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2015 LAW AND GRADUATE STUDENT TRANSPORTATION WRITING COMPETITION

The *Journal of Transportation Law, Logistics and Policy*, which is published by the Association of Transportation Law Practitioners ("ATLP"), announces its 2015 law and graduate student writing competition, seeking quality articles related to transportation. The winning articles will be published in the *Journal*. ATLP's members are composed of legal, academic, business and government experts in the field of transportation. The *Journal,* which has been published quarterly since 1935, contains academic-quality articles on timely subjects of interest to transportation academics, attorneys, government officials and a wide variety of policy leaders in the field. Articles in the *Journal* cover all modes and all aspects of transportation policy and law, including both freight and passenger issues, and matters of interest both nationally and internationally. Subscribers to the *Journal* include academic and legal experts, practicing attorneys, government officials, and many others.

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Journal of Transportation Law, Logistics & Policy
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1. All articles should be submitted in Microsoft Word. Please do not PDF the file.

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3. Pages should be single-spaced, in Times New Roman font, no smaller than 11 points. Double space between paragraphs. Page numbers should be placed at the bottom of each page. The first line of each paragraph should be indented .5 inches. Case citations should be italicized.

4. Subheadings: All subheads should be flush with the left margin, with one line space above:

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THE ECONOMICS OF EVOLVING RAIL RATE OVERSIGHT: BALANCING THEORY, PRACTICE, AND OBJECTIVES

Mark Burton

ABSTRACT

The Staggers Rail Act of 1980 largely left the development and application of changed rail rate oversight to federal regulators. As the Interstate Commerce Commission undertook these tasks, it soon developed a set of processes and standards that conformed, as well as possible, to guiding economic principles. Over time, however, in an effort to expedite what is unarguably an arduous and expensive rail rate review process, the Commission and, later, the Surface Transportation Board, have modified the early post-Staggers standards, so that current processes adhere less rigorously to economic guidance.

The current paper retraces this regulatory evolution in an attempt to identify when, where, and why, current rate challenge and adjudication processes now deviate from economic principles. This review also notes both actual and potential harms that might be attributable to such deviations. Ultimately, the conclusion is that, to date, departures from a faithful adherence to careful economics has not resulted in unsatisfactory regulatory outcomes. However, the pattern of sacrificing economic rigor in favor of administrative expediency does suggest a need for ongoing vigilance.

INTRODUCTION

In establishing the basis for regulatory oversight, the 1980 Staggers Rail Act did not abandon rate regulation or overlook the interests of rail shippers. Nonetheless, the residual rate protections afforded the relatively small subset of shippers who were (or would become) "captive" were somewhat vague.[1] Staggers mandated a rate oversight program that minimizes economic intervention *and* assures sound shipper protections, but Congress largely left the details of an explicit course for rate oversight to the Interstate

[1] For a discussion of the gap that often occurs between broad legislative intent and specific regulatory practice, see Beard, et al (2014).

Commerce Commission (ICC).[2]

As the effects of rail industry reform unfolded, any imprecision in Staggers' rate protections garnered little public attention. Staggers' overall content, the relaxation of other institutional constraints, and the somewhat coincident availability of new, cost-reducing technologies, led to unprecedented productivity gains, generally *declining* railroad rates, and the desired rail industry revitalization.[3] For more than two decades, these outcomes eclipsed most concerns over residual rate governance.

Meanwhile, the ICC and later the STB developed required standards and procedures as they continued to adjudicate individual rate disputes between railroads and shippers.[4] Beginning with their initial implementation in 1981 and moving forward, federal regulators have attempted to strike a tenuous balance between statutory fidelity, adherence to economic principle, and the desire for rate remedies that are, at least, tolerably simple and affordable to pursue.

Even in a sterile environment, unaffected by narrow financial interests or broader philosophical bent, achieving this balance would be difficult. But the environment in which railroad policy is executed is not sterile. Instead, the profits of both carriers and shippers are affected by the nature and extent of rail industry oversight, so that both groups have incentive to manipulate the regulatory environment. Further, political opinion continues to cycle through periods in which active government intervention in markets is first vehemently rebuffed by the public then later embraced.[5]

Against this backdrop, the policy tools used in the daily governance of rail industry pricing are steadily moving away from the procedures developed in the first two decades after Staggers. Their replacements favor processes that, to some degree, sacrifice economic veracity in exchange for expediency and ease of application. Not surprisingly, rail shippers would accelerate and extend this transition as they pursue still-greater rate protections. Alternatively, the railroads decry these regulatory changes as potentially ruinous to for carrier solvency, future capacity investments, and overall freight mobility.

The current paper peels back the layers of economic and legal complexity that have accumulated over the past 40 years in an exploration of still-evolving federal railroad rate

[2] The majority of Staggers' rate provisions are contained in Title II. See, *The 1980 Staggers Rail Act*, P.L. 96-448—OCT. 14, 1980 94 STAT. 1895.

[3] See Burton (2014).

[4] The Surface Transportation Board was created in 1996 to undertake a subset of regulatory functions formerly under the jurisdiction of the ICC that was terminated through a 1995 Congressional action. See P.L.104–88—DEC. 29, 1995 109 STAT. 803. Both the ICC and STB have been criticized for their case-by-case development of ongoing practice. See Stone (1991, p. 46).

[5] See Mayo (2013).

protections. The hope is that a thorough, thoughtful examination of this sort will give both context and content to the forward-looking discussions of future railroad policy now taking place. Accordingly, Section 2 describes Staggers' rate protections and the application of these protections in the first 15 years of post-Staggers rail rate governance. Early STB modifications to those practices, including efforts to streamline rate adjudication, are described in Sections 3. Section 4 looks at more recent STB rate-related actions and indicated trends. Finally conclusions with respect to future policy application are provided in Section 5.

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2. Staggers and ICC Shipper Protections

The Staggers Act, signed in October of 1980, was the fourth piece of federal legislation in a 10-year series of Congressional actions aimed at reversing railroad industry declines.[6] Key among a variety of potentially significant provisions, the legislation further relaxed federal railroad rate oversight and created the environment for the current rail rate governance structure.

Nearly all of the 29 sections in Title II of the Staggers Act involve the oversight of railroad rates or related topics. However, even in advance of this extensive treatment, the Act's findings, goals, and statement of federal rail transportation policies provide the cornerstones of Congressional intent. Specifically, the first enumerated guideline states that federal policy will be:[7]

> (1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;

[6] In October 1970, less than six months after the Penn Central bankruptcy filing, Congress passed The Passenger Rail Service Act (P.L. 91-518) which reduced freight railroad involvement in passenger operations. This was followed in 1973 by The Regional Rail Reorganization (3R) Act (P.L. 93-236) that addressed the problems of the Penn Central and other failed or failing Northeastern freight railroads and ultimately led to the creation of Conrail. Finally, in 1976, Congress passed The Railroad Revitalization and Regulatory Reform (4R) Act which largely completed the implementation of the Conrail plan, provided further federal funding, and began the process of reforming railroad rate governance.

[7] Staggers § 101(a).

Notwithstanding this emphasis on competition, the above policy guidance is followed by the provision that the federal policy is also:[8]

> (6) to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital;

To pursue the first of these policies and the underlying goal of rail industry restoration, Staggers' rate provisions took three forms. First, the Act contained elements that allowed railroads to vary individual published rates with impunity as long as these variations were within a specified range and/or were loosely traceable to changing costs.[9] Second, as will be explained, Staggers reduced the likelihood that either existing or proposed rates would face shipper challenges. And finally, where the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) teased both carriers and shippers with the *potential* of effective contracting, Staggers fully enabled this practice with only a few residual constraints.[10]

Again, however, while Staggers promoted rail pricing flexibility, it did not abandon shipper protections or the policy objective that rail rates remain "reasonable" for shippers who have limited transportation alternatives. Instead, the Act mandates what has emerged as a three-step process through which shippers can challenge rail rates and potentially achieve relief through regulatory intervention. Under this process:

1. To demonstrate market dominance, a shipper must show that the issue rate exceeds a prescribed rate-to-variable cost (R/VC) threshold of 180 percent. If this condition is not met, the complaint will not proceed, but a rate that exceeds the prescribed threshold is not to be treated as proof of carrier dominance.
2. If the issue rate exceeds the prescribed R/VC of 180 percent, shippers are given the chance to further demonstrate that the incumbent carrier is market-fdominant within what was intended as a qualitative hearing process.
3. Finally, if the demonstration of market dominance is successful, the rates are adjudicated to evaluate their reasonableness.

Each of these steps is briefly described in turn.

[8] *Ibid*.

[9] Stone (1991) provides a concise and understandable descriptions of these specific rate provisions.

[10] Carriers engaging in confidential contracts were required to attain ICC approval for each agreement and, while the contract terms were (and remain) confidential, the ICC was to develop a monitoring process. Moreover, regarding the movement of agricultural products, carriers still faced a requirement to make similar contractual terms available to similarly situated agricultural shippers. Finally, there were restrictions regarding the share of freight car capacity that railroads could obligate to contracted use. See Staggers § 203.

Rate Challenges, Market Dominance, and Substitutes (Round One)

The 4R Act, which predates Staggers by four years, required that the ICC define and implement a method for determining the presence of railroad "market dominance". The standards that emerged in 1978 included three conditions that were each individually sufficient to establish this finding.[11] The 1978 benchmarks included (1) an observed revenue-to-variable cost ratio (R/VC) greater than 160 percent, (2) an incumbent railroad market share of the shipper's traffic greater 70 percent, or (3) shipper investment in rail-captive infrastructure with a value greater than $1 million. Meeting one of these three standards was relatively easy so that market dominance could often be established under these standards.[12]

Staggers redefined market dominance, so that its consideration first rests exclusively on the observed R/VC ratio. Complaints based on issue rates that fall below the prescribed threshold are dismissed. Initially set at 160 percent, this threshold has effectively been 180 percent since 1984. The implication is that any rate that is less than 180 percent of a movement's average variable cost is sufficiently competitive in appearance to avoid regulatory attention, but a rate that is 180 percent or greater than the movement's AVC is, at least, suspect in its reasonableness.

