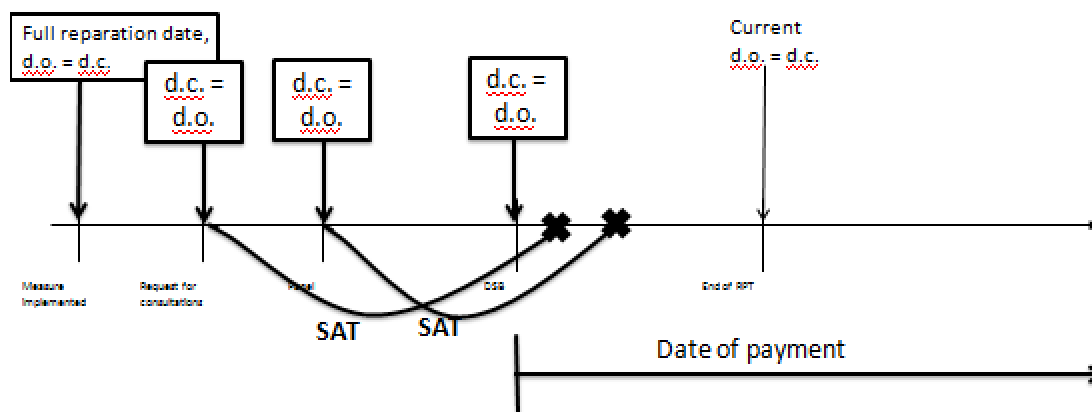
For partial reparation, two options may be considered with respect to these two dates. Figure 6 shows monetary compensation when the two dates are separated. The date of obligation would arise at the end of the RPT (as it does under prevailing WTO practice), but the date of calculation would be moved back to an earlier point in the dispute resolution process.

Figure 6. Partial Reparation based on Separation of Dates (Option 1)



In Figure 7, the dates are not separated, but they are not determined by the date the measure was imposed (which would be full reparation).

Figure 7. Partial Reparation based on Equalization of Dates (Option 2)



As indicated in Figures 6 and 7, potential dates of calculation are these:

1) the date the measure was imposed
2) the date a request for consultations was filed
3) the date the panel was established
4) the date the DSB adopted the panel or AB report finding a violation

The 2003 proposal of Mexico listed three of these as possible dates: "the date of imposition of the measure OR request for consultations OR establishment of the panel."[70] Davey supported the second or the third date, but did not suggest a date earlier than the consultation request.[71] Two brief notes on these figures: First, whatever dates are used for the obligation and the calculation, the date of payment cannot come before the panel or AB report has be adopted by the DSB. Second, the "sufficient amount of time" (SAT) is modelled on the RPT and is designed to serve the same purpose of giving Members some amount of policy space to reconsider measures after either the request for consultations or panel establishment. This concept is developed below in Part III.A.

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[70] WTO, *Communication from Mexico*, TN/DS/W/40 (January 27, 2003), p. 6.

[71] Davey, *Sanctions*, *supra* note 21, at 366.

With these options in mind, consider the problems of ineffective retaliation and the remedy gap. Monetary compensation as partial reparation is sufficient to solve ineffective retaliation. The date of obligation arises is the day after the RPT expires (Option 1), so monetary compensation respects the right to RPT and applies when a Member cannot retaliate. However, partial reparation can be calculated from an earlier date and so provide the necessary monetary compensation to the complaining Member. Under Option 1 for partial reparation, monetary compensation is not awarded as a retrospective remedy, though it is based on broader time frame for calculating the harm. Option 2 would also address ineffective retaliation, but it would create an obligation before the RPT expires—an aspect of these proposal that some Members object to.[72] Option 1 is thus preferable because it addresses the problem while respecting the right to RPT. In this way, monetary compensation as partial reparation remedies the problem of ineffective compensation.

Solving the remedy gap must consider whether the issue is prolongation or a hit-and-run measure. For prolongation, like ineffective retaliation, partial reparation under either Option 1 or Option 2 is a solution. The key feature is that the earlier date of calculation (regardless of which date of obligation is used) will act as a credible threat of an effective compensatory remedy, and so incentivize violating Members to comply and comply more quickly. This is true whether one conceives of WTO remedies as aimed at inducing compliance or at rebalancing negotiated rights.[73] For a hit-and-run measure, the only solution is full reparation or partial reparation under Option 2, since these measures are characterized by their withdrawal before the end of the RPT. These measures can only be remedied by retroactive remedies and removing the right to the RPT.

[72] See WTO, *Meeting Minutes of Special Session of the Dispute Settlement Body, 13 - 15 November 2002*, (March 31, 2003), TN/DS/M/6 (hereinafter WTO, *DSB Meeting Minutes*), para. 38 (statement by representative of Canada).

[73] Davey, *Sanctions*, *supra* note 21, at 365. On the variety of goals of retaliation, and the trend from rebalancing to compliance, see generally Joost Pauwelyn, *The calculation and design of trade retaliation in context: what is the gal of suspending WTO obligations*, in BOWN AND PAUWELYN, RETALIATION, *supra* note 19, at 36.

D. Conclusion

Monetary compensation as full or partial reparation can efficiently address these limitations in WTO remedies. As the preceding discussion shows, the effectiveness of this solution depends on the design of the measure and its integration in the WTO dispute settlement system. In addition to these and other procedural matters, the substantive calculation of monetary compensation is of great importance. As developed more fully in the next Part, the level of monetary compensation consists of three main variables—namely, the amount of monetary compensation to be paid, the date of calculation of monetary compensation, and the adjustment of the amount of compensation over the course of time. The way these three factors are combined differs depending on whether the goal is to solve the problem of ineffective retaliation or the remedy gap issues. With respect to the WTO system of trade liberalization, it is important to bear in mind that monetary compensation has less of a trade-distorting effect than the current WTO remedies have.[74] Thus, Members do not need to "shoot[] themselves in the foot" to induce compliance of violating Members whose measures are already causing negative trade impacts.[75]

[74] *See* Bronckers & van den Broek, *Financial Compensation*, *supra* note 44, at 110.

[75] Mavroidis, *Remedies*, *supra* note 23, at 806.

III. Substantive and Procedural Aspects of Monetary Compensation

While the previous Parts of this Memorandum explained the foundations of a system of monetary compensation as it relates to the current limitations of WTO remedies, this Part delves into the substantive and procedural aspects of implementing a mechanism of monetary compensation in the DSU. It considers step-by-step a number of substantive and procedural questions that must be addressed to determine the effectiveness of monetary compensation in the DSU. It provides options and recommendation for discussion of this remedy as it can address problems of ineffective retaliation and the remedy gap.

A. The Calculation of the Level of Monetary Compensation

As stated in the previous chapter, monetary compensation and therefore the effectiveness of monetary compensation, depends on three general factors: 1) the date of the calculation of monetary compensation, 2) the level of monetary compensation, 2) change of the level of monetary compensation over the course of time. This section determines the possible ways of calculating the level of monetary compensation. It provides the means to calculate monetary compensation whether it is conceived as full reparation or as partial reparation. First, it evaluates possible time horizons for the calculation of monetary compensation and its impact on the effectiveness of monetary compensation in general. Then it investigates the possible ways of establishing the level of monetary compensation. Finally, it discusses the importance of the change of level of monetary compensation in the course of time and its influence on the effectiveness of the monetary compensation as a solution to the problems of the WTO dispute settlement system.

This section provides a broad assessment of the effectiveness of the stated above parameters on the solution of the remedy gap and ineffective retaliation. It relies on the relationship between international treaties and private contracts and employs mechanisms that are available under the investment law. It provides potential procedures for calculating the level of monetary compensation for a measure violating WTO obligations.

1. The Date of Calculation of Monetary Compensation

As discussed, Article 22.2 of the DSU does not allow compensation to be provided while the violating Member is exercising its right to RPT. This is one of the determinants of the existence of the "remedy gap" problem of the DSU. Addressing this problem can also address the ineffective retaliation problem, as it will be shown in the conclusion for this part. This section first provides options for date of calculation of the monetary compensation and discusses the effectiveness of application of the date of calculation of the monetary compensation for addressing the problems.

Under the current WTO procedures, the level of monetary compensation should be calculated only after the RPT expires. As has been shown in a number of studies,[76] the violating member then has a higher incentive to exaggerate the RPT required to comply and to delay the compliance. Therefore, other options for starting the calculation of the monetary compensation are considered for the purpose of this paper.

As discussed above, most WTO violations create trade-restricting or trade-diverting effects for as long as they are in place and WTO remedies are not calculated until the violating member has had a reasonable period of time to implement the report of the panel or Appellate Body.[77]

It is important though to go back to the reason of existence of the RPT within the WTO framework. As to insure prompt and full compliance, the Member has to withdraw the measure right after the corresponding decision of the DSB is taken. Nevertheless, it could be impossible or ineffective to withdraw the measure immediately and the Member requests RPT in order to comply with the decision of the DSB. The main reason for impossibility and ineffectiveness of the immediate compliance is the economic and administrative restrictions of the Member. Time is needed in order to adjust the economy to the implementation of the corrected measure. This is called "the right to RPT" and is one of the WTO rights that are strongly defended by some scholars and one of the main reasons for hesitance in assessing the proposals of the Members.[78]

The rationale of the existence of the RPT could be retained within the following proposed dates of calculation of the level of monetary compensation. Indeed, the nature of the measure at issue might be complicated and require a sufficient amount of time (SAT) to be withdrawn when

[76] *See* Davey, *Sanctions*, *supra* note 21, at 367.

[77] Article 21.3, DSU.

[78] *See, e.g.*, Sykes, *Optimal Sanctions*, *supra* note 19.

the violator is acting in the good faith. Then utilizing the set of options laid out before and applying SAT provides with new options for the date of calculation of the monetary compensation:

1) monetary compensation could be calculated after SAT from the request for consultations – the logic is that at the time of the request of consultations the violator is notified that the measure at issue is doubted to be WTO consistent and the member could act so that to modify the measure at issue to be WTO-consistent in the perspective of the complaining member;
2) monetary compensation could be calculated after SAT from the date of the submission of the Panel – the logic imitates the one from 1).

These proposed dates contain the rationale for the RPT and the Members have their right to withdraw the measure without imposing harm on their economies.