To be clear, neither in 1980, nor at any time since, has there been either empirical or theoretical evidence to support the use of 180 percent as a threshold rather than some other arbitrarily derived value. This threshold *does not* represent some form of average, breakeven markup.

Market Dominance, the Qualitative Evaluation, and the Issue of Allowable Substitutes

The second step summarized above requires a definitive qualitative assessment as to the issue of market dominance. Neither Staggers, nor the federal code it modified provides any real guidance regarding the specific course or content of this evaluation. The law simply states that, " 'market dominance' means an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies."[13] Making this definition operational has been the responsibility of first the ICC and later the STB. A relatively recent decision by the latter summarizes current practice.

> The Board determines whether there are any feasible transportation alternatives that are sufficient to constrain the railroad's rates to competitive levels,

[11] See ICC EP 320, 1978.

[12] Cost determinations necessary to the calculation of the R/VC are made via an application of the Uniform Rail Costing System (URCS) developed under the ICC and maintained by the STB.

[13] 49 U.S.C. Sec. 10707(a).

> considering both intramodal competition-competition from other railroads-and intermodal competition-competition from other modes of transportation such as trucks, transload arrangements, barges, or pipelines. Even where feasible transportation alternatives are shown to exist, those alternatives may not provide "effective competition. Effective competition for a firm providing a good or service means that there must be pressures on that firm to perform up to standards and at reasonable prices, or lose desirable business.[14]

Notably missing is any reference to product or geographic substitutes. In a traditional antitrust setting, an often early and always critical part of market assessment involves defining the relevant market based on the availability and substitutability of alternative goods or services.[15] Typically, this will include both product and geographic dimensions. Thus, in the case of a rail-served market, the market definition process might consider rail and non-rail transportation alternatives evaluated over both the issue and alternative origin destination pairs. And it might also include the substitution of an alternative commodity if the transportation options for that alternative are different than those available for movement of the commodity in question.

Staggers does not directly address the issue of product or geographic substitutes. Thus, the definition of market dominance established under the 4R Act as described above remains in force.[16] This definition notwithstanding, the ICC acted, in 1981, to include four specific substitutes within its qualitative evaluation of market dominance. These include: (1) intramodal (other rail) transportation substitutes, (2) intermodal (other modal) substitutes, (3) geographic substitutes in the form of alternative origins or destinations, and (4) product substitutes that might afford different transportation alternatives.[17] Thus, in its application of a market dominance standard, the ICC adopted a position that was consistent with economic practice in other settings. However, as described in Section 3, the ICC's position on geographic and product substitutes was reversed in a 1996 STB decision.

Rate Reasonableness and Constrained Market Pricing (CMP)

Just as rates that exceed the 180 percent R/VC threshold are necessary, but not sufficient for a finding of market dominance, a finding of market dominance is not sufficient proof that issue rates are unreasonable. More simply, a determination that a railroad has market power is not proof that it has exercised it inappropriately. Accordingly, the final step in a shipper rate challenge is to demonstrate that the rates

[14] See STB NOR 42123, December 7, 2012, p. 2.

[15] For a thorough discussion of market definition see US Department of Justice Horizontal Merger Guidelines (2010).

[16] 49 U.S.C. Sec. 10709(a).

[17] See *Market Dominance and Consideration of Product Competition*, 365 ICC 118 (1981) and *Rail Market Dominance* 365 ICC 116 (1981). With this noted, the 1981 ICC decision represented a reversal from an earlier position.

charged by the market-dominant carrier are unreasonable. Further, while both the 4R Act and Staggers are relatively specific in establishing a threshold R/VC against which rail rates can be evaluated as a first step in establishing market dominance, neither statute provides guidance regarding rate *reasonableness*.[18] Instead, this task has been left almost exclusively to the ICC and the STB.

After at least one aborted attempt to develop reasonableness criteria, The ICC, in 1983, announced its intent to establish principles as they were then to be applied to coal movements and which were subsequently applied to most cases in which market dominance had been established.[19] These standards are embodied within an overall construct known as *Constrained Market Pricing* (CMP). CMP is a hybrid combination of *Ramsey* pricing and accompanying policies tied to the mechanics of *Contestable Markets*. Because the CMP methodology dominated residual rail regulation for two decades and retains a prominent role under current oversight, it warrants careful consideration here.

To begin, the efficient production of railroad services entails the shared use of common network elements that impose costs that often cannot be "attributed" or made incremental to specific freight services. These common costs, in combination with seemingly inexhaustible economies of density, lead to a situation in which marginal (or incremental) cost pricing fails to generate sufficient railroad revenues and in which the would-be revenue shortfalls cannot be recovered by assigning easily-justified higher rates for some or all of the subject railroad traffic.

In a classic regulatory setting, this problem might be addressed by applying Ramsey or *quasi-optimal* pricing. Under Ramsey prices, at least in this setting, necessary deviations between price and marginal cost for specific services are inversely proportional to the own-price elasticity of demand for each service grouping, where that elasticity is expressed as an absolute value.[20] Further, these deviations are scaled so that the regulated seller earns adequate revenues, but nothing more. Notationally, this simplest form of Ramsey prices can be represented as prices such that:

[18] Staggers sometimes makes distinctions between the standard of reasonableness applied to existing rates versus the reasonableness of rail rate increases. Generally, however, these are treated similarly. In both cases, the statute directs the ICC to consider the revenue needs of the carrier, but to also, ". . .prevent (a) carrier with adequate revenues from realizing excessive profits on the traffic involved. . ." Staggers also directs the ICC to consider, ". . .the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues." See Staggers § 203.

[19] See *Coal Rate Standards – Nationwide*, EP 347 (Sub No. 1), February 24, 1983. An only slightly different variant of these standards was later applied to rates for the movement on non-coal commodities. See *Rate Guidelines – Non-Coal Proceedings*, EP 347 (Sub No. 2), December 1996.

[20] As Baumol and Sidak (1995) carefully point out, this simplified application of Ramsey theory requires that the various outputs be independent in consumption, that is they are neither substitutes nor complements. If the various goods are not independent in consumption, a Ramsey solution also requires the inclusion of cross-price elasticities reflecting the magnitude of the relevant relationships.

$$\frac{(P_i - MC_i)}{P_i} = \lambda \frac{1}{|\varepsilon_i|} \quad (1)$$

where the subscript *i* denotes a particular service; *P* and *MC* indicate price and marginal cost; ε is the own price elasticity and λ is a scalar ($0 \leq \lambda \leq 1$). Notably, a scalar value of 0 suggests prices that are identical to those observed under perfect competition and a scalar value of one reflects fully unencumbered, profit maximizing price discrimination. Both presumption and empirical evidence suggest that most rail-served markets are effectively competitive so that for most movements, the price-cost deviation prescribed under Ramsey pricing would be very nearly zero. It follows that only a small subset of movements would bear the burden of unattributable common costs. Under such an outcome, the magnitude of any associated equity concerns is a direct function of the relative size of unattributable costs and the number of rail shippers with relatively inelastic demands.[21]

Staggers specifically urges competitively determined rail market outcomes, so whether or not courts would have allowed an intrusive application of Ramsey pricing is uncertain.[22] However, this question is largely moot. Individual rail-served markets are defined across thousands of distinct origin-destination-commodity combinations that are subject to continuous change. Identifying, estimating, and maintaining the countless demand elasticities necessary to active Ramsey pricing would be impossible. Moreover, to the extent that prices imposed under such a regime might errantly deviate from marginal costs in cases where railroads actually face effective competition, the resulting traffic losses would represent an economically inefficient diversion of freight and would, likely, exacerbate any issues of revenue inadequacy.[23]

In the face of this complexity, CMP allows railroads to freely discriminate in setting rates among customers so long as two conditions are met. First, overall firm returns cannot exceed a competitive level. Second, individual rates cannot exceed levels that are consistent with competitive outcomes. The determination of this second threshold or ceiling is based on the *Stand-Alone Cost* (SAC) of providing the specific service (or services) in question.

The concept of stand-alone cost was introduced to most economists by Gerald Faulhaber's seminal (1975) work on regulatory cross-subsidies. However, in the current

[21] This issue is discussed extensively in Friedlaender (1992) and is taken up here in Section 3.

[22] Staggers § 101(a).

[23] Again as Baumol and Sidak observe, Ramsey pricing is often simply a guidepost in the development of regulatory policy rather than a prescriptive means of determining actual prices. *Supra* Note No. 21, p. 33.

context, stand-alone cost is made relevant by its key role within the theory of Contestable Markets.[24]

To define the SAC concept, consider a multiproduct firm producing N outputs, (x_1. . .x_n). In this case, stand-alone cost is defined as the total cost incurred by an efficient alternative producer that chooses to produce a set of outputs, M, where $M \subseteq N$. Based on this definition, and assuming no barriers to entry or exit and no sunk costs, any incumbent producer that attempts to raise price above the SAC (which includes a normal profit) will face immediate entry. Thus, in contestable markets, even a monopoly seller will find it impossible to extract supra-competitive profits. Moreover, because contestability assumes potential entrants have access to efficient technologies, incumbents must produce at the lowest possible cost or, again, face the disciplining force of entry.

Clearly, almost every rail-served market fails to meet the contestability criteria. There are both economic and institutional barriers to entry and exit and there are significant sunk costs. Nonetheless, based on the contestability construct, if regulators limit railroad earnings to only a normal rate of return and cap (or judge as reasonable) prices at stand-alone cost, then railroads can be allowed to freely set individual prices as they choose without any risk of monopoly profit taking or any loss of economic efficiency.[25] In summary under CMP, Ramsey-like price discrimination allows railroads to generate revenues sufficient to account for unattributable common costs, but the contestability constraints represented by limits to total earnings and the use of stand-alone costs as a *de facto* rate ceiling assures the absence of supra-competitive profits.[26]

In its 1985 decision, the ICC finalized four criteria that have come to define CMP as applied to rail rate reasonableness. These include:

1. The stipulation that CMP is only available to railroads with revenues that are inadequate based on the ICC's application of Staggers' definition.
2. CMP is only available to railroads that are efficiently managed as evidenced by their operating practices, investment decisions, and pricing;
3. Stand-alone costs are to serve as a regulatory guidepost. In the words of the court decision upholding CMP "If a complaining shipper pays no more than the cost of

[24] The theory of contestable markets was introduced and described at length by Baumol, et al. (1982). However, its most extensive application to issues of economic regulation is found in Baumol and Sidak (1995).

[25] In a multiproduct setting where there are economies of scope linking the costs of various products, this prescription is a bit more complicated. "[T]he combinatorial stand-alone price ceiling means that the prices of every combination of the firm's products must yield combined revenues not exceeding the corresponding standalone cost of the combination of products in question." See Baumol and Sidak (1995).

[26] EP 347 (Sub No. 1), Final Decision announced September 3, 1985.

providing service tailored to its need, it is benefiting from the economics resulting from shared facilities, whereas if it is paying more than that cost the shipper may be subsidizing service from which it derives no benefit."[27]

4. If shippers can demonstrate a probable disruption to their business, CMP rates are to be imposed over time.

3. Early STB Rate Governance

As noted, CMP was ultimately adopted by the ICC as the reasonableness criteria for nearly all rail rate adjudications, not simply those pertaining to coal. These standards were eventually reviewed, upheld, and occasionally modified through a variety of additional ICC dockets and judicial proceedings, largely focused on the issue of capital valuation and that valuation's impact on the ICC's calculation of adequate carrier revenues. Still, the overall rate appeal process developed by the Commission in 1983 changed little for more than a decade.

While the first post-Staggers decade required the ICC to treat important rate-related matters like substitutability, market dominance, and rate reasonableness criteria, the same years also saw a flurry of other Staggers-induced activities that required Commission attention. By the mid-1990s, however, there was growing evidence that the rail industry restructuring associated with Conrail, the 4R Act, and Staggers was leading to the intended revitalization.[28] Moreover, the reduction in direct railroad oversight, combined with a similarly diminished role in motor carrier regulation, had significantly reduced the Interstate Commerce Commission's workload and size.[29] As a consequence, in what many judged as a mostly symbolic action, Congress opted to terminate the Interstate Commerce Commission.[30]

In retiring the Commission, ICC Termination Act (ICCTA) also eliminated a number of functions no longer deemed necessary in a "deregulated" environment.[31] Remaining responsibilities were transferred directly to existing U.S. Department of Transportation (USDOT) administrations where possible. Alternatively, in the case of rail industry

[27] This decision provides useful descriptions of all four criteria. See Consolidated Rail Corporation v. United States of America, the Interstate Commerce Commission, 812 F.2d 1444, U.S. Third Circuit Court of Appeals, Decided February 23, 1987.

[28] For a description of post-Staggers Rail industry performance, see Burton (2014).

[29] Between 1980 and 1995, the number of Commissioners was reduced from 11 to 5 and overall ICC employment was reduced from roughly 2,000 to 350. Over this same timeframe, the Commission's nominal annual appropriate was reduced from $80 million to $30. *Ibid*.

[30] See Cooper (1995).

[31] *The Interstate Commerce Termination Act of 1996*, P.L. 104–88—DEC. 29, 1995 109 STAT. 803

regulatory functions, duties were passed to the newly created, quasi-independent Surface Transportation Board.[32] The ICCTA also explicitly instructed the STB to streamline the rate evaluation processes developed by the ICC and, in doing so, ushered in what might be considered the second generation of post-Staggers rail rate oversight.[33]

The Congressional directive contained in the 1995 legislation was based on sharp criticisms over the adequacy of shipper protections, particularly in the wake of the continuing railroad mergers. Criticisms of existing ICC processes fell into three broad categories, including – (1) doubts regarding the effectiveness of CMP as a regulatory framework, especially its reliance on stand-alone costs as a means and measure of market discipline; (2) fears that, regardless of efficiency implications, concentrating the burden of common cost recovery on a relatively small number of shippers was distasteful and politically untenable; and finally (3) widespread criticism condemning the high temporal and financial costs of pursuing rate relief as unacceptable.[34]

In responding to these criticisms, the STB has continued its reliance on CMP as the basic framework for federal rail rate oversight. Nonetheless, the Board has sought to expedite the adjudication of even the largest rate cases by limiting the scope of the associated evaluations. Further, the STB has developed alternatives to the original derivation of stand-alone costs that may be used in rate cases where potential damages are below specified monetary amounts. Individually, and particularly in combination, these ongoing, incremental changes in STB practice represent a less rigorous adherence to economic theory in favor of administrative tractability. There is no *a priori* fault in this transition, but it does motivate a careful look at the emerging procedural substitutes and benchmark measures, along with an assessment of their potential consequences.

Revisiting the Question of Relevant Substitutes

Early in 1998, at Congress' request, the STB opened an *ex parte* proceeding exploring access and other competitive issues.[35] Within the course of that proceeding, the matter of geographic and product substitutes as determinants of market dominance surfaced as a major shipper concern. Accordingly, later in 1998, the Board solicited comments on the question of substitutes and subsequently ruled to, ". . .eliminate from the market dominance determinations evidence of product and/or geographic competition."[36] This

[32] *Ibid.*

[33] *Ibid* § 102.

[34] For generalized critiques and criticisms of CMP and the use of stand-alone costs, see Pittman (2010), and Faulhaber (2013). Further, as described in Section 3, a description of equity concerns is provided by Friedlaender (1992).

[35] See STB EP 575, February 20, 1998.

[36] See STB EP 627, December 21, 1998.

decision unleashed a succession of regulatory appeals and court challenges by the railroads, but the 1998 STB ruling remains in place.[37]

The STB's explanation of its decision did not disparage the economic relevance of non-transportation substitutes. Instead, the Board's actions were aimed at expediting the rate adjudication process and, reducing its own regulatory burden, and perhaps, dampening the railroads' propensity to exercise pricing power. The Board wrote:

> We believe that the limited impact on the rail industry from this decision is far outweighed by the chilling effect that inclusion of product and geographic competition can have on the filing of valid rate complaints by captive shippers and on the resolution of rate complaints in a timely manner. And we also believe that negating this chilling effect will further level the playing field between railroads and shippers to the extent that disputes will be resolved in the private sector.[38]

The STB further contended that, in the face of truly effective geographic or product substitutes, shippers would not have an incentive to pursue costly rate challenges.[39] Their decision states:[40]

> Many shippers acknowledge that product and/or geographic competition can effectively constrain a railroad's rates, especially when such competition provides a direct transportation alternative. However, in such circumstances, AAR agrees that rate complaints are unlikely to be filed with the Board, because rate litigation is a costly, time-consuming and thus an ineffective means of obtaining competitive rates when actual competitive options give shippers negotiating leverage.

Finally, the Board suggested that its decision to disallow geographic and product substitutes in the determination of market dominance was made largely moot by its practice of combining that determination with its evaluation of rate reasonableness. The Board wrote:[41]

> [H]aving to defend the reasonableness of the rate in cases where product and geographic competition arguably could be found to

[37] While the topics of geographic and product substitutes are still relevant in terms of economic import, legal challenges to the STB's decision appear to have concluded with the DC Court of Appeals decision rendered in 2009. See 07-1369, CSX v. STB, June 9, 2009.

[38] See STB EP 627, December 21, 1998, p. 2.

[39] *Ibid*, p. 9.

[40] *Ibid*

[41] *Ibid*, pp. 12-13.

> effectively constrain the rate level imposes no additional burden on the railroads, because under our present procedures we generally do not bifurcate rate cases into separate evidentiary phases for the market dominance and rate reasonableness issues. Therefore, a carrier is generally required to fully defend the reasonableness of its rate before we make the market dominance determination.

While this apparently does not conflict with legal interpretation of Staggers or its changes to U.S. code, the STB's process very clearly attaches increased regulatory importance to the R/VCs that are used as regulatory gate-keepers and reinforces the need to reexamine these values and other similarly derived benchmark measures.

Alternatives to CMP and the Full Stand-Alone Cost Test

By all accounts, pursuit of a rate complaint under the CMP process is expensive and time-consuming, with complainant costs measured in millions of dollars and procedural durations measured in years. Accordingly, almost from the time of CMP's introduction in 1983, shipper organizations had encouraged the ICC to develop a simplified analytical process that could be used in rate challenges with smaller potential awards.[42] Indeed, the task of doing so was specifically mandated by Congress in its termination of the ICC and creation of the STB.[43]

In response, early in its tenure, the STB finalized a simplified rate challenge process that can be substituted for the CMP evaluation in cases of lesser value.[44] This process replaces the CMP evaluation with an analysis based on three benchmarks, each of which is a function of specific revenue-to-variable cost ratios. The Board did not contend that any of these ratios is, alone, sufficient to confirm or refute the reasonableness of an issue rate, nor did it suggest that, when combined, the Three-Benchmarks are a perfect substitute for the full CMP process. Instead, the Board wrote:

> While none of the benchmarks is perfect, we are satisfied that each is instructive for a simplified rate reasonableness analysis. Taken together, they allow us to consider each of the relevant statutory factors. . . Moreover, as explained above, the three benchmarks are only the starting point for our analysis. They can and should be supplemented, as appropriate, with any

[42] *Supra* Note No. 19.

[43] *Supra* Note No. 31, § 102

[44] See STB EP 347 (Sub-No. 2), December 31, 1996.