2. The Level of the Monetary Compensation

Establishing the appropriate level of monetary compensation is one of the main issues to be addressed when applying the monetary compensation. A number of commentators and scholars[79] have discussed that the level of monetary compensation could be different in design and in value. Moreover, they clarify that it should not necessarily be equal to the full amount of reparation that could have been issued. A "baseline" approach to calculating the level of monetary compensation is based and proposed on this logic. This approach incorporates the various ways to calculate the maximum possible boundary for level of monetary compensation to be issued—the "baseline" level—and then discuss the options on determining the appropriate level of monetary compensation as within the baseline level.

The advantage of this approach is that the general rules on calculating the baseline level of monetary compensation can be formed, but the appropriate level of monetary compensation could follow a case-by-case determination under some certain circumstances. It will be shown

[79] *See* Trachtman, *WTO Cathedral*, *supra* note 22, at 160; *see also* Bronckers & van den Broek, *Financial Compensation*, *supra* note 44, at 113–14.

further, that there exist a strict set of rules for addressing the "hit-n'-run" measures and general recommendations for other applications.

i. Determination of Baseline Level

For determining the baseline level of monetary compensation this Memorandum proposes to utilize the existent WTO practice in calculating the level of retaliation. This is proposed on the basis of the fact that under certain circumstances monetary compensation can act as an alternative to retaliation, and also because the calculation procedures undertaken at WTO are the following the general idea of compensation for harm (estimating "trade" or "economic" effects of the non-compliant measure, utilizing the standard of equivalence[80]).

Accepting the general WTO procedures in calculating the level of retaliation for calculation of the baseline level of monetary compensation also reduces the difficulties incurred when expanding the notion of monetary compensation at WTO. Before discussing the calculation procedures, this section considers the possibility of including a duty to mitigate damages in the calculation of the baseline level.

a. Mitigation of Damages

The concept of mitigation must be carefully designed to cover only that conduct which is attributable to the complaining Member. The conduct of private actors in the Member's industry cannot affect any duty to mitigate by the Member itself, just as a State is not responsible for the actions of private parties under international rules of attribution.[81]

In some circumstances, the mitigation of damages could be required under certain restraints. In international trade, mitigation of damages refers to directing trade to another country, or to the same Member but with less favorable conditions, because of that Member's WTO-inconsistent measure. Considering the attribution issue, the ability of the complaining Member to conduct that level of trade if the measure were not in place must be taken into account. Consider the circumstance where the amount of re-directed trade combined with the amount of trade that would have been directed to the violating Member is higher than the real production capacity of the complaining Member. In such circumstance, a baseline level of

[80]Article 22.4 of the DSU, retaliation "shall be *equivalent* to the level of the nullification or impairment."
[81] *See* ILC Draft Article 2(a); *see also* ILC Draft Articles 4-11.

monetary compensation to be determined can be decreased by partially accounting for the amount of re-directed trade. Thus, this procedure partially resembles the procedure of mitigation of damages in investment arbitration.

In investment arbitration, in principle the tribunal has to calculate the amount of damage based on the actual loss of the investor. However, there are situations when the guarantee of full damage is not appropriate. Several factors may reduce the compensation paid for the investor.[82] These factors include cases when injury was caused by concurrent causes, only one of which is attributable to the respondent member. Such concurrent causes can be ascribed to the victim of the breach, which has then committed contributory negligence or fault, or by third party. The second factor include, the victim of the breach may have failed to mitigate the damage once it has materialized.

The commentary to Draft Article 34 on State Responsibility also provides that compensation is limited to damage actually suffered as a result of the wrongful act of the state by excluding damage which is indirect or remote.[83] However, the *CME v Czech Republic* tribunal, quoting the Draft Articles noted that concurrent causes do not justify a reduction in damages unless the victim contributed to that cause.[84] The tribunal highlighted the issue of attribution—only if "some part of the injury can be shown to be severable in causal terms from that attributed to the responsible state injury attributable," then the complaining state has a duty to mitigate and so damages may be reduced.[85]

Importantly, the concept of mitigation need not be explicit in the international agreement. A tribunal will reduce compensation for failure to mitigate harm even without express mention in the treaty. In *Middle East Cement v. Egypt*, the tribunal stated that "this duty [to mitigate] can be

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[82] *See* Walde & Sabahi, *Compensation*, 1093ff; CAMPBELL MCLACHLAN, LAURENCE SHORE AND MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION SUBSTANTIVE PRINCIPLES 335ff (2007).

[83] ILC Draft Articles Commentary, at 95–96.

[84] *CME Czech Republic BV v Czech Republic* UNCITRAL Arbitration Rules, I.I.C 61, (2001), Partial Award and Separate Opinion of September 13, 2001, para 583.

[85] *CME Czech Republic BV v Czech Republic* (quoting Commentary para. 13 to ILC Draft Article 31).

considered to be part of General principles of public international law which, in turn, are part of the rules of international law."[86]

The mitigation of damages is a specific option for calculation of the baseline of monetary compensation. It incorporates the constraint on the production possibilities of the Members. As an example consider a Member state Antaland, which requests a baseline level of monetary compensation of 20bln USD as a result of the measure undertaken by Member Primerland. Primerland may provide evidence of the production capacity and trade re-direction of Antaland. Assume the production capacity of Antaland for the addressed period of time was 30 bln USD, and during this period it has sold 18bln USD to Volland, another state. Under the proposed mitigation duty, the baseline level of monetary compensation could be adjusted as a response to the losses Antaland actually suffer, rather than the simple amount of trade diverted away from Primerland because of the measure. The application of full mitigation of damages would not be required (i.e. not awarding 12bln USD [30bln USD capacity less 18 bln USD re-directed trade] instead of the 20bln USD trade impact). Instead, a panel or Arbitrator should look into this and other background information (which may lead to an adjustment of the baseline level by, say, 6bln USD under the totality of the circumstances). This duty to mitigate may make the concept of monetary compensation more appealing to some WTO Members, even if it would increase the complexity of calculation.

b. The Application of the Baseline Calculation

As stated before, the calculation of the baseline level for monetary compensation is a first step in order to provide the appropriate level of monetary compensation. After the baseline level is calculated, there are three ways proposed to determine the actual level of monetary compensation. First, the level equivalent to the baseline' level of monetary compensation could provide full monetary compensation for the suffered damages, similar to the level of retaliation at a certain period of time in monetary definition. This is an appropriate level to solve the "remedy gap" issue for the "hit-and-run" measures. The assumption here is that the baseline level of monetary compensation is equivalent to the compensation for the full harm caused, and

[86] *Middle East Cement Shipping and Handling Co. SA v.Egypt*, ICSID Case No. ARB/99/6, Award of 12 April 2002, Para 167.

therefore, have to be applied as an appropriate level of monetary compensation as through full reparation.

Second, a fifty percent level could be decided *a priori* and applied to the level of nullification or impairment to give the amount of monetary compensation for the complaining Member. This level of monetary compensation was previously used in the Article 22.15(5) of the US-Chile FTA. Third, another partial level (percentage) could be used. In this case the level of monetary compensation is decided by the arbitrators based on the evidence provided by the suffering WTO member. Investment arbitrations have used other partial levels for calculating compensation. For example in MTD v. Chile, the tribunal simply stated that the investor's damages would be reduced by 50%, reasoning that this amount of loss was due to the risk the investor took in buying land from a private party without adequate legal protection.[87] In the trade context, the evidence to be considered includes claims and requests by the home companies suffering losses and proof of the harm to the customers.

ii. The Calculation for Other Agreements

The baseline level of monetary compensation is applicable to violations under all WTO Agreements. However, the appropriate level of monetary compensation may be determined based on different criteria depending on the Agreement in issue. This section will analyze how the appropriate level of monetary compensation should be determined in case of the trade remedy cases, specifically those arising under the Agreement on Subsidies and Countervailing Measures (SCM Agreement).

a. Trade Remedy Cases: The Example of the SCM Agreement

The main reason for specific consideration of trade remedy cases is that Members apply trade remedy measures at a domestic level, which may be challenged later at the WTO. This section provides modifications to the approach for calculating the baseline level of monetary compensation. It recommends determination of applicable level of monetary compensation in this context.

[87] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, 2005, paras. 242-243.

Along with the exception for the rules and procedures set forth in Article 22 of the DSU, there is also a separate set of rules and procedures of calculation of retaliation. Hence, there should be a separate approach to calculate the baseline level of monetary compensation for disputes under the SCM Agreement. WTO case law allows for different approaches for calculating retaliation in the subsidies context. Therefore, in calculating the baseline level of monetary compensation, the level can either constitute to the amount of the subsidy, or the effect of the subsidy. In *Brazil – Aircraft (Article 22.6 – Brazil)* the and *Canada – Aircraft (Article 22.6 – Canada)*, the Arbitrators discussed the adverse effects of the subsidy and peculiarities of calculation in these cases.

Then following the established procedures for calculation under these cases, the baseline amount of monetary compensation will depict the general effect of the violation, which in most of the cases does not limit itself to a certain country. It can also be the case that the complaining Member is not the one who is effected the most by a subsidy. Therefore, a certain criteria of determining the appropriate level of monetary compensation should be imposed.

Therefore, in the case of finding a violation under the SCM Agreement, the panel is empowered to establish the "global" effect of the violation—the effect of non-compliance spreading to all WTO members. The applicable level of monetary compensation should be based on the share of the effect suffered by the complaining party. The effect of the WTO-inconsistent measure could be calculated based on the complaining Member's share in the world economy, share of the world trade in particular sector, or another metric.[88] The calculation of this share could potentially take into account the prospective trend of the development/impairment of this share.

3. Calculating Monetary Compensation over the Course of Time

The change of the amount of monetary compensation over the course of time is an important procedure for monetary compensation to solve the problem of ineffective retaliation. When applied appropriately it also induces compliance with WTO obligations. This change of the amount of monetary compensation over the course of time can be accomplished by two

[88] Depending on the type of violation and the variety of impacts it could have on a complaining Members, the precise metric and any necessary adjustments (including the country's share in the world population) must be determined on a case-by-case basis.

procedures (separately or in combination): 1) the application of an interest rate, and 2) the periodic review of the level of monetary compensation.