> particularized evidence that would qualify or modify what one or more benchmarks might otherwise indicate.[45]

The simplest of the three benchmarks is referred to by the STB as $R/VC_{>180}$ and as this reference suggests, is the average R/VC for the whole of a subject carrier's traffic that moves at an R/VC of greater than 180 percent. *Assuming* that a R/VC of 180 percent represents something like an average competitive markup, $R/VC_{>180}$ measures the extent to which the carrier's prices on less than perfectly competitive traffic generate additional revenues that can be used to afford unattributable fixed and common costs.
To evaluate the carrier's overall financial outlook, one need only compare $R/VC_{>180}$ to an average R/VC that *would* generate revenues adequate to fully cover all costs. Based on this definition, the targeted average R/VC is derived through an application of the STB's *Revenue Shortfall Allocation Method* (RSAM) and is the second of the three STB benchmarks. Notationally, the RSAM value for carrier *i* can be expressed as:

$$\text{RSAM}_i = \frac{(R_{>180i} + S_i)}{VC_{>180i}} \quad (2)$$

where R denotes revenue and S indicates the revenue shortfall.[46]

Two points regarding these first two benchmarks are important. First, each is developed as an average. $R/VC_{>180}$ is an actual average of observed railroad rates and the RSAM value is a target average. While both values truncate the lower R/VC bound at 180 percent, neither the actually observed average ($R/VC_{>180}$) nor its counterpart target average (RSAM) contain any information that describes the distribution of the rates that determine actual revenues and average R/VCs or the potential distribution of rates that might result in targeted revenues. Thus, there is no way to compare the issue rate to the other rates that form these calculations.

By virtue of their construction, the RSAM and $R/VC_{>180}$ benchmarks reveal nothing about the comparative demand or cost-side variations that might distinguish the issue rates from the average benchmark measures. This is particularly troubling given the role that Ramsey pricing is presumed to have within the more general regulatory framework. This concern apparently motivated the creation of the third STB benchmark, R/VC_{COMP}. As stated by the Board:

> The third benchmark is revenue-to-variable cost comparison (R/VC_{COMP}). This benchmark is used to compare the markup on the challenged traffic to the average markup assessed on other potentially captive traffic involving the same or a similar

[45] *Ibid*, pp. 30-31.

[46] In the case of excess revenues, S can very readily assume a negative value. RSAM can also be interpreted as a rate differential by simply dividing both numerator by the quantity of traffic that moves under RVCs greater than 180 percent.

> commodity with similar transportation characteristics. The R/VC_{COMP} ratio for appropriate comparison traffic is computed using traffic data from the rail industry Waybill Sample and applying the Board's Uniform Rail Costing System.[47]

The STB's logic in the development of this benchmark is curious. The Board writes:

> . . .the R/VC_{COMP} benchmark evidence can be supplemented, where appropriate, with specific evidence as to why the markup on the traffic at issue *should* be higher or lower than that of the comparison traffic. We believe this imperfect approach is far preferable to abandoning any effort to take demand-based differential pricing into account in a simplified analysis. [**emphasis added**]

It is the word "should" that motivates further inquiry. Referring to Equation (1) in Section 2, it is clear that in all but the most unusual cases, the issue rate *will* be the same as rates for truly comparable shipments if the railroad in question is acting to maximize profits.[48] Thus, if the issue rate is measurably different from rates charged for movements that appear to be comparable, either the railroad's pricing proficiency or the actual comparability of the movements is suspect. In this light, one must wonder whether or not R/VC_{COMP}, serves its intended purpose.

In the years since the original Three-Benchmark methodology's introduction, the shortcomings observed here have been aptly noted by STB proceeding participants and by the Board itself. To these troubles, parties have added a raft of additional definitional and measurement concerns. However, as the STB has indicated, a certain amount of precision must be sacrificed if a more tractable path for shipper rate challenges is to be available. The real question is whether the three benchmarks, even in combination, actually help to distinguish rates that are "reasonable" or "fair" from rates that are not.

Fully evaluating the stand-alone cost calculations required under ICC's original CMP development or under the STB's simplified SAC procedures (described below) is outside the scope of the current paper. Suffice it to say, however, that these calculations are tedious, contentious, expensive to produce, and often unsatisfying. This critique notwithstanding, the SAC process offers two critical features that are both missing from the original Three-Benchmark methodology. First, the SAC application of CMP defines rate outcomes that are "fair" or "reasonable". These are rate outcomes that *could* be observed in an effectively contestable market setting. Second, the SAC application of

[47] STB EP 689 (Sub-No. 3), February 24, 2012, p. 2.

[48] Burton and Wilson (2006) demonstrate that, in very rare cases and under very specific cost conditions, railroads may be induced to charge prices that exceed traditional profit-maximizing levels if doing so will foreclose the participation of other movement participants.

CMP provides a bright line for identifying this outcome. If the firm-level rate of return is at a competitive level and if the issue rate is less than the stand-alone cost, the issue rate is fair and reasonable. As we shall see, in its subsequent actions, the STB has both supplied a definition of fair and reasonable and established a bright line for use in the Three-Benchmark process. However, the Board's remedies in these regards are, by no means, consistent with the Ramsey pricing principles that purportedly govern the broader rate oversight regime.

4. The Continuting Evolution of STB Rail Rate Oversight

More than a decade passed after the introduction of the simplified procedures relying on the Three-Benchmarks process, but no shippers chose to pursue a rate challenge under these guidelines.[49] During the same period, a much lauded pattern of industry recovery further matured into what pundits popularly referred to as a *rail industry renaissance* where long-sought stability gave way to forward-looking growth.[50] At the same time, the shipping community continued to decry the expense and duration of the traditional CMP process, claiming that rail industry prosperity was coming at the direct expense of captive rail shippers.

Revised Rate Challenge Procedures

Within this environment, the STB held hearings in 2003 and 2004, proposed procedural changes in 2006, and finalized new procedures for rate challenges in 2007. [51] These revisions retain the full SAC application for the largest rate cases, provide a simplified SAC process for cases with an intermediate potential value of $5 million or less over five years, and make a revised Three-Benchmark method available for rate challenges where potential rewards are $1 million or less over the same five year period.

The STB's application of the full SAC analysis has two purposes. The first is to ensure that the carrier is not charging a rate that is, ". . .more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper."[52] The second purpose is to, ". . . detect and eliminate the costs of inefficiencies in a carrier's investments or operations. In isolation, the first of these tasks can be achieved relatively simply based on the carrier's observed infrastructure and traffic volumes. However, in seeking to assure that the relevant cost calculations reflect the best possible infrastructure mix (as opposed to what is actually in place), the second task requires the development and simulation of various complex counterfactual scenarios. Thus, the *Simplified Stand-*

[49] STB EP 646 (Sub-No. 1), July 28, 2006, p. 1.

[50] The phrase "railroad renaissance" is often attributed to industry financial expert Tony Hatch.

[51] STB EP 646 (Sub-No. 1), July 28, 2006, September 5, 2007.

[52] STB EP 646 (Sub-No. 1), September 5, 2007, p. 13.

Alone Cost Methodology embraced by the Board retains the first of these tasks, while eliminating the second.

In defending this simplifying concession the STB openly validated the influence competition has had on post-Staggers railroad industry investment and the extent to which that investment has resulted in an appropriately sized and configured rail network.[53] The Board went further still in stating:

> If a carrier makes a prudent investment in a rail line or facility that will last many years, it should be entitled to earn a reasonable return on the depreciated value of that investment over the entire life of that asset, even if it might elect not to replace that asset when it wears out.[54]

The simplified SAC methodology relaxes the rigor of the economic standards by assuming that the level and form of rail industry investment is efficient, but the principal theoretical guideposts of competitive firm returns and prices that cannot exceed stand-alone costs are left unchanged. The same adherence to economics is not found in the Board's changes to the Three-Benchmarks methodology.

As Section 3 observes, economics provides no definitions for "fair" or "reasonable", nor does it attach any efficiency implications to the three benchmarks either individually or in combination. Thus, there is no bright line (or any line at all, really) to separate reasonable from unreasonable railroad rates that can be based on benchmark values. The Board's 1996 decision recognized this limitation and, accordingly, refrained from embedding a non-economic threshold condition within the Three-Benchmarks process. The 2007 decision shows no such restraint.

The 2007 STB revisions to the Three-Benchmarks process impose a multi-step method for establishing the reasonable / unreasonable threshold. The first step entails the determination of the railroad movements to be included in the calculation of R/VC_{COMP}. Next, each R/VC in the comparison group is adjusted to reflect the relative revenue needs of the subject carrier through the use of an adjustment factor defined as:

$$\frac{\text{RSAM}}{\text{R/VC}_{>180}} \tag{3}$$

[53] *Supra* Note No. 50, p. 11.

[54] *Ibid*, p. 21. This same issue has been a controversy in other regulated industries with long-lived assets. See, for example Sidak and Spulber (1996).

This step is followed by calculating the mean value that constitutes R/VC_{COMP} and its corresponding standard deviation, σ. Finally, the process involves the calculation of a confidence interval around R/VC_{COMP}. The upper bound of this confidence interval is then used as a threshold against which the issue rate is compared. Specifically, this threshold equals:

$$(4) \qquad R/VC_{COMP} + t_{n-1}\left[\frac{\square}{(n-1)^{1/2}}\right]$$

where n is the number of observations in the sample group for which R/VC_{COMP} is the mean value.[55]

If the issue rate is beyond this threshold and there is not additional information to point to a contrary result, the rate is judged to be unreasonable and the Board can order it lowered to the threshold rate level.

There are a number of technical issues that can be raised regarding this construct. For example, is there reason to treat the distribution of sample rates surrounding R/VC_{COMP} as normal or was the use of a normal distribution a matter of simple convenience? But if one's concern is for the economic validity of this threshold, the answers to technical questions about its construction are moot. Rationally, as an expedient, this threshold may be inoffensive, but it nonetheless has no basis whatsoever in economic reason. Again, as noted above, the principles of Ramsey pricing, in combination with profit maximizing firm behavior suggest that R/VC_{COMP} may not be a valid measure of *anything*. The development of a confidence interval surrounding R/VC_{COMP} is equally devoid of meaning. Thus, the manner in which that confidence interval is constructed is of little importance.

Further Change and an Extended Reliance on RSAM

In its 2006 evaluation of rate challenge processes, the STB seemed to recognize that the Three-Benchmarks methodology suffers significant limitations and should only be used when other methods are infeasible. The Board wrote:

> We believe that the Three-Benchmark method should be reserved for use only as a last resort, once we have exhausted reasonable measures to simplify the SAC analysis, as CMP with its SAC test remains our preferred method for assessing the reasonableness of a challenged rate where there is an absence of effective competition. See Simplified Guidelines. . . [Three-

[55] *Supra* Note. No. 52, pp. 21-22.

> Benchmark method] must be used as sparingly as possible, reserved for only those cases where CMP is not a realistic option.[56]

This view notwithstanding, the STB continues to embrace additional methodologies that rely heavily on the three benchmarks, particularly the RSAM measure. Indeed, in 2012, within the context of an ongoing market dominance adjudication, the Board introduced an altogether new analytical construct based on RSAM and a newly devised metric it refers to as "limit price." In doing so, the STB wrote:

> . . . we have developed a methodology specifically designed to gauge objectively whether feasible direct truck or truck/rail transload alternatives are effectively constraining CSXT's [ISSUE CARRIER] pricing. The three components of this methodology, described in greater detail below, are as follows. First, we calculate the "limit price," i.e., the highest price CSXT theoretically could charge M&G [ISSUE SHIPPER] without causing a significant amount of the issue traffic on a particular rail movement to be diverted to any particular competitive alternative. Second, we calculate the "limit price R/VC ratio" by comparing the limit price to CSXT's variable costs of providing the service at issue. We then compare CSXT's most recent Revenue Shortfall Allocation Method (RSAM) figure-the measure of the average markup that CSXT would need to collect from all of its potentially captive traffic to earn a return on investment equal to the cost of capital-to the limit price R/VC ratio. If the limit price R/VC ratio exceeds CSXT's most recent RSAM figure, we preliminarily conclude that the alternative cannot exert competitive pressure sufficient to effectively constrain the rate at issue. If the limit price /lVC ratio falls below the RSAM figure, we preliminarily conclude that the competitive alternative effectively constrains the rate at issue.[57]

One need not explore the STB definition of "limit price", how this limit price relates to the observed railroad rate, or whether the concept makes any economic sense at all within a Ramsey framework to understand the policy implications of the Board's suggested methodology.[58] Very simply, *any* rate that exceeds the *average* rate necessary to assure

[56] *Ibid*, p. 11.

[57] STB NOR 42123, September 27, 2012, pp. 3-4.

[58] Robert Willig (2013) provides an assessment of the STB's "limit price" methodology in testimony provided within a separate rate challenge (STB NOR 42121).

adequate railroad revenues is likely to be treated as *de facto* proof that the railroad is market-dominant.[59]

The rate dispute that prompted the STB's introduction of this new methodology was resolved by the carrier and shipper prior to any Board decision.[60] Nonetheless, the implications of the STB's proposed methodology are significant. This methodology (1) substitutes a metric with, at best, limited economic content for a qualitative economic evaluation of market conditions, (2) it reverses what was likely a Congressionally intended role for RSAM, and (3) it adds weight to perennial efforts to cap maximum allowable railroad rates at some level.
The first of these points is highlighted in testimony provide by Robert Willig Professor Willig writes:

> Reliance on the "limit price R/VC ratio" rather than the railroad's actual R/VC ratio continues to require more detailed consideration. For this distinction to be meaningful, it must be the case that there are significant differences between actual and "limit price" R/VC ratios. The use of limit prices implies that the Board believes this to be the case, but it has offered no explanation to support that determination. If it is because the methodology used by the Board to determine the "limit price R/VC ratio" systematically omits some forms of competitive pressure (relatively low value of service, for example) that keep actual prices below the Board's calculated limit levels, then this methodology is founded on an expectation of systematic inaccuracy and is inherently flawed.[61]

In short, if the "limit price", as determined by the Board, is actually a limiting factor, then that should be the price observed in the transaction between railroad and shipper. If the "limit price" identified by the STB is greater than the observed price, then the estimated "limit price" is incorrect. For this reason, the construct offers no additional information regarding the possession or exercise of carrier pricing power.

The second issue is closely tied to the evolution of the RSAM measure. In the original Staggers language, the 180 percent R/VC threshold below which competition is generally presumed was actually expected to vary between 160 and 180 percent based on a measure referred to as the *cost recovery percentage,* defined as:

[59] This assumes that carriers will charge "limit prices" – an assumption that is not made explicit by the STB. However, given the functional linkage between demand elasticity, limit prices (at least, as defined by economists), and carriers' desires to maximize profits, it is difficult to understand how they would charge anything other than a limit price.

[60] *Supra* Note No. 58, January 7, 2013.

[61] See STB EP 722, Reply Comments, Association of American Railroads, November 4, 2014, Verified Statement of Robert D. Willig.

> . . . the lowest revenue variable cost percentage which, if all movements that produced revenues resulting in revenue-variable cost percentages in excess of the cost recovery percentage are deemed to have produced only revenues resulting in the cost recovery percentage, would produce revenues which would be equal, when combined with total revenues produced by all other traffic transported by rail carrier, to the total fixed and variable cost of the transportation of all traffic by rail carrier.[62]

This text identifies essentially the same RSAM measure defined in Equation (2) above. Thus, originally within Staggers, rail rates falling below the RSAM measure were presumed to be sufficiently competitive to avoid further scrutiny. Conversely, under the Board's "limit pricing" method, any rates that exceed RSAM are presumed to demonstrate market dominance. Not only is this result paradoxical, it seems at conflict with the intent embodied in Staggers which states:

> A finding by the Commission that a rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than the applicable [cost recovery] percentage under paragraph (2) of this subsection does not establish a presumption that (A) such rail carrier has or does not have market dominance over such transportation, or (B) the proposed rate exceeds or does not exceed a reasonable maximum.

Setting aside Congressional intent, the STB's "limit pricing" methodology and that methodology's reliance on RSAM in the determination of market dominance, demonstrates that aggregate benchmark measures are of no value in the adjudication of individual railroad rates. As a benchmark, RSAM provides useful information about the *average* deviation between price and average variable cost needed to move railroads toward the goal of revenue adequacy. As a specific measure applicable in the evaluation of an individual rate, RSAM is useless. By definition, unless all R/VCs equal RSAM, there will necessarily be a distribution of rates both above and below this mean value. Thus, concluding that an issue rate is greater than the carrier's RSAM value is of no help in determining whether the rate is necessary to the railroad's recovery of efficiently incurred costs or, alternatively, embodies supra-competitive profits.

Indirect Forms of Rail Rate Constraints

Finding an effective, affordable, expeditious, and economically sound course through which rail shippers can lodge rate challenges has proven frustrating. In the face of this disappointment, shippers have pursued less direct, but more fundamental means of

[62] Staggers § 202.

achieving lower railroad rates. At least two such methods are subjects of current STB *ex parte* proceedings. These include a proposed program of "competitive access" and, alternatively, a program that would cap allowed railroad revenues.[63] Both are presumed by shippers to lead to measurably lower railroad rates. Unfortunately, both courses are probably hollow in that promise.

Proposals for rail network access take many forms. Alternative carriers can be given physical access to incumbents' networks through trackage rights; incumbents can be compelled to interchange traffic at locations where they would not otherwise do so; or in the extreme, currently integrated network ownership and operations can be vertically separated and operating rights can be extended to one or more providers through franchise bidding or some similar program.[64] Regardless, however, of specific access form, the fundamental problem of pricing network supply within the context of common costs and economies of density does not disappear with the imposition of access. Imposing access requirements would simply move the pricing problem to a newly created stage in the vertical production process. At least some access prices would need to exceed marginal access cost if infrastructure owners are to remain solvent. Gallamore and Panzar (2004) summarize the dilemma as follows:

> Any regulatory system that does not permit railroads to use some kind of "mark-up" strategy for customers able and willing to pay more than the marginal cost of their services will end private sector railroading, as we know it in America. Any plan to compel new market entry ("competitive access") as a policy alternative to legal and laudable price differentiation will have the same result. . .

Realizing that access cannot eliminate carriers' needs to fully recover costs, it is difficult to see how adding a new layer of operational and pricing complexity would reduce the STB's regulatory burden or provide captive shippers with less offensive rail rates.

Discussions of revenue adequacy and potential limits to railroad earnings are less absolute. Still it is unlikely that more carefully constraining railroad revenues in a way that remains consistent with Ramsey pricing would provide shippers with the outcomes they have failed to achieve under existing rate protections. In order to explain this conclusion, the simple Ramsey pricing rule noted in Equation (1) is repeated here as Equation (5).

[63] Access is currently the topic of STB EP 711, while revenues, revenue adequacy, and revenue constraints are being considered within STB EP 722.

[64] While not as extensive as in other network industries, there is a rich economics literature on competitive access in freight railroading. For example Baumol and Willig (1999) consider the pricing of input pricing over bottleneck segments and Pittman (2005) explores the performance of vertical separation in a railroad setting.

$$\frac{(P_i - MC_i)}{P_i} = \lambda \frac{1}{|\varepsilon_i|} \quad (5)$$

Macher, *et al* (2014) carefully explain the regulatory evolution of revenue adequacy within the railroad context and also provide a thorough empirical comparison of actual railroad revenues to revenues in other economic sectors. Based on their analysis (and that of the STB), it appears nearly all railroads have failed to earn revenues that are adequate during most of the post-Staggers era. In terms of the Ramsey equation, this implies a value for λ of one. Practically, then, from a rate oversight perspective, revenue *inadequacy* has meant that the railroads have been able to freely engage in price discrimination so long as individual rates have not exceeded stand-alone costs.[65]

However, current arguments by shippers suggest that railroad revenues are now adequate to account for all costs and sustain forward-looking investment.[66] Without wading into this debate, we must realize that adequate revenues would simply imply that the current rate structure is "just right" in its ability to assure railroad solvency and sufficient future investment. Moreover, even the judgment that rail rates are marginally *greater* than adequate would not negate the need for differential pricing. To the contrary, in a Ramsey context, ongoing railroad revenues that are marginally greater than what is necessary would simply suggest a value for λ that is marginally less than one and that price-cost margins should decline very slightly for *all* shippers who are currently called on to contribute to the recovery of unattributable costs. Any prescription to the contrary would mean a wholesale departure from the principles of Ramsey pricing. Thus, a more careful oversight of railroad revenues would only provide substantive relief to captive shippers if aggregate railroad revenues are demonstrated to *grossly* exceed what is necessary. That finding is unlikely.