This section begins with a description of the legal framework for interest rates in international law. It then considers the two types of interest rate. The first ("interest rate to induce compliance") applies to all awards of monetary compensation because it incentivizes a Member to bring its illegal measure in line with WTO obligations. The second ("interest rate on the cost of money") is an enforcement mechanism that incentivizes a non-compliant Member to make full and prompt monetary compensation payments. This section also proposes a procedure for a periodic review of the amount of monetary compensation and adjusting it according to fluctuating market conditions and trade flows. When combined with the date of calculation and the level of monetary compensation, these procedures to adjust an award in light of the time element (interest rates and periodic review) have an impact on the effectiveness of the monetary compensation.

i. Interest Rates Application

The payment of interest is a common feature of legal systems concerning monetary damages or compensation. With different systems, the purpose of applying interest rates, the calculation of interest rates, and relevant time periods may vary. The international rules on interest rates derive from general international law, but they have developed in other areas of, especially, international economic law. This section these rules general international law and in other areas of international law (specifically, BITs and FTAs). The discussion provides the legal framework for the proposed types of interest rates and other adjustments to the level of monetary compensation over the course of time.

a. General International Law

The payment of interest is common in general international law, as well as most domestic legal systems.[89] The purpose of the payment of interest is not, however, to penalize failure to pay

[89] ILC, *Draft Articles*, *supra* note 26, at art. 38 and ILC Draft Articles Commentary, p. 108, para. 7:

> Although the trend of international decisions and practice is towards *greater availability of interest* as an aspect of full reparation, an injured State has no automatic entitlement to the payment of interest. The awarding of interest depends on the circumstances of each case; in particular, on whether an award of interest is necessary in order to ensure full reparation. This

compensation or damages. According to ILC Draft Article 38, interest is "payable when necessary in order to ensure full reparation."[90] Interest is tied to the concept of full reparation, and the "rate and mode of calculation shall be set so as to achieve that result."[91] As for the time period, the interest runs from the date payment is due until actual payment.[92] Concerning compound or simple rates of interest, international practice has usually been limited to simple rates. For example, the Iran-United States Claims Tribunal generally disallows compound interest, even when compound interest was required by contractual terms.[93] Compound interest has been awarded in some cases, but the Commentary to the Draft Articles suggests that it be exceptional—that is, only when there are "special circumstances which justify some element of compounding as an aspect of full reparation."[94]

The concept of interest in international law is relevant because interest rates are applied from the date of the calculation of damages and going forward. While the ILC Draft Articles focus on the goal of full reparation, interest under the DSU could be designed for the two purpose suggested above: to induce compliance with WTO obligations (i.e. DBS rulings and recommendations) and to induce payment of monetary compensation during the time of non-compliance. The general rules of interest rate were developed mainly in regard to the first goal (inducing compliance with international obligations), and under a legal system designed to ensure full reparation. However, the same rules outlined above can apply to both types of interest rate discussed here.

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approach is *compatible with the tradition of various legal systems as well as the practice of international tribunals*. (emphasis added)

[90] ILC, *Draft Articles*, *supra* note 26, at art. 38(1).

[91] ILC, *Draft Articles*, *supra* note 26, at art. 38(1); *see* ILC Draft Articles Commentary, p. 109, para. 10 (mentioning possible rates: "the applicable interest rate (rate current in the respondent State, in the applicant State, international lending rates)").

[92] ILC, *Draft Articles*, *supra* note 26, at art. 38(2); *see* ILC Draft Articles Commentary, p. 109, para. 10 (mentioning other alternatives: "starting date (date of breach, date on which payment should have been made, date of claim or demand)" and "the terminal date (date of settlement agreement or award, date of actual payment)").

[93] ILC Draft Articles Commentary, p. 109, para. 8, note 615 (citing the 1986 case of *Anaconda-Iran, Inc. v. The Government of the Islamic Republic of Iran*).

[94] ILC Draft Articles Commentary, p. 109, para. 9.

b. Other Areas of International Law

Interest is provided especially in treaties in the area of international economic law—that is, BITs and FTAs. These treaties provide precedents for the inclusion of interest payments in the WTO context. While they do not answer all of the questions of procedure and implementation raised in the discussion of the general international law of interest, they provide useful examples for the system of monetary compensation in the WTO.

Concerning investment law, the UK model Bilateral Investment Treaty (BIT) of 2005 includes the provision of interest. It states in relevant part:

> *Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is the earlier, shall include interest at a normal commercial rate until the date of payment, shall be made without due delay, be effectively realizable and be freely transferable.*[95]

In the area of FTAs, the North American Free Trade Agreement (NAFTA) and most regional FTAs include the payment of interest. For example, Article 1135(1) (a) of the NAFTA provides that tribunal may award separately or in combination with other remedies, monetary damages and any applicable interests. Arbitral awards under these treaties have not been consistent as to rate of interest applied and whether it is to be simple or compound.[96] A panel or Arbitrator may make such a determination based on the particular requirements of a case.

c. The Date of Calculation of the Interest Rate

The date of calculation of the interest rate should be determined by the arbitrators. The ILC's Commentary to the Draft Articles provides a number of potential options.[97] The start date could be 1) the date of breach, 2) the date on which payment should have been made, 3) the date of claim or demand. The ending date could be either the date of settlement agreement or award or the date of actual payment.

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[95] Article 5.1, UK Model BIT.

[96] *See* ILC Draft Articles Commentary, p. 109 (citing the ICSID case of *Santa Elena v. Costa Rica*, in which compound interest was awarded).

[97] ILC Draft Articles Commentary, p. 109.

ii. Interest Rate to Induce Compliance with the WTO Obligations

The interest rate to induce compliance is an interest rate on the amount of monetary compensation that is determined based on the facts of a case. Those factors impacting the amount of damage (and thus, monetary compensation) can themselves change over time. The first aspect of this interest rate takes all the factors into account to adjust the level based on the circumstances. The second aspect of this interest rate is an adjustment for inflation

First, a WTO-inconsistent measure can have an expanding effect on trade over time. It may come from an indirect effect on the complaining Member's economy or through the lost possibilities of that Member. The greater the time period from the start of the implementation of the measure, the more the international trade is being diverted from the status quo ante. Therefore, bringing in the concept of the interest rate to induce compliance to the WTO obligations could be an efficient instrument of inducing compliance/paying for the adverse effects of the violating measure. There are two methods proposed to calculate interest rate to induce compliance to the WTO obligations: 1) an average rate of return on the assets/bonds of the complainant Member, or 2) an average rate of return on the assets/bonds of the violating Member. The second part of the interest rate to induce compliance is the interest rate pegged at the inflation rate to stop depreciation of the amount of monetary compensation owed to the complaining Member.

Throughout the time span of the calculation of the monetary compensation the interest rate on the cost of money (simple or compound) should apply to the sum. There are two proposed benchmarks for the interest rate: 1) the interest rate of the Central Bank of the complainant Member, or 2) the interest rate of the Central Bank of the violating Member. Calculating interest rate based on the second option is more efficient, as it will increase the incentive of the violating Member to comply and reflects the development of the violator's economy. If the violating Member's economy is larger than the complaining Member, then the monetary policy of the central bank of the violating member is likely to be more efficient. The interest rate of compensation could be calculated on the short-term interest rate, calculated based on 3-months period, 6-months period or on the long-term interest rate.

The design of the interest rate to induce compliance provides increasing incentives to comply. The interest rate to induce compliance includes the opportunity costs of the complaining member. Through application of the interest rate to induce compliance, the violating Member has

to pay an increasing amount of monetary compensation over the course of time. Eventually, the increases due to accumulated interest overrides the incentive to not comply with WTO obligations, and therefore brings the violator to compliance.

iii. Interest Rate on the Cost of Money

This interest rate applies when the Member obligated to pay monetary compensation is not making those payments. The interest rate on the cost of money acts as an enforcement mechanism for the duty to pay monetary compensation through the idea of "prompt compliance" to the DSB decisions.[98] If the violating Member fails to pay the monetary compensation during the period provided to do so, then the interest rate on the secondary obligation should be applicable for the time period when the monetary compensation has not been paid.

The interest rate on the secondary obligation describes the loss to the complainant Member's economy caused by not eliminating the negative effects of the non-conforming measure at time it could have done so if the payment would have been done on time. There are two methods proposed to calculate the interest rate to induce compliance to the WTO obligations: 1) an average rate of return on the assets/bonds of the complainant Member, or 2) an average rate of return on the assets/bonds of the violating Member.

iv. Review of the Level of the Monetary Compensation

The review of the level of monetary compensation is a procedure to capture the diminishing or increasing effects of the violating measure in time and to induce compliance of the WTO Members to their WTO obligations.

One of the ways to improve the effectiveness of the monetary compensation as a solution to the ineffective retaliation is to increase the level due each year until the compliance with the report's recommendations is effectuated. This method to induce compliance has precedents in current WTO practice of suspension of concessions (or retaliation), and it could be translated into the context of monetary compensation based on that model. The retaliation model will be discussed next, and then some comments about the practice applied to monetary compensation follows.

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[98] Article 22.1, DSU.

In *US – FSC (Article 22.6 – US)*, the European Union (EU) effectively employed an increasing amount of retaliation to bring the United States (US) measure in line with its WTO obligations.[99] The US law on Foreign Sales Corporations (FSCs—usually US companies' subsidiaries in foreign territories selling US goods to foreign partners) provided tax exemptions to the FSCs, but these were held to be prohibited subsidies. Because the dispute was initiated in 1997 but the EU's authorization to retaliate did not come until 2003, the EU opted to implement its countermeasures below the full level. This method allowed the EU to begin with a duty of 5% on certain US products and then raise it by 1% per month until reaching a ceiling of 17%. According to Davey, this method was meant to keep the non-compliance issue at the forefront, and comments made during the Congressional debate on the repeal of the FSC law shows that it was successful.[100] In fact, the US repealed the impugned law prior to date on which the duty was to reach the ceiling.

Even though the general proposition is to organize the review on the early basis, the time period of the review of the monetary compensation could be more or less frequent upon the decision of the arbitrators or the request of the Members concerned. This alternative time periods should be based on the assessment of the character of the violating measure.