5. Concluding Observations

There is little question that the policy changes loosely referred to as deregulation and closely associated with the Staggers Rail Act of 1980 allowed a badly ailing U.S. railroad industry to pursue otherwise unavailable efficiencies, forestall financial ruin, and ultimately avoid the need for a far more expansive and expensive federal role in surface freight transportation. In providing the Staggers remedy, policy-makers attempted to simultaneously ensure that shippers were afforded residual protections against railroad rates that are "unreasonable". Still, there is no suggestion that the benefits to regulatory change have, in any way, been symmetrical. To the contrary, shippers with the greatest needs, fewest alternatives, and a demonstrable ability to pay, have been required to

[65] Faulhaber (1975) demonstrated that Ramsey Prices would not necessarily be subsidy-free. Therefore, in the absence of regulatory oversight, there is no guarantee that individual rates will not exceed the SAC threshold.

[66] See STB EP 722, Reply Comments, Concerned Shipper Associations, November 4, 2014.

shoulder a differentially higher share of fixed and common costs. In *individual* cases this differential can be remarkable.

After studying this outcome, the late Professor Ann Friedlaender (1992) made two predictions. First, she hypothesized that nothing in a post-Staggers setting would undo the rail industry cost characteristics that necessitate a disproportionate distribution of unattributable costs across the rates charged to shippers with the least elastic demands. Second, Professor Friedlaender suggested that the equity implications of the Ramsey-like principles embodied in the ICC's program of Constrained Market Pricing would probably generate outcomes that were politically untenable.

Twenty years after the fact, there is ample evidence that Professor Friedlaender's first prediction was more correct than she might have known. Economies of density, in combination with fixed and common costs remain the hallmarks of railroad network production costs. With regard to the second prediction, the same two decades have witnessed a tireless torrent of protests from captive shippers, but without any substantive change to the guiding regulatory framework.

The stability of this regulatory regime in the face of endless challenge is probably the result of two factors. First, as the above text demonstrates, no theoretically faithful economic alternatives have emerged as candidate replacements for CMP. To the extent that the STB has acted to placate aggrieved shippers, it has generally done so by reducing the veracity of its adherence to economic principles. Still, there is no evidence that these lapses in economic fidelity have brought any harm to the railroad industry.

Similarly, it is likely that the longevity of the current regulatory regime is anchored in the apparent well-being of freight rail users. While some few individual rail customers are sometimes understandably livid over the rates they face, there is no evidence that any identifiable segment of the community of railroad shippers would have been better off under the pre-Staggers regulatory framework or that they could be made better off today by any sustainable, forward-looking regulatory alternative. To the contrary, industry-specific patterns of real rate declines, growth in both absolute traffic and traffic share, sustained industry-funded investment, and the emergence of new services suggest just the opposite.[67]

What many simply refer to as "the railroad problem" has eluded any consistent, enduring policy treatment for 150 years.[68] The regulatory revisions that culminated in the Staggers Act 35 years ago brought wholesale change to the methods of federal rail rate oversight that were almost singly aimed at industry restoration. That goal was achieved

[67] *Supra* Note No. 3.

[68] For a remarkably eloquent expression of the same sentiment see Gaskins (2008).

more quickly and more effectively than anyone anticipated. Accordingly, for more than 20 years federal policy has drifted from a strict adherence to Staggers' economic guideposts in favor of marginally more expedient and affordable rate challenge procedures. There is no evidence this trend will abate nor is there immediate reason that it should so long Staggers' fundamental tenets are sustained.

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FORUM SELECTION CLAUSES

James N. Hurley and Christine M Walker[1]

BACKGROUND ON CHOICE OF FORUM ISSUES

Forum Selection Clauses

Historically, American courts have not favored forum selection clauses.[2] Courts often found such clauses were contrary to public policy or the clauses ousted the jurisdiction of the court.[3] Over time, however, courts have demonstrated less hostility toward forum selection clauses, finding the clauses valid unless proven as unreasonable under the circumstances, a high burden of proof.[4] To prove unreasonableness, the petitioner must demonstrate a forum selection clause was procured by fraud, is overreaching, violates strong public policy, or deprives the plaintiff of his day in court.[5]

The favorable shift by courts towards forum selection clause enforcement acknowledges that, in a commercial context, forum selection clauses serve valuable efficiency and fairness considerations. The negative beginnings of forum selection clauses likely derives from the natural association of forum selection clauses to forum shopping. Defined broadly, forum shopping describes a plaintiff exercising the option to bring a lawsuit in one of several different courts. The excessive cost of litigation in the United States has created powerful incentives for litigants to gain leverage over adversaries by choosing an inconvenient forum for the other party.[6] Forum shopping also provides benefits to domestic and foreign litigants.[7] For example, contingency fees appealed to alien litigants litigation against foreign tortfeasors, while, irrespective of residency and citizenship, both alien and domestic litigants were drawn to jurisdictions known for generous jury verdicts.[8]

In actuality, decisions over forum can determine the outcome of a case. With that in mind, the term forum shopping is really just a derogatory way of stating that a plaintiff chose the jurisdiction where the case can be most favorably be presented, when offered with a choice of jurisdictions.[9] As a result, forum shopping will exist until jurisdictional variation are eliminated.[10] Perhaps, however, the state of modern maritime contracts will militate any of the remaining residual negativity associated with purposeful forum

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[2] *M/S Bremen v. Zapata Off-Shore Co.,* 407 U.S. 1, 9-11 (1972).
[3] *Id.*
[4] *Id.*
[5] *Belloza v. Chios Sky Shipping & Trading, S.A., et al.,* No. 98-2092, 1999 WL 694020 * 2 (Ed. La. Feb. 9, 1999).
[6] *See* Friedrich K. Juenger, *"Forum Shopping, Domestic and International"* 63 Tul. L. Rev. 553, 554 (1989).
[7] *See Id.* at 560.
[8] *Id.*
[9] *Id.* at 571.
[10] *Id.* at 574.

selection. For example, an action based in admiralty could deal with a bill of lading or charter party contracting for the transportation of cargo from one port to another. Iit is highly probable in that case the parties reside in different jurisdictions. Creating certainty as to choice of forum becomes an important component of the negotiated transaction.[11]

The Supreme Court has provided extensive guidance on the enforcement of forum selection clauses. To that end, first, this paper provides a history of the enforceability of forum selection clauses in admiralty actions under United States law. Second, this paper considers various court's decisions on enforcement of clauses that designate an arbitration tribunal as the selected forum. Last, this paper considers the Supreme Court's most recent opinion on the proper procedural mechanism to enforce forum selection clauses and how lower courts have interpreted the opinion.

1. LANDMARK MARITIME FORUM SELECTION CLAUSE CASES

Maritime Forum Selection Clauses

Ocean going vessels travel through many jurisdictions.[12] Without utilization of forum selection clauses, the parties with a stake in the vessel's voyage could become subject to laws of a particular jurisdiction somewhat haphazardly.[13] In theory, agreeing in advance on choice of forum eliminates allows parties to better ascertain the value of the bargain at the time of contract formation.[14] The following is an overview of maritime forum selection clause cases that reached the Supreme Court as well as subsequent lower court interpretation of the principles opined by the Supreme Court.

Towage Contracts

The seminal maritime forum selection case arose out of towage contract. Under a towage contract, one vessel expedites the voyage of another vessel by pushing or pulling it at a greater speed than it may travel on its own.[15] Since a towage contract involves two vessels, the difficulties in forum choice only grow greater in a towage context. In recognition of the complexities in towing ventures, the Supreme Court set the precedent for enforcing forum selection clauses.

In *M/S Bremen v. Zapata Off-Shore Company*, the Supreme Court considered the enforceability of a forum selection clause within an international towage contract.[16] More specifically, the M/S Bremen contracted to tow Zapata's a self-elevating drilling rig, the Chaparral, from Louisiana to Italy.[17] The contract contained a clause stating "[a]ny dispute arising must be treated before the London Court of Justice."[18] A gale damaged the legs on the Chaparral shortly after the M/S Bremen put to sea. The M/S Bremen diverted to

[11] *See Bremen,* 407 U.S. at 1 (1972).
[12] *Marinechance Shipping, Ltd. v. Sebastian*, 143 F.2d 216, 220 (5th Cir. 1998).
[13] *Id.*
[14] *Id.*
[15] *Sacramento Navigation Co. v. Salz,* 273 U.S. 326, 328 (1927).
[16] *Bremen*, 407 U.S. at 2.
[17] *Id.*
[18] *Id.*

Tampa, Florida, the nearest port on Zapata's orders.[19] Despite the forum selection clause, Zapata brought suit in the United States District Court of Tampa. Unterweser, the insurer of the M/S Bremen, brought the case before the London Court of Justice and filed a motion to dismiss in the United States District Court of Tampa.[20] The District Court denied the motion, forcing Unterweser to litigate in Tampa.[21] To protect itself, Unterweser's filed a limitation of liability action in Tampa.[22] Subsequently, the District Court found that it had jurisdiction in the limitation proceeding and pendant jurisdiction to hear Zapata's claim, thereby declining to enforce the forum selection clause.[23]

On appeal, the Fifth Circuit also declined to enforce the forum selection clause concluding the District Court did not abuse its discretion in finding jurisdiction.[24] The majority concluded that "at the very least the case stood for the proposition that a forum-selection clause will not be enforced unless the selected state would provide a more convenient forum than the state in which suit is brought."[25]

On certiorari, the Supreme Court reversed, holding the lower courts gave far too little weight and effect to the forum clause in resolving the controversy.[26] The Supreme Court looked to other federal cases, other common law countries, and the Restatement of Conflict of Laws in making its determination.[27] The Court found Judge Wisdom's dissent persuasive, agreeing that forum selection clauses are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be "unreasonable" under the circumstances.[28] In declaring the presumptive validity of forum selection clauses, the Supreme Court found compelling reasons why freely negotiated private international agreements, unaffected by fraud, undue influence, or overweening bargaining power, should be given effect.[29] Likewise, the Supreme Court also found the forum selection clause manifested a reasonable effort of the parties to obtain certainty as to the applicable substantive law.[30] Therefore, under the *Bremen* decision, the correct approach regarding maritime forum selection clause is to enforce the clause unless the unjustness of the clause is specifically shown.[31] By way of example, the Supreme Court opined that two Americans resolving their essentially local disputes in a remote alien forum might merit a finding that a forum is so inconvenient that the clause should not be enforced under a reasonableness standard.[32] The *Bremen* decision has since stood for the proposition that forum selection clauses in a commercial international contract are enforceable absent a strong showing that it should be set aside.[33]

[19] *Id.* at 4.
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.* at 7-8.
[25] *Id.*
[26] *Id.* at 8.
[27] *Id.* at 8-11.
[28] *Id.* at 10. *See also In re Unterweser Reederei, GmbH*, 428 F. 2d 888, 896 (5th Cir. 1970) (Wisdom, J. M., dissenting)
[29] *Bremen*, 407 U.S. at 12.
[30] *Id.* at 13.
[31] *Id.* at 15.
[32] *Id.* at 17.
[33] *Id.* at 15.