Following the logic of Article 22.6 of the DSU, the violating Member can submit a request to the DSB in order to calculate the new level of monetary compensation if the violating measure has a diminishing effect in time on the trade diversion.

v. The Effectiveness of Adjusting the Level over the Course of Time

If there is no interest rate on the cost of money applied, the real value of the monetary compensation depreciates in the course of time, and the violator is getting better off while not complying with its WTO obligation.

If there is no interest rate to induce compliance with the WTO obligations applied to the level of monetary compensation, the violator may be getting better off or remaining in the same state through not complying with its WTO obligation. If the measure at issue has a prospective

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[99] *See* SHERZOD SHADIKHODJAEV, RETALIATION IN THE WTO DISPUTE SETTLEMENT SYSTEM 140-44 (2009) [hereinafter SHADIKHODJAEV, RETALIATION].

[100] William J. Davey, *Implementation in WTO Dispute Settlement: An Introduction to the Problems and Possible Solutions*, Illinois Public Law Research Paper No. 05-16 (November 30, 2005), p. 17, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=862786 [hereinafter Davey, *Implementation*].

character and there are future factors that improve the economy through utilizing the effects of the measure violating the WTO obligations, the violator is receiving increasing gains from the violation in the course of time. As the interest rate to induce compliance with the WTO obligations is by construction aimed to capture the future benefits of the violating measure, it induces compliance with the WTO obligations.

The review of the level of monetary compensation pursues the same goals as the interest rate to induce compliance to the WTO obligations. It is aimed to take into account the changing circumstances of the state of the world's economy. In case there are initially unobserved benefits of the violating measure it pursues to increase the level of the monetary compensation accordingly. If the measure at issue has effects that are diminishing, it adjusts the level of the monetary compensation accordingly.

Therefore, adding an according procedure for the change of the level of the monetary compensation in the course of time, allows for the more efficient solution for the "ineffective retaliation".

4. Conclusion

Bringing monetary compensation into the WTO system allows WTO Members access to a more effective way of inducing free trade. Monetary compensation does not restrict trade as does retaliation. The complaining Member does not raise the tariffs or impose any other restrictions, and therefore, trade diversion in other sectors does not occur. It also allows the complainant Member to diminish (or exhaust) the effects suffered because of the trade-restricting measure of another member.

As discussed above, the date of calculation earlier than the end of RPT (current date used in DSU) does not necessarily mean that the Member will have to pay such monetary compensation, as the obligation might never occur if the Member complies within the RPT. Therefore, the ineffective retaliation problem is directly addressed through the earlier dates of calculation—the earlier the calculation starts the bigger the monetary compensation will be applicable in case of non-compliance. The same logic applies to the calculation of the level of the monetary compensation. Therefore, the more effective combination of these two parameters (the level of monetary compensation closer to the baseline level, the date of calculation closer to

the date of implementation of the measure) lead to higher incentive of the Members to comply within the RPT. This statement stays true for both types monetary compensation whether full or partial reparation. This indicates that applying monetary compensation means that ineffective retaliation occurs in fewer cases.

If this procedure is applied but the Member still does not comply, the parameter of the interest rate to induce compliance to the WTO obligations plays a role in inducing compliance. As described in this section, the interest rate to induce compliance to the WTO obligations has a crucial role in inducing compliance when there is no compliance observed after the RPT.

Before concluding this section on the calculation of monetary compensation, a few examples or illustrations of hypothetical case will help to clarify the operation of the calculation process. Combining the three aspects of the calculation (the date, the level, and interest) in different ways can address different limitations. The following examples apply the concepts discussed in this section.

In Big Union-Bravaria case, Big Union was found violating their obligations under SCM agreement through supporting their publication industry with indirect tax rebates, hurting publishers of Bravaria. The decision was made on 15 January 2000, with the RPT determined at 10 month. The compliance to this decision yet has not been observed. Big Union claims that the main legislative body - the United Congress - is not allowing for this change of legislation. The reason stated by the United Congress is that the change of the regulation at issue will provoke negative spill-over effects on other industries. As the measure at issue is violating WTO obligations of the Big Union, Bravaria's publishers still continue receiving negative impact of it. Bravaria's publishing industry is not big enough to retaliate, and the cross-retaliation is only possible within the banking sector. If this is done, Bravaria's government suspects huge losses within the banking sector to be encountered. This is an evident example of the "ineffective retaliation" problem. In presence of monetary compensation Bravaria's publishing industry would have been compensated for the losses at least since end-2000 (as of the end of RPT), and if any of the means for increasing the level of monetary compensation over time would have been applied, the United Congress might face higher incentives to agree with the change of the regulation.

For an effective solution of the remedy gap problem, however, full reparation is needed. In this framework, the baseline level of the monetary compensation should be used as a determinant

for level of monetary compensation, and the date of implementation of the measure should be used as the date that the obligation arises. Note that the interest rate to induce compliance to the WTO obligations can also be applicable in these cases. The application of the interest rate to induce compliance to the WTO obligations will reflect the loss of potential profits (future gains) for the complaining Member and increase the motivation of the violating Member to cease the measure sooner. If this is applied, Members will potentially be more careful and unbiased in exploiting the remedy gap. This will, in turn, lead to a more efficient dispute settlement system and a higher level of compliance to the WTO obligations, as well as fewer cases that fall under the remedy gap conditions).

In the case of Antaland and Primerland, the Arbitrator has decided that the measure was inconsistent to the WTO obligations of Primerland. The request for consultations was filed in on 7 January 2001, negotiations did not succeed and due to complex investigation the final decision of the DSB was issued on 28 February 2002. The RPT for Primerland was established as half a year, and was expiring on 31 August 2002. The Primerland has officialy complied to the decision on 02 August 2002. Therefore, for this case, Antaland's fishery was suffering the effects of the measure for 20 month (the measure was introduced in January 2000 – a year before the request of consultations was filed in). Experts estimate that the general harm to the fishery of Antaland was constituting up to 0.3bln USD per year. Then, applying the monetary compensation, the fishery of Antaland would have been compensated somehow for the harm encountered. If applying the monetary compensation through full reparation the monetary compensation of 0.5bln USD should have been issued to Antaland.

As mentioned above in the date of calculation section, the "remedy gap" refers to both "hit-and-run" measures and the issue of Members' prolongation of the RPT. As discussed before, in general, the remedy gap can be addressed through full reparation. Nevertheless, one of the logical suggestions will be that to decrease the prolongation of the RPT and increase the incentives of Members to comply faster, earlier dates of calculation are effective. Then the date of obligation should be moved to an earlier period of time. For example, if we treat the date of request for consultations as a date when the member receives information on the displeasure of another Member with the existent measure, then the end of SAT after the date of consultations can be treated as a determinant for date of obligation (alternatively, other proposed dates could

also be considered). Then, if the SAT has expired (this happens already after the decision of the panel or the Appellate Body on the case), the Member still has time until the end of RPT to comply, but needs to pay monetary compensation for that time – as a payment for the diverted trade. Then if after the RPT expires, the violating member does not comply, the suffering member can implement retaliation procedure (or, as suggested through the course of this paper, be request "monetary compensation") but be entitled to the monetary compensation calculated for the time period between the end of SAT and end of RPT. This procedure will decrease the incentive of members to prolong the RPT and therefore increase the effectiveness of the dispute settlement at WTO. Note that the described above procedure does not solve the remedy gap problem, but efficiently address one of the arising complications and inefficiencies of it – the incentive to prolong the RPT.

The Zarimland-Timberia case has started in 2001, when Timberia filed a case against Zarimland. Zarimland was implementing the "Registration of Aircrafts" 1999 Bill for controlling the imports of aircrafts on their territory. The case has taken 2 years to be solved (the decision was taken by DSB on 14 February 2003), and the Registration of Aircrafts Bill was found to violate the WTO obligations of Zarimland. The Timberia's estimation of the effect of the measure was 200 thousand USD per year. The RPT was requested at the maximum lengh – 15 month, so Timberia had to suffer the diverse effects of the measure even when it was found a violation till it was eliminated in June 2004. This could be seen as a prolongation of RPT problem. Following the framework outlaid above, Timberia would have received monetary compensation for some time it was suffering the consequences of the measure. There is no particular date that we can impose as a recommendation in this case, but, as also discussed above – the earlier is better and the closer the appropriate level of monetary compensation is to the baseline level, the more the "prolongation" problem is resolved. The SAT idea can also be applied in this scenario.

Therefore, this section has provided the calculation methods for monetary compensation. Both of the limitations of the DSU can be efficiently addressed through the design of monetary compensation. It has also been shown, that monetary compensation provides the effect of inducing the motivation of the members to comply with their obligations and a source of keeping up to the principle of reciprocity in trade. Therefore, a mechanism of calculating the level of

monetary compensation should be in place to enhance the level of commitment by members to the WTO obligations.

B. Procedural Placement of Monetary Compensation in the DSU

To support the goals of the WTO dispute settlement system, effective procedures should make monetary compensation a remedy in addition to the existent "compensation" and retaliation. The concept of monetary compensation may be incorporated into the existing remedy structure that the DSU provides, or it may be an alternative to the current system. In general, monetary compensation would complement the existing DSU system of remedies, while in particular cases it may be employed to the exclusion of certain other remedies. Whatever option is ultimately considered, the procedures to access monetary compensation must be clear and fair.

The four options are as follows:

1) monetary compensation could come within "compensation" in Article 22.1 of the DSU;
2) monetary compensation could be another available option at the same point that a Member could choose the suspension of concessions;
3) monetary compensation could be made available only after suspension of concessions is proven to be inadequate;
4) monetary compensation could be presumptively available as S&D treatment.

This section presents the overview of benefits and drawbacks of each option in relation to existing WTO law and provides recommendations.

1. Monetary Compensation as Article 22 "Compensation"

First, monetary compensation could function as trade compensation currently does. Because Article 22.1 of the DSU, already includes reference to compensation without qualification as trade or monetary, this would not necessarily require an amendment of the text. In this option, it would be subject to the requirements of that article—namely, that it be voluntary and consistent with the WTO Agreements (the MFN issue). With respect to the first requirement,

voluntary monetary compensation is not the best option because it is unlikely that a violating Member would choose to pay.[101]

2. Introducing Monetary Compensation as a New Remedy

Second, monetary compensation could be provided as another option to complaining Members when there is non-implementation of panel or AB recommendations. In this option, monetary compensation would be an equal option with retaliation, either of which would be available to the complaining Member. This option is currently used under some recent US Free Trade Agreements (FTAs).[102] However, those agreements make monetary compensation voluntary because it is at the election of the violating State. This aspect is problematic for the WTO because it could encourage efficient breach of WTO obligations by Members, which would fail to ensure the goal of inducing compliance. Further, the simple payment of monetary compensation by violating Members may not be a temporary incentive for compliance. For this to be effective in the WTO, monetary compensation must be mandatory and available based on the choice of the complaining Member. An additional problem with placing the option for monetary compensation here is that it would be generally available to any successful complaining Member, regardless of whether that Member has the capacity to effectively retaliate. This is especially acute in cases of complaints by larger or developed economies against smaller or developing ones. This problem could be solved by making monetary compensation available only after a showing that retaliation is or would be ineffective. The third and fourth options consider alternative procedural mechanisms for showing that retaliation is effectively unavailable. The third option is to introduce a process similar to that for cross-retaliation under Article 22.3 of the DSU, and the fourth option is to make it available on an S&D basis.

[101] *But see US – Upland Cotton (Article 22.6 – US II)* and *United States – Section 110(5) of US Copyright Act*, WTO Doc. WT/DS/160/ARB25/1, Recourse to Article 25 of the DSU, Award of the Arbitrators, 9 November 2001 (examples of solutions of monetary compensation that were mutually agreed between the parties).

[102] *See* Table 1 on FTAs in Appendix.

3. Procedural Limitations to Access Monetary Compensation

The third option has a number of distinct benefits, while avoiding some of the drawbacks of the first two options. Under a similar process as seen under Article 22.3 DSU, a complaining Member would have the burden to prove that retaliation is ineffective. Under that article, cross-retaliation outside of the sector of violation is allowed only if certain, cumulative conditions are met. Article 22.3(a) states the preference for retaliation in the sector and agreement of violation. To retaliate in other sectors under the same agreement, a Member must show that such retaliation is "not practicable or effective."[103] Retaliation under a different agreement is only authorized if retaliation in other sectors of the same agreement is "not practicable or effective" and that "circumstances are serious enough."[104] An analogous procedure could be applied to the availability of monetary compensation. A complaining Member would have to demonstrate that suspension of concessions is ineffective in inducing compliance—that retaliation would disproportionately impact the retaliating Member with only minimal impact on the violating Member's economy. With such a process before recourse to monetary compensation, the WTO could guarantee that monetary compensation is a limited remedy of last resort. It would effectively prevent large or developed Members from access to monetary compensation because those Members can effectively suspend concessions.

For some developing countries, however, this option may not be as appealing. In fact, a proposal from a number of developing countries suggested that this process be removed altogether in the context of cross-retaliation on an S&D basis.[105] While this has procedural effectiveness and would allow introduction of monetary compensation on a general, unrestricted basis, the next option is to replace this procedure with a requirement that monetary compensation be available only as an element of S&D treatment.[106]

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[103] Article 22.3(b), DSU.

[104] Article 22.3(c), DSU.

[105] WTO, Negotiations on the Dispute Settlement Understanding – Special and Differential Treatment for Developing Countries, WTO Doc. TN/DS/W/19, 9 October 2002, pp. 1–2 (proposal by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe).

[106] *But see* ANDREW MITCHELL, LEGAL PRINCIPLES IN WTO DISPUTES 245-56 (2008) (discussing the potential challenges with application of this principle in WTO dispute resolution).

4. Monetary Compensation on an S&D Basis

The fourth option would be simply to introduce monetary compensation as the preferred or an additional option for developing countries only. As with the third option, monetary compensation would come only after retaliation has been shown to be ineffective. The difference is that the burden of proving ineffectiveness is removed from the complaining Member. Instead, the DSU would provide a presumption that retaliation is ineffective for developing countries and that. This presumption could be irrebuttable, thus making monetary compensation the preferred and only option for developing Members. Or it could be rebuttable, if the violating Member could show that the specific developing Member under the particular facts of the case should not be able to claim monetary compensation. Making the presumption rebuttable would benefit those developing or small economies by not requiring them to prove that retaliation is ineffective in each case, yet it would allow a violating Member to withhold monetary compensation from those developing Members that have larger economies and potentially could retaliate. Thus, the fourth option is to make monetary compensation presumptively available on an S&D basis, but to provide an escape valve through making that presumption rebuttable.

5. Conclusion

This section has provided four options for introducing monetary compensation into the remedial procedures of the DSU and related issues of timing. Each option has benefits and drawbacks. To adequately respond to the problem of ineffective retaliation, this Memorandum recommends adoption of either the third or the fourth option, which are in some sense the opposite sides of the same coin. While the third option makes monetary compensation generally available to all WTO members, the procedural requirements and burden of proof effectively limits it to smaller or developing Members. The fourth option would make it available as a part of S&D treatment, but the rebuttable presumption would limit it to only those developing Members that truly need monetary compensation to gain an effective remedy. These options are designed to respond to the problem of ineffective retaliation. To counteract the remedy gap, any of these options could be employed but retroactivity of remedy calculation would be a necessary element. The next section will consider the issue of enforcement of monetary compensation, if a violating Member has failed to pay.

C. Methods to Enforce the Obligation to Pay Monetary Compensation

Because of the enforcement difficulties that complaining Members may encounter from non-paying respondents, methods to ensure enforcement of payment of monetary compensation must be available. This section analyzes potential procedural mechanisms that could allow Members to ensure compliance with an award of monetary compensation:

1) making awards enforceable in Members' domestic courts;
2) making the right to monetary compensation tradable or negotiable;
3) increasing the level of monetary compensation over time;
4) levying fines for non-payment on the original amount;
5) providing expedited procedures for similarly injured Members to seek monetary damages.

This section concludes by weighing these options to provide recommendations.

1. Enforcement of Awards in Domestic Courts by Members

This option focuses on enforcement measures that WTO Members (or potentially private parties—see next section) could take to enforce an award of monetary compensation outside of the WTO. It considers enforcement methods that are recognized in international law—namely, the recognition and enforcement of foreign award under the New York Convention, and the treaties that follow a similar model (including the Convention on the Settlement of Investment Disputes between States and Nationals of Other States [ICSID Convention] and certain FTAs).

To allow enforcement in domestic courts, certain procedural issues would have to be resolved—namely, recognition and enforcement of the award of monetary compensation, and sovereign immunity. Concerning recognition and enforcement, the award must have effect in Members' domestic courts. In the WTO context, domestic enforcement could follow one of two approaches. First, the DSU could be amended to provide that awards are enforced as final judgments in Member states under the New York Convention. Second, a DSU amendment could be modelled on the Washington Convention, as is Article 54 of the ICSID Convention.

The procedures for this type of enforcement are well-known in international law, as the 1958 New York Convention is one of the most widely ratified international treaties.[107] Article III of that Convention requires that the States parties recognize and enforce foreign arbitral awards.[108] This option is not completely straightforward for two reasons. The Convention refers to "foreign arbitral awards"[109] and it is not clear that 1) a WTO report is "foreign" (rather than international) and 2) a WTO report is an "arbitral award." These critiques can be answered. First, if "foreign" is understood to be "not domestic", then an international award may qualify. As Article I(1) explains, foreign award means it was made "in the territory of a state other than the state where the recognition and enforcement of such awards are sought."[110] To the extent that a WTO adjudicator determines the award in Switzerland and outside of the State of enforcement, it is "foreign." Second, if the calculation and award of damages is undertaken by an Article 21 or 22 "arbitrator" as opposed to the WTO panel, then it could be considered an arbitral award. Further, Article I(2) of the New York Convention includes in the term arbitral award "not only awards made by arbitrators appointed for each case but also those made by permanent arbitral bodies to which the parties have submitted."[111] The WTO and the AB are permanent bodies, though panels and arbitrators are constituted *ad hoc*. In any event, the New York Convention and practice following it provides an important model.

The recognition and enforcement of investment arbitration awards under the ICSID has similar language to the New York Convention. Article 54(1) of the ICSID Convention provides, in relevant part**:**

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[107] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, entered into force on 7 June 1959. The convention has 146 parties. UNCITRAL, "Status", http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html, accessed 25 March 2012.

[108] Article III, first sentence, New York Convention states: "Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles."

[109] Article I.1 of the New York Convention applies to "arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought." However, that same article applies to "arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought", which may cover *international* awards (if not explicitly "panel reports").

[110] Article I(1), New York Convention.

[111] Article I(2), New York Convention.

> *Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.*[112]

This method used in the ICSID has been followed in many settings. For example, Article 1136(4) of the NAFTA states that each party shall provide for enforcement of an award in its territory. The US-Colombia FTA provides that Colombia and the U.S must legally provide for enforcement of a tribunal award in their territory,[113] either through pertinent arbitration conventions (such as the ICSID Convention, the New York Convention, or the Inter-American Convention).[114] This shows that the domestic enforcement of compensation is not problematic, as it is clearly provided by the respective treaties imposing obligation on parties to the agreement to recognize and enforce the award.

A second procedural issue concerns sovereign immunity. For a private party to sue a violating Member in its own courts, the Member must have waived immunity for the specific purpose. For this type of enforcement to be effective, the Member must change its own domestic law to permit such a lawsuit. The WTO then must require that WTO Members change their laws, which begins to encroach on Members' sovereign right to legislate. However, to the extent that some Members' domestic law already waives sovereign immunity for suits relating to commercial activities, this may not pose a major hurdle.[115] Relatedly, an award is not enforceable against the sovereign assets of a Member, so a party could only enforce an award of monetary compensation against those commercial assets which are not protected by sovereign immunity.

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[112] *See* Article 54(1), ICSID Convention.

[113] Article 10(26)(7), Colombia-US FTA.

[114] Article 10(26)(9), Colombia-US FTA.

[115] In the US, for example, the Foreign Sovereign Immunities Act provides a general rule of sovereign immunity from adjudicatory jurisdiction, *see* 28 U.S.C. § 1604, followed by a list of exceptions, *see* 28 U.S.C. § 1605. The two key exceptions are waiver (§ 1605(a)(1)) and commercial activity (§ 1605(a)(2)), either of which could be relevant in the WTO context.