Passenger Carriage Contracts

In *Carnival Cruise Lines, Inc. v. Shute*, the Supreme Court decided whether to enforce a forum selection clause found in a passenger carriage contract. Eulala and Russel Shute signed a cruise contract stating that all disputes will be litigated "in and before a Court located in the State of Florida, U.S.A., to the exclusion of the Courts of any other state or country" (emphasis added).[34] Eulala slipped during the cruise and brought suit in the District Court for the Western District of Washington.[35] Carnival filed a motion to dismiss, which the District Court granted based on lack of personal jurisdiction due to the forum selection clause.[36]

On appeal, the Ninth Circuit reversed finding Carnival solicited business in Washington, thereby subjecting itself to jurisdiction in Washington.[37] The court acknowledged the Supreme Court's holding in the *Bremen supra* finding forum selection clauses as prima facie valid.[38]

On certiorari, the Shute's argued that the forum selection clause was not a product of the negotiation and enforcement would effectively deprive the them of their day in court. In the alternative, the Shute's argued the clause violated the Limitation of Vessel Owner's Liability Act.[39] The Shute's and Carnival agreed that *Bremen* applied, but both had different interpretations on its relevance in this case.[40]

In its decision, the Supreme Court distinguished the Shute's contract from the contract in the *Bremen* because *Bremen* constituted a unique negotiated transaction between two companies and the Shute's transaction constituted a purely routine passenger carriage transaction.[41] By not recognizing the distinctions in the transactions, the Supreme Court found that the Ninth Circuit distorted its analysis. Unlike a negotiable towage contract between two business entities, it would be highly unusual for a form passenger carriage contract to be negotiable.[42] Moreover, a passenger carrier has a special interest in limiting the forum of suit because it carries passengers from many locales and passengers enjoy the benefits of reduced fares created through that limitation.[43] Having a set forum also spares litigants the time and expense of pretrial motions to determine the appropriate forum.[44]

Accordingly, in *Shute*, the Supreme Court determined that the Shute's did not satisfy the heavy burden of proof mandated by *Bremen* to set aside the clause on the grounds of inconvenience.[45] The Supreme Court also determined that the forum clause was fundamentally fair because there was no indication that by selecting the Florida forum legitimate claims would be discouraged, that the Shute's agreement to the forum selection

[34] *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 587-588 (1991).
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] *Id.* at 589.
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Id.* at 594.
[44] *Id.*
[45] *Id.* at 595.

was due to fraud or overreaching tactics, and because the Shute's had notice of the forum provision, yet, still accepted the contract.[46]

On the limitation of liability issue, the Shute's argument failed because Florida courts qualify as courts of competent jurisdiction under the Limitation of Vessel Owner's Liability Act and judicial resolution in Florida would not limit Carnival's liability for negligence.[47]

Effectively, the *Shute* decision stands for the proposition that forum selection clauses in form passage carriage contracts are enforceable provided that they pass a test of judicial scrutiny for fundamental fairness. Subsequent to the Supreme Court's finding in *Shute*, a Texas court applied the holding in Shute to dissimilar facts in *Schaff v. Sun Line Cruise, Inc*. In *Schaff*, the plaintiff bought a non-refundable ticket, did not have the option to reject the contract, and the forum selected was in Athens, Greece.[48] The *Schaff* court found the forum selection clause unenforceable pursuant to *Shute* because the facts failed to pass a test of judicial scrutiny for fundamental fairness.[49] Accordingly, *Schaff* provides insight into what factors may make forum selection clauses in passenger carriage contracts unenforceable under the standard articulated in *Shute*.

Also of note, the Southern District of Miami is currently deciding *Terry v. Carnival*. *Terry* was filed after an engine room fire left a cruise ship disabled, without power, plumbing, water disposal and refrigeration for almost an entire week.[50] On the issue of negligence, Judge Graham has stated that mishap that occurred would not have happened absent negligence on the part of Carnival.[51] This finding open the door for the Southern District to rule on whether the Carnival's current cruise contract fails the fairness test, which could impact the enforceability of the forum selection clause found in the cruise contract.[52]

Foreign Seaman Employment Contracts

As seaman's employment contracts may fall under the purview of federal statutes, the enforceability of forum selection clauses in seaman's employment contracts requires interpretations of legislative intent as well the application of *Breman* and *Shute*. Generally, the Fifth Circuit has held forum selection clauses in a foreign seaman's employment contract enforceable.[53] In *Bodzai v. Artic Fjord, Inc.*, the Supreme Court of Alaska made a distinction in the enforcement of seaman's employment contract arising from federal statute, for example, maintenance and cure, unseaworthiness and Jones Act, to those arising purely from contract.[54]

In addition to federal statutes and the principles of contract, previous Supreme Court decisions provide guidance in evaluation of forum selection clauses found in seaman's

[46] *Id.*
[47] *Id.* at 596.
[48] *Id.*
[49] *Id.*
[50] *Terry v. Carnival Corp.*, 2014 AMC 1337 (S.D. Fla. 2013)
[51] *Id.*
[52] *Id.*
[53] *Marinechance,* 143 F.3d at 216.
[54] *See Bodzai v. Artic Fjord, Inc.*, 990 P.2d 616 (Al. 1999).

employment contracts.[55] In *Sawicki v. K/S Stavanger Prince*, a Polish seaman was injured 30 miles of the coast of Texas and treated for his injuries in Louisiana.[56] The seaman filed a claim in Louisiana as a Jones Act seaman.[57] His employment contract was the result of a collective bargaining agreement and provided that the agreement was subject to Norwegian law and to the jurisdiction of Norway.[58] The District Court dismissed the case on the grounds that jurisdiction was proper in Norway or Poland.[59] The Fifth Circuit affirmed the District Court's decision finding that the seaman entered into a collective bargaining agreement with an enforceable forum selection clause.[60]

The Louisiana Supreme Court reviewed the case and directed their focus to the interaction between the principles opined in *Bremen*, the employment contract, and an applicable Louisiana state statute.[61] The court noted that *Bremen* required forum selection clauses upheld unless the clause contravenes a strong public policy of the forum in which the suit is brought.[62] Specifically relevant to the facts of this case, Louisiana had a state statute mandating the invalidity of a forum selection clause unless an employee expressly, knowingly, and voluntarily agreed to and ratified the validity of a forum selection clause in a collective bargaining agreement.[63] The Louisiana statute dictates strong public policy.[64] Therefore, the Louisiana Supreme Court found the forum selection clause unenforceable.[65]

In *Belloza v. Chios Sky Shipping & Trading, S.A., et al.*, the Louisiana Supreme Court cited *Shute* as controlling authority. There, a Nicaraguan seaman sustained an injured while a Panamanian vessel was moored in Louisiana.[66] The seaman's employment contract provided that personal injury cases should be litigated in Greece under Greek law.[67] The contract was in English, but the seaman could not speak or read English.[68] The contract was not explained or translated to him.[69]

Applying *Shute*, the court found the forum selection clause enforceable.[70] The *Belloza* court explained that the forum selection clause would only be deemed unenforceable if the clause itself was obtained through overreaching tactics.[71] The allegations that the entire contract was procured by defendants' overreaching tactics was found inapposite to the forum selection clause enforceability determination, which precedes the determination of contract validity.[72] Accordingly, despite its sympathies, the court upheld the contract's forum selection clause.[73]

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[55] *See Sawicki v. K/S Stavanger Prince,* 802 So.2d 598 (La. 2002).
[56] *Id.* at 600.
[57] *Id.*
[58] *Id.*
[59] *Id.* at 601.
[60] *Id.*
[61] *Id.* at 602.
[62] *Id.*
[63] *Id.* at 603.
[64] *Id.*
[65] *Id.* at 606.
[66] *Belloza v. Chios Sky Shipping & Trading, S.A., et al.*, No. 98-2092, 1999 WL 694020, at * 1 (Ed. La.Feb. 9, 1999).
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *Id.* at *2.
[71] *Id.*
[72] *Id.*
[73] *Id.*

U.S. Seaman Employment Contracts

When deciding whether to enforce a forum selection clause, some court have distinguished enforcement of forum selection clauses applying to foreign seaman from those which involve domestic seaman.[74] The cases which distinguish foreign seaman from domestic seaman consider the policy implications of enforcing or declining to enforce a forum selection clause and the legislation which provides domestic seaman rights under federal law.[75] To illustrate, in *Boutte v. Cenac Towing, Inc.,* the court determined that a forum selection clause applying to a U.S. seaman did not require enforcement because the public policy consideration behind enforcement is weaker when no international concern form comity exists.[76] Likewise, an employer's position for enforcement is weekend when the applicable federal statute aims to protect the substantial right of seaman in selecting the forum for suit.[77] In *Nunez v. American Seafood*, the court further explained why cases with international seaman present different issues than those with domestic seaman.[78] The *Nunez* court found *Bremen* had an international flavor and came about as products of the general maritime law.[79] In contrast, cases with domestic seaman involve the general maritime law modified by the Jones Act.[80] To support its reasoning, the *Nunez* court explained that the Jones Act incorporated a predecessor statute, the Federal Employers' Liability Act ("FELA"), which applies to railroad workers.[81] Importantly, FELA permits railroad workers to select the venue of a law suit.[82] The Jones Act applies to seaman and, through the incorporation of FELA, places an injured seaman in the shoes of an injured FELA worker.[83] The United States Supreme Court has held that forum selection clauses are not enforceable for FELA workers.[84] Accordingly, *Nunez* held that forum selection clauses are also unenforceable for Jones Act seaman.[85]

ARBITRATION AGREEMENTS ACTING AS FORUM SELECTION CLAUSES

In maritime activities, arbitration is often requested. Substantively, arbitration clauses are a type of forum selection clauses because arbitration clauses designates the location and type of forum to hear any issues arising from the underlying maritime contract. As such, a synopsis of useful maritime arbitration clause cases is provided.