2. Negotiable Rights to Monetary Compensation

Another possibility for the enforcement of the right to monetary compensation is to allow other Members or private parties to undertake the enforcement, by making the right negotiable by the original holder. Concerning trading the right among Members, the right being sold could be either the right to monetary compensation itself or the right to retaliation in the amount of the level of monetary compensation. As for private parties, this option does not give private parties standing at the WTO. Rather, it would allow private purchasers such as trade unions, chambers of commerce, and pension or other investment funds to buy and sell monetary compensation from Members. This section discusses negotiable monetary compensation with respect to each class of actor.

a. WTO Members

This section considers first the purchase of the right to retaliate up to the level of monetary compensation, and then the negotiation or trade of the right to monetary compensation itself. The latter may be less effective because the problems of enforcement would simply be transferred to the purchasing Member. Yet it also has certain benefits.

Transferring the right for monetary compensation as the right to retaliation to another Member may be effective in the context of WTO Members seeking enforcement through WTO procedures. Under this option, as proposed by Mexico,[116] the Members buying and selling would each benefit from the exchange, and would further the goals of the WTO. The transaction would better rebalance rights or concessions, since the Member selling the right to monetary compensation would gain a financial or other benefit, and the buying Member would be able to pursue its economic (or political) goals through the rights acquired. Since the buyer may be able to retaliate more effectively, the goal of inducing compliance of the original violator would also be served. Additionally, the buying Member would be within its rights to take WTO-inconsistent measures, which it may have intended to take in any case. The purchase of the rights then diffuses a potential dispute before it occurs, even if the right to retaliate is temporary. Bagwell, Mavroidis, and Staiger favor this method because both increases compliance and provides additional revenues to pay developing countries' legal fees[117] (whether the revenue goes directly

[116] WTO, *Communication from Mexico*, TN/DS/W/23 (4 November 2002), p. 5.

[117] Kyle Bagwell, Petros C. Mavroidis, Robert W. Staiger, *The Case for Auctioning Countermeasures in*

to the country or to a WTO fund). In one possible scenario, a complaining Member could sell the right to retaliate to a larger Member, who then would transfer, as payment to the complaining Member, some portion of the benefits earned by retaliating. This would allow the complaining Member to gain some monetary relief and would allow the retaliating Member the right to retaliate legally (especially if that Member is considering WTO-inconsistent measures itself). Importantly, this process would keep all of the parties to the dispute seized of the matter so that the goal of inducing compliance does not give way to efficient breach or monetary compensation at the expense of compliance.

A number of objections have been raised to this method, however.[118] Some countries have argued that an auction model would create a market in trade restrictions that is prone to abuse,[119] while others have highlighted that politicization of the dispute settlement system that might result.[120] Poland objected to this approach, arguing that such a system would discourage the negotiation of mutually agreed solutions because parties would know that they could later negotiate away any remedies.[121] On the other hand, the arbitrator in *Canada – Aircraft (22.6 – Canada)* intended precisely the opposite: setting the retaliation level in that case at approximately the same level as had been determined in the *Brazil – Aircraft (22.6 – Brazil)* case was meant to encourage the two Members, each simultaneously respondent and complainant, to reach "a mutually satisfactory agreement . . . in this case *in their broader context*."[122] In support of this option, Trachtman stated that auctioning off retaliation rights may solve issues of

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the WTO, National Bureau of Economic Research Working Paper 9920 (August 2003), *available at* http://www.nber.org/papers/w9920, at p. 4.

[118] *See, e.g.*, SHADIKHODJAEV, RETALIATION, *supra* note 995, at 175.

[119] WTO, *DSB Meeting Minutes*, *supra* note 72, paras. 18, 39, 63 (statements by representatives of Chile, Canada, and the Philippines).

[120] WTO, *DSB Meeting Minutes*, *supra* note 72, paras. 48, 50, 55 (statements by representatives of Pakistan, Cuba, and Hong Kong, China).

[121] WTO, *DSB Meeting Minutes*, *supra* note 72, para. 52.

[122] *Canada –Aircraft (Article 22.6 – Canada)*, para 4.4 (emphasis in the original). See discussion in Hunter Nottage, *Evaluating the criticism the WTO retaliation rules undermine the utility of WTO dispute settlement for developing countries*, in BOWN AND PAUWELYN, RETALIATION, *supra* note 19, (hereinafter Nottage, *Criticism*) p. 334.

enforcement by smaller Members,[123] so it could equally solve issues of enforcement of monetary compensation rights.

Second, the transfer of the right to monetary compensation may avoid some of these criticisms, especially since it does not have as direct an effect of markets and competitiveness. The right to sell monetary compensation at first glance would simply transfer the problems of enforcement from one country to another. However, some circumstances may make this an attractive offer. A complaining Member without the resources to pursue enforcement may trade its right to a higher amount of monetary compensation later for a lower amount now. The complaining Member benefits by gaining relief for its economy and industry. The purchaser may be better situated to pursue enforcement options. The purchaser in this scenario could be another WTO Member, a WTO body tasked with enforcement, or private parties.

An example may illustrate this enforcement procedure. Assume that Trustland is entitled for monetary compensation of 10mln USD from Yulandia, but Yulandia refuses to pay. Trustland is suffering detrimental effects of the WTO-inconsistent measure yet cannot enforce the payment itself. If the right to monetary compensation is tradable in the form of the right to retaliation, Trustland can sell its right to Yunador, another Member of WTO, at a price up to the amount of monetary compensation (or whatever Yunador is willing to pay). Yunador, which has market size and power to effectively retaliate against Yulandia, can suspend concessions up to the amount of monetary compensation in a sector it finds appropriate. Thus, Trustland gets its monetary compensation (either the full amount or lesser, but some compensation to the affected economy and industry), and Yulandia, facing retaliatory measures from Yunador, is incentivized to comply with its WTO obligation by bring the measure into compliance.

This right to sell monetary compensation is not in itself a solution to the enforcement problem. Rather, it must work in conjunction with other enforcement mechanisms such as enforcement in domestic courts (discussed below) or the right to retaliate (discussed above). Further, such a system of trading WTO remedies would require some oversight from the DSB. This oversight could be provided through the DSB's current surveillance of implementation function under Article 22.6 of the DSU. Monitoring the procedures, costs, and bargaining

[123] *See* Trachtman, *WTO Cathedral*, *supra* note 22, at 155. Yet, Trachtman still noted that retaliation is welfare-reducing so less efficient and less desireable. *Id.*

process of trading these rights by the DSB itself would ensure that abusive or unfair transactions are avoided.

b. Private Party Purchase of the Right to Monetary Compensation

Private party standing at the WTO may in some cases lead to more enforcement of WTO obligations,[124] and a similar model has been effective in international investment law.[125] Yet, this concept is neither contemplated in the WTO legal system nor supported by Members and commentators.[126] Thus, the possibility of direct effect of WTO obligations or private enforcement of remedies is not a realistic option. Yet, private parties often bear the brunt of other Members' violations, and may be well-situated and well-resourced to ensure compliance. Because of the benefits for enforcement, the possibility of enforcement by private parties such as trade unions, chambers of commerce, and pension or other investment funds is considered as an alternative to WTO standing for private parties.

A method of giving private parties the ability to enforce awards against a violating Member avoids the problem of WTO standing, but goes further than the current system of compensation as mutually agreed between parties to a dispute. The monetary compensation would be mandatory and claimed by the complainant party, but private persons would ensure that it would be enforce. Alternatively, the purchaser of the right may be a private party rather than only another WTO Member. This option creates new issues that are distinct from a WTO Member as purchaser. First, the private party enforcement mechanisms discussed above must be in place. Second, a private party would not be able to use the right as a justification for

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[124] This is so where a Member may fail to act for political reasons, *see* Huerta-Goldman, *Mexico's Experience*, *supra* note 70, p. 287 (suggesting that the ongoing negotiation on an EC-Mexico FTA may have influenced Mexico's decision not to retaliate in the *EC – Bananas III* case), because of a lack of resources, *see* Nottage, *Criticism*, *supra* note 122, p. 330, note 55 (postulating that a number of disputes by developing countries may never have been initiated because of the concerns with effective retaliation), or due to other sovereign or policy concerns.

[125] See ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS 6 (2009) (discussing the move away from the diplomatic protection paradigm of investor protection to private investor standing in disputes with States).

[126] Petros C. Mavroidis, Comment on chapter 16: Money talks the talk (but does it walk the walk?), in BOWN AND PAUWELYN, RETALIATION, *supra* note 19, at 356 (noting that "the WTO is a government-to-government contract", which precludes private standing).

retaliation, since only a Member can retaliate. This section will elaborate some of the benefits as well as critiques of this method of enforcement.

Allowing a private party to participate in the auctioning of monetary compensation rights has certain advantages. If the industry or companies in the complaining Member that were impacted by the violation have gone out of business, then other parties could undertake the enforcement in their stead. Certain private parties would be well-situated to enforce the award, including large pension funds, other investment funds, and companies that specialize in collection of debts and judgments.

By opening the purchase of these rights to private parties, other issues would arise including the question of selling stock in the claims to monetary compensation. The selling of stock adds a level of complexity to the issue, but it is not unheard of. The concept of litigation financing, where outside investors purchase a share of a legal claim thus underwriting the cost of litigation in expectation of a return from the final judgment, has been developing for some time. Pioneered in Australia and the United Kingdom and given the imprimatur of the Australian High Court in 2006, the practice has slowly spread to other common law jurisdictions like the United States.[127] One initial question relating to selling stock in the claim to monetary compensation is the timing when a party could buy shares of the claim. It may be relatively uncontroversial to allow purchase of shares after the award has been rendered by the WTO arbitrator so as to support enforcement. On the other hand allowing such a purchase while the dispute remains before WTO bodies may require additional oversight mechanisms. Nonetheless, the benefits of litigation funding could provide further support to developing countries whose claims may be stymied by a lack of resources to expend in dispute settlement at the WTO. Building on the litigation financing practice, the option to sell stock in claims, and the concomitant increase in the efficiency of enforcing awards of damages, becomes possible.

3. Increasing Levels of Monetary Compensation

While a method of raising retaliation levels incrementally is not useful for those countries that cannot benefit from retaliation as a remedy in the first instance,[128] the model of increasing

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[127] Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 Minn. L. Rev. 1268, 1279 (2011).

[128] SHADIKHODJAEV, RETALIATION, *supra* note 995, at 176.

levels of monetary compensation can be useful. For example, if the level of monetary compensation were pegged at, say, 50% of the level of nullification or impairment,[129] then the amount can be increased annually with no impact on the "equivalence" standard.[130] Alternatively, the equivalence standard could be removed or lessened, if only in the context of monetary compensation (and leaving it in place for calculation of the amount of suspension of concessions).

Further, the use of increased amounts of monetary compensation would be very effective to limit delay tactics with unnecessary Article 21.5 cases. Since retaliatory measures are allowed to continue during disputes under that article,[131] monetary compensation calculations, by analogy, should continue to add up. Thus, if the amount of compensation is increasing (or compounding) throughout this type of dispute, then a violating Member may limit its recourse to this procedure when it is not warranted.

4. Additional Fines for Failure to Pay

Another measure to enforce payment of monetary compensation comes from discussions of alternatives to retaliation, though it has not been applied to date. The idea that annual fines amounting to the level of trade impact assessed by the panel could replace retaliatory measures was articulated in the 2000 Meltzer Report.[132] Similarly, the recent US FTAs with Chile and Australia include the option of paying fines for certain violations such as labor or environmental obligations.[133] This proposal operates more with respect to the idea that WTO remedies are liability rules or rebalancing of negotiated rights. Hence, larger or wealthier Members could use their economic resources to avoid compliance with WTO obligations. When considering this

[129] *See, e.g.*, Chile-US FTA (Article 22.15(5)) and Australia-US FTA (Article 21.11(5)), which allow for the violating party to pay 50% of the nullification or impairment on a yearly basis instead of suffering suspended concessions.

[130] Article 22.4, DSU.

[131] *See generally* WTO, United States – Continued Suspension of Obligations in the EC – Hormones Dispute, Appellate Body Report (Oct. 16, 2008), WT/DS321/AB/R.

[132] Trachtman, *WTO Cathedral*, *supra* note 22, at 156 (citing ALLAN H. MELTZER, REPORT OF THE INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION 109 (2000)).

[133] *See, e.g.*, Chile-US FTA (Article 22.16), Australia-US FTA (Article 21.12).

type of fine in the context of enforcing payment of monetary compensation, a number of possible mechanisms could be designed to avoid this perverse incentive, as discussed next.

Davey suggests two methods to avoid the problem. First, the fine could be based on the size of the violator's economy.[134] Such a fine for failing to pay monetary compensation need not be tied to the level of damage or harm, since that will have already been calculated for the original assessment of damages. Pegging the fine to the violator's economic status will make the fines effective against larger Members while also not overly burdensome to smaller Members. Additionally, Bronckers and van den Broek indicate that developing countries could be allowed to plead a special defense against the payment or that levels be capped for those countries.[135] Davey's second suggestion is to provide a sliding scale of fines so as to "minimize 'discrimination' against poor Members."[136] Bronckers and van den Broek note that a properly crafted system, highlighting the temporary nature of monetary compensation and the ultimate goal of ensuring compliance with obligations, will avoid this problem.[137]

A related question to the matter of fines is to whom the fines would be payable. Since the fine is meant to induce the payment of monetary compensation, which would be owed to the complainant Member, a number of options could be provided for the recipient of this fine. First, the fine itself could also go to the complaining Member. According to Davey, this method would operate to effectuate both goals of WTO obligations (i.e. ensuring compliance and rebalancing rights).[138] Yet, this may not be as effective since the problem is that the violating Member already is failing to pay damages to the concerned Member. Second, the fines may be administered through the WTO itself. For example, it could establish a fund that would be used to support technical cooperation or to underwrite legal costs of developing countries seeking to use the dispute settlement procedures. The US-Chile FTA provides for this option in the context of environmental and labor violations: monetary compensation is to be paid into fund administered by a commission which uses the moneys for related initiatives.[139] The use of the

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[134] DAVEY, ENFORCING WORLD TRADE RULES, *supra* note 53, at 96.

[135] Bronckers & van den Broek, *Financial Compensation*, *supra* note 44, at 120.

[136] DAVEY, ENFORCING WORLD TRADE RULES, *supra* note 53, at 96.

[137] Bronckers & van den Broek, *Financial Compensation*, *supra* note 44, at 118-19.

[138] DAVEY, ENFORCING WORLD TRADE RULES, *supra* note 53, at 96.

[139] *See* Article 22.16(4), US-Chile FTA:

funds, therefore, is connected to the violations that led to payment of the funds. In this case, using funds paid because of WTO violations to provide litigation expenses and costs to WTO Members may be an efficient use of the funds. The discussed fines could also take form of the Member losing some of its privileges at the WTO. A certain "rating" could be formed within the WTO Members, and if the member is not paying the monetary compensation it is entitled to pay, the rating of the Member will be "downgraded." It could result in a penalty such as being able to engage less experts in the cases, or less participation in the panels.

5. Expedited Procedures for Other Injured Members

A final option to encourage payment of monetary compensation, and to induce compliance with WTO obligations, is to allow other injured Members the right to seek or claim monetary compensation without the need to prosecute an entirely separate dispute through the DSU process. Oftentimes, WTO-inconsistent measures will impact a number of other Members, yet usually only one Member will bring a complaint. For example, a WTO-inconsistent subsidy may impact the global market, but only a portion of that violation impacts the complaining member.[140] Only the Member prosecuting the claim, however, can implement retaliation or other WTO remedies. If multiple Members are harmed by the WTO-inconsistent conduct, then each Member must initiate its own separate case to be able to claim WTO remedies.[141] While one might expect that a successful complaint by one Member would lead to other "piggy-back" litigation, where the second Member is sure to be awarded some remedy, this is not the case in practice.[142] However, the DSU could allow for other Members to bypass the bulk of the dispute resolution phase and simply prove its level of nullification or impairment before an Article 22.6 arbitrator. Alternatively, this request by other Members for a remedy could be tied to the DSB's

> *Assessments shall be paid into a fund established by the Commission and shall be expended at the direction of the Commission for appropriate labor or environmental initiatives, including efforts to improve or enhance labor or environmental law enforcement, as the case may be, in the territory of the Party complained against, consistent with its law. In deciding how to expend monies paid into the fund, the Commission shall consider the views of interested persons in the Parties' territories.*

[140] *See, e.g.*, *US – FSC (Article 22.6 – US)*.

[141] Article 22, DSU.

[142] *See* Shaffer and Ganin, *Purpose from Practice*, *supra* note 21.

ongoing surveillance of implementation duties in Article 22.6. This would limit the problem of the remedy gap for the new complaining Member because of its expeditious nature, and it would induce the compliance of a violating Member. The threat that other Members may claim monetary compensation based on an earlier panel report will be an effective deterrent to violations.

To ensure that payment of monetary compensation, rather than as a general procedure to induce compliance, additional procedures would have to be implemented. For example, if a complaining Member is receiving monetary compensation, then this expedited process would not be available. That would mean that a second-comer would be required to initiate its own dispute. In this way, this option could enforce payment of monetary compensation directly while protecting the violating Member from immediate additional obligations to pay.

6. Conclusion

The ability to enforce the proposed monetary compensation in the WTO is a key challenge that has been raised against the proposals for monetary compensation. Yet, this section has shown that many options exist or could be devised to ensure the payment of monetary compensation. The possibility of enforcing monetary compensation awards from the WTO in the domestic courts of responding or other Members is a promising approach to ensure the payment of that remedy. The experience of the New York Convention, especially has it has been modified and tailored to unique international legal regimes through the ICSID, BITs, and FTAs, provides a useful model. The DSU could be amended to include this type of enforcement language to ensure payment. In conjunction with a negotiable right to monetary compensation, available either to other Members or to private parties under proper procedural safeguards, domestic enforcement will be ensured by those with adequate resources to pursue such secondary litigation while the original complaining Member is able to gain some relief immediately through the sale.

D. The Determination of Beneficiaries of Monetary Compensation

To make monetary compensation amenable to WTO Members considering DSU reforms in this area, the operational aspects of the remedy must be clear so that it is effective and not given to abuse. Certain conditions must be fulfilled in order to make monetary compensation available. Also, when considering the questions of who is entitled to monetary compensation and who

makes that determination, two opposite extremes are possible: 1) the process could be opened to the public international law standards, which gives the discretion to the Member entirely, or 2) a mechanism could be designed to allocate the funds directly to companies, thereby bypassing the Member state entirely. Of course, many variations exist between these two extremes, such as placing the collected funds in an escrow account or creating a general WTO fund. All of these options need further clarification. This section will consider 1) the possible parties that are entitled to monetary compensation, and 2) the party that is making the determination of these beneficiaries.

1. Who is Entitled to Monetary Compensation?

As the WTO members are states, the entity entitled to monetary compensation by another member is another state. Therefore, the government of the suffering member is the initial receiver of the monetary compensation. Nevertheless, the issue of entitlement does not limit itself to the initial receiver, as what matters is who is the end-receiver of the monetary compensation. There could be three possible types of the end-receivers: the customers (population of the suffering member), domestic industry (private parties of the suffering member) and the government of the suffering member itself. This section provides different option of distributing the monetary compensation to the end-receivers once it is issued to the initial receiver. The entity entitled to monetary compensation is likely to be one of four options: the complaining Member state, that Member's affected industry, or consumers directly, or the WTO in general. It also addresses the possibility of the WTO in general being entitled to receive the monetary compensation.

a. Complaining WTO Member

The most obvious choice is the complaining Member itself. This Member has brought the case, paid the litigation expenses, and is suffering from a lack of effective remedy. To give the monetary compensation to the Member is a direct, simple answer to this question, and is supported by commentators.[143] Further, it simplifies the calculation of nullification or

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[143] *See, e.g.*, Bronckers & van den Broek, *Financial Compensation*, *supra* note 44; Davey, *Implementation*, *supra* note 100, at 16-18; Kyle Bagwell, *Remedies in the World Trade Organization: An Economic Perspective*, in MERIT

impairment by looking at only one recipient of the monetary compensation. The Member, or relevant ministries of its government, can then utilize this monetary compensation to invest in green technologies, to support industry and trade groups, or other goals. These goals could include consumer welfare, the ultimate beneficiaries of free trade. Yet, the fact that a Member receives the funds directly does not change the fact that the direct harm or injury does not necessarily flow to the government. Further, it is not clear to what extent a Member under its own legal system would be required to—or would in practice—use the funds for such purposes. The Member then could be required to use the funds for the benefit of certain constituencies, to be discussed in the next three sections.

b. Domestic Industry in the Complaining WTO Member State

The second likely recipient of the monetary compensation is the specific industry or group of companies that was harmed by the WTO-inconsistent measures. Compensating this beneficiary directly has the benefit of repairing the direct damage of the measure at the source of that damage, without relying on the Member to distribute it. A side benefit here relates to financing of litigation: if the monetary compensation award goes directly to companies, then this would incentivize more enforcement of obligations by law firms which operate on a contingency fee basis.

Within this option, many potential beneficiaries could be identified: for example, companies who initiate the domestic investigation leading to a WTO complaint, companies on the initial list of affect parties when the Member files its disclosure to the WTO, companies identified when the aggregate trade impairment is calculated at the end of WTO proceedings, or companies who demonstrate that they suffered injury during the monetary compensation phase. To identify companies early in the investigation or proceedings has the benefit of encouraging companies to pressure their government to investigate potential violations. However, some or all of these companies may not still be operating when monetary compensation is award, depending on the nature of the violation and its effect on the domestic industry's viability. To identify companies later in the process makes it more likely that these companies will be around to collect the award. However, the benefit of incentivizing investigations would be lost.

E. JANOW, VICTORIA J. DONALDSON AND ALAN YANOVICH (EDS.), THE WTO GOVERNANCE, DISPUTE SETTLEMENT & DEVELOPING COUNTRIES (2008), at 751-53.

This discussion raises the issue of what to do when companies harmed by the violation have been bankrupted before monetary compensation could be awarded. In this case, the compensation could go to the Member state, to the company's creditors, if any, or to a general WTO fund. This latter fund is the third and final option for the beneficiary of the monetary compensation.

c. Consumers

The Member could provide the monetary benefits directly to the consumer. This could be done through tax rebates or other such methods. The justification is that consumer welfare is one of the ultimate goals of liberalized trade—the other key group being producers. However, to the extent that producers shift costs downstream, which ultimately harm consumers, the redistribution of monetary compensation to those consumers would lead to the greatest increase in societal welfare. However, in the political setting of the WTO, this option does not carry much weight.

d. General WTO Fund

The final option is to create a general fund at the WTO to collect and utilize the compensation awarded. This precedent has been set by recent US Free Trade Agreements, which provide for a fund to receive the monetary compensation paid.[144] This option is less likely to appeal to Members and their industry when they are foregoing retaliation rights (whether effective or not). However, it is useful in the event of bankrupt companies harmed by the violating measure, and it is sensible in the context of additional fines that are designed to ensure payment of monetary compensation (discussed in Section V). As mentioned there, such a fund would benefit all developing WTO Members if used for technical cooperation, litigation expenses, and similar ends. A WTO-monitored fund also may better enforce the payment of monetary compensation or additional fines for non-payment as compared to an individual Member. This may come from the reputational costs of failing to comply with a directly

[144] *See* Article 22.15(6) US-Chile FTA, Article 20.11(6) US-Morocco FTA, and Article 20.16(7) CAFTA.

multilateral obligation as opposed to a violation of a trade concession or obligation that at least some Members conceive as primarily bilateral relations.

2. Who Determines the Beneficiaries?

The determination of the beneficiaries could be undertaken by the panel or arbitrator hearing the case, or individual governments. During the case, the panel is already determining the amount of nullification or impairment, and so is well-situated to make this determination. Procedures including the submission of documents or requests for recognition must be developed. The procedures could either be directed at the Members themselves, or alternatively, provide for limited private party access to the panel solely for the purpose of making an application for recognition. Some might argue that this simply adds yet another level of complexity to the calculation of private party monetary compensation. However, if the panel is already undertaking to calculate individual harms caused, it is not a major addition to have the panel determine the beneficiaries.

Another possible party to make the determination is the government of the complaining Member. This has intrinsic appeal because the Member is the one bringing the case and seeking to protect the interests of its industry. So it is best situated to determine how to distribute the monetary compensation received. Under the concept of "sovereign discretion", Brockner and van den Broeck note that this is the "only realistic" option.[145] The decision could either be left entirely in the hands of the Member government, or there could be some amount of oversight by the panel or another committee of the DSB. The determination of the recipients, while left to states, could be notified to the DSB so that the list of beneficiaries can be monitored.

3. Conclusion

The complaining WTO Member itself is the best-situated entity to receive the payments. However, a number of other beneficiaries could be entitled to the compensation. Further, giving the funds without further monitoring or requirements on the Member may not ensure that the actors most deserving of the monetary compensation or support actually receive it. This determination could be left up to the Member, or the DSB could provide some oversight and

[145] Bronckers & van den Broek, *Financial Compensation*, *supra* note 44, at 126.

monitoring. The active role of the DSB would ensure proper functioning of this remedy and avoid abuse of the process.

E. Avoiding Similar Effects to Those of Actionable Subsidies

This section analyzes the potential effects from monetary compensation that can be comparable to actionable subsidies. To ensure that monetary compensation is an effective remedy that is also in line with the WTO Agreements, these similarities and effects must be eliminated. The first part reviews the legal definition and questions at issue regarding subsidies in this context. The second part considers the economic effects of monetary compensation. This section concludes that the superficial similarities to subsidies are not convincing and can be adequately avoided.

1. Legal Definition of Monetary Compensation Differs from Subsidy

A subsidy is defined in the SCM Agreement to have three features. First, the measure must constitute a "financial contribution" or "price support" (Article 1.1(a), SCM). Second, it must provide a "benefit…conferred" (Article 1.1(b), SCM). Third, it satisfy the requirement of "specificity" (under Article 2, SCM) or be "prohibited" (as defined in Article 3, SCM) (Article 1.2, SCM). The first and third prongs of this definition may be satisfied by the receipt of monetary compensation by a Member to be distributed to its constituents. Money damages are undoubtedly a financial contribution, and they would be specifically provided to the sectors or companies harmed by the original violation. However, if calculated correctly monetary compensation is not a benefit conferred. To the extent that monetary compensation flows from and is calculated in respect of trade losses and actual harm suffered, it can hardly be said that such "reparation" or compensation is a "benefit." Rather, at most it would make the recipient whole or put it in the position expected but for the violation.

It is possible that monetary compensation could be given to a specific party well beyond the actual damage suffered by the party. However, this result could be avoided in a number of ways. First, the distribution of the award by the Member government could be monitored by a WTO organ (e.g. the panel or the DSB). Second, the WTO could distribute the funds directly without using the Member government as an intermediary. Third, to the extent that provision of

excessive amounts of the award to one private party would be to the detriment of other parties, the domestic lobby or influence of those impacted industry actors would ensure proper distribution.

2. Economic Effects of Monetary Compensation Differ from Subsidy

The legal requirements of monetary compensation, as discussed above, allow the complaining Member to request of the DSB a measure to compensate for the damages caused. Therefore, the obligation to provide monetary compensation is formed when a Member has implemented a measure inconsistent to its WTO obligations and it would be inefficient or harmful to implement other forms of remedies as to induce compliance to the WTO obligations. The ways of distributing the monetary compensation will allow for the negative effect of the measure at issue to be compensated. Therefore, the determination of the end-receivers of the monetary compensation prior to the decision on the entitlement of the monetary compensation is taken, provides the way to diminish the effect of the subsidy in the monetary compensation.

If the monetary compensation has consumers as its beneficiaries, then the direct consumer compensation allows for direct elimination of the negative consequences of the measure that violates the WTO obligations.

If the monetary compensation has private parties of the suffering member as its beneficiaries, then the indirect compensation of the negative consequences of the measure violating the WTO obligations is observed. In this case the private parties will be considered to use the amount of monetary compensation they were entitled to make up for the lost profits of the diverted trade that they would have received if the measure at issue would have never taken place. And as the harm they have suffered would not have taken place if the violating member has not diverted from its WTO obligation, this monetary compensation to private parties should not be considered as a subsidy.

If the monetary compensation has the state as its beneficiary, then the general compensation of the negative consequences of the measure violating the WTO obligations is observed. In this case the suffering state is being compensated for the lost benefits of the country's economy in general and is believed to use the amount of monetary compensation to improve the state of the economy in general, the monetary compensation should not be considered as a subsidy.

3. Conclusion

The effect of a subsidy is eliminated through monitoring the distribution of the monetary compensation. As it is initially being formed as to make up for the damages caused by a WTO-inconsistent measure, the monitoring of the monetary compensation being delivered to the actual victims or to the recipients stated by the suffering member and approved by the WTO, does not invoke an effect of a subsidy.

IV. Conclusion

This Memorandum builds on a wealth of WTO Member proposals and academic commentary. The remedy of monetary compensation is meant to induce compliance with WTO obligations, with a certain amount of rebalancing of negotiated rights. Importantly, it would remedy specific limitations in the WTO dispute settlement system—that is, the problems of ineffective retaliation and the remedy gap. However, this suggestion has been a part of negotiations over DSU reform for the better part of a decade because it has met opposition from some Members and commentators. Those opposed to the use of a remedy of monetary compensation rightly raise important issues. Many questions relate to its implementation, its procedures and requirements, its effects (intended and unintended), and generally, its relation to the goals and functions of the international trading system as it has developed since at least 1947. The obstacles faced by implementation of monetary compensation at the WTO, however, are not insurmountable. This Memorandum has responded to a number of those questions and provided multiple options to respond to the difficulties of implementing this remedy. This analysis leads to the conclusion that not only can the difficulties be confronted and overcome, but that they can be overcome in a number of ways. Thus, Members negotiating the precise operation of a mechanism of monetary compensation can choose the most appropriate way to implement the remedy. This Memorandum contributes to the development of economic, legal, and procedural means and methods to implement a functioning system of monetary compensation into the current structure of the WTO.

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