[74] *See e.g. Boutte v. Cenac Towing, Inc.*, 345 F. Supp.2d 922 (S.D. Tex. 2004), *Nunez v. Am. Seafood*, 52 P.3d 720 (Alaska 2002).
[75] *Great Lakes Dredge & Dock Co., LLC v. Larrisquitu, et al.*, 2007 AMC 2141 (S.D. Tex 2007).
[76] *Boutte*, 345 F. Supp.2d at 932 (S.D. Tex 2007).
[77] *Id.* at 928-932. The *Boutte* court reached the conclusion that the Jones act provides a seaman with a substantial right to select the forum for suit based on the Jones Act incorporation of the Federal Employers' Liability Act, which explicitly provides railroad workers the right to select the venue for suit.
[78] *Nunez*, 52 P.3d at 721 (Alaska 2002).
[79] *Id.*
[80] *Id*.
[81] *Id.* at 721-723.
[82] 45 U.S.C. §§ 51-60 (2012).
[83] *Nunez,* 52 P.3d at 722 (Alaska 2002).
[84] *Boyd v. Grand Trunk Western Railroad Co.*, 338 U.S. 263 (1949).
[85] *Nunez*, 52 P.3d at 724 (Alaska 2002).

Arbitration Agreements in Foreign Seaman Employment Contracts

When deciding whether to compel arbitration in a foreign seaman's employment contract, a court will undergo a very limited inquiry based on the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("Convention").[86] In *Lindo v. NCL (Bahamas), Ltd.*, the Eleventh Circuit required satisfaction of the following four jurisdictional prerequisites to compel arbitration: (1) a written agreement to arbitrate; (2) the foreign forum selected for arbitration is a signatory of the Convention; (3) the agreement arises out of a non-commercial legal relationship; and (4) one party is not a United States citizen.[87] If the agreement meets these jurisdictional prerequisites, the Court then looks to determine whether any of the Convention's affirmative defenses apply, such as fraud, mistake, duress, waiver, or if the arbitration clause is otherwise inoperative or incapable of performance.[88] Assuming the foregoing is met, typically, courts will find an arbitration clause in a foreign seaman's employment contract enforceable.[89]

Arbitration Agreements in United States Seaman Employment Contracts.

Similarly, courts will enforce an arbitration clause in a domestic seaman's employment contracts.[90] For example, in *Terrebonne v. K-Sea Transp. Corp.*, the Fifth Circuit found an arbitration clause in a domestic seaman's employment contract enforceable after determining that a proper interpretation of the Jones Act yields a conclusion that the Jones Act does not incorporate FELA's venue provision found at 45 U.S.C. §56.[91] Without the incorporation of FELA's venue provision into the Jones Act, the Fifth Circuit felt that the Federal Arbitration Act's ("FAA") public policy in favor of enforcing arbitration agreements outweighed any other public policy considerations.[92]

Arbitration agreements may present a wrinkle to the position of *Boutte* and *Nunez* courts because those courts found that the Jones Act incorporated FELA's venue provision. The implication of the courts differing positions on the incorporation of FELA means if a domestic seaman has forum selection clause designating a particular court, case precedent exists to defeat the same. Alternatively, if a domestic seaman has a forum selection clause designating arbitration tribunal instead of a particular court, case precedent dictates enforcement. Unfortunately, this distinction in enforceability creates a result contrary to admiralty and maritime law's goal of uniformity.

[86] *See generally Lindo v. NCL (Bahamas), Ltd.*, 352 F.3d 1257 (11th Cir. 2011).
[87] *Id.*
[88] *Id.*
[89] *See generally Francisco v. M/T STOLT ACHIEVEMENT*, 293 F.3d 280 (5th Cir. 2002)(finding an arbitration clause in a foreign seaman's employment contract enforceable).
[90] *See e.g. Terrebonne v. K-Sea Trasp. Corp*, 477 F.3d 271 (5th Cir. 2007).
[91] *Id.* at 281.
[92] *Id.* at 285. As noted, at issue in *Terrebone* was an arbitration agreement, not a forum selection clause. In consideration of the similarities between arbitration agreements and forum selection clauses, in *Great Lakes Dredge & Dock Co., LLC v. Larrisquitu*, a district court in Texas considered how to reconcile *Terrebone* with *Boutte* and *Nunez* when a forum selection clause applied to a domestic seaman was at issue. The *Great Lakes* court held that in light of *Terrebone*, a domestic seaman seeking to defeat a forum selection clause must present a strong public policy argument in favor of lack of enforcement.

Arbitration Agreements in Towage & Salvage Contracts

As previously stated, under a towage contract, one vessel agrees to expedites the voyage of another vessel by pushing or pulling it.[93] Salvage is defined as compensation for a person by whose voluntary assistance at sea to a ship, her cargo, or both, resulted in the saving the same from impending peril, or in recovering such property from actual peril or loss, as in cases of shipwreck, derelict, or recapture.[94] Salvage is either classified as pure salvage or contract salvage.[95] Contract salvage is distinguishable from pure salvage because in contract salvage an agreement exists between the parties prior to the salvage operation.

The FAA provides in that "a written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration … shall be valid, irrevocable, and enforceable..."[96] In *McCaddin v. Southeast Marine Inc.*, a pleasure craft broke down and required a tow.[97] The owner signed a contract for the towage , but a factual dispute existed as to whether the owner could read the contract because he did not have his glasses.[98] The contract contained an arbitration clause.[99] The court considered the enforceability of the arbitration clause under the FAA.[100] The owner's inability to read the contract required the court to evaluate whether fraud in the inducement existed because a ground for non-enforcement under the FAA includes whether a reason at law or equity exists to prevent contract enforcement.[101] Ultimately, however, the court found no fraud existed.[102] The arbitration clause was therefore enforced.[103]

Arbitration agreements involving salvage also fall within the FAA and are ordinarily enforceable.[104] Enforceability, however, still rests on compliance with the FAA or, if an international connection exists, with the Convention.[105] In *Brier v. Northstar Marine, Inc.*, a motor yacht ran aground and required salvage.[106] The salvage contract contained a London arbitration provision.[107] Both the FAA and the Convention provide a court with the power to determine the enforceability of a foreign arbitration provision.[108] The parties to the contract in *Brier* were both American and did not have a significant connection to London.[109] The court found the Case fell outside the Convention because the fourth jurisdiction prerequisite, foreign citizenship of one party, was not met, making the governing legislation the FAA.[110] The FAA permits a foreign forum arbitration if a reasonable relation to the foreign forum exists.[111] In the instant case, the *Brier* court found

[93] *Sacramento,* 273 U.S. at 328 (1927).
[94] *The "Sabine"*, 101 U.S. 384, 384 (1880).
[95] *The Elfrida*, 172 U.S. 186, 192 (1898).
[96] 9 U.S.C. §2 (2012).
[97] *McCaddin v. Southeast Marine Inc.*, 567 F. Supp. 2d 373, 376 (E.D.N.Y. 2008).
[98] *Id.*
[99] *Id.*
[100] *Id.* at 377.
[101] *Id.* at 377-384.
[102] *Id.* at 385.
[103] *Id.*
[104] *Id.* at 364. *But see Jones v. Sea Tos Servs. Freeport N.Y. Inc.*, 30 F.3d 350 (2d Cir. 1994)(refusing to enforce a contract for salvage with a foreign forum arbitration provision when the vessel owner and salvor were both U.S. citizens.).
[105] 9 U.S.C. §2 (2012).
[106] *Brier v. Northstar Marine, Inc.*, Case No. 91-597(JFG), 1992 U.S. Dist. LEXIS 20931, *3-5, (D.N.J. April 28, 1992).
[107] *Id.* at *6.
[108] *Id.* at *19.
[109] *Id.* at *20-29.
[110] *Id.* at *21-22.
[111] *Id*. at *22.

no reasonable relation to London present.[112] Accordingly, compelling arbitration in London conflicted with the FAA.[113] The arbitration provision was therefore unenforceable despite the designation of the same in the salvage contract.[114]

Arbitration Agreements for the Carriage of Goods

As to the carriage of goods, *Vimar Seguros y Reaseguros, S.A. v. M/B Sky Reefer*, governs.[115] In *Sky Reefer*, the Supreme Court evaluated the enforceability of foreign arbitration clauses in a maritime carriage of goods contract.[116] The Supreme Court analyzed the protection provided under the Carriage of Goods by Sea Act ("COGSA"), the ability of a foreign forum to properly apply the statute, and the commercial context.[117] In the *Sky Reefer*, the vessel issued a standard bill of lading for a shipload of Moroccan oranges and lemons.[118] The bill of lading stated that all disputes must be arbitrated in Tokyo, Japan, under Japanese law and heard by the Tokyo Maritime Arbitration Commission of the Japan Shipping Exchange, Inc.[119]

While underway, thousands of boxes of oranges shifted in the cargo hold of the vessel causing over one million dollars in damage.[120] The relevant section of COGSA states, "any clause, covenant, or agreement in a contract of carriage relieving the carrier or the ship from liability for loss or damage to or in connection with the goods, arising from negligence, fault, or failure in the duties or obligations provided in this section or lessening such liability otherwise than as provided in this chapter shall be null and void and of no effect."[121]

The Plaintiff asserted the invalidity of the foreign arbitration clause in the bill of lading because it would lessen liability under COGSA.[122] The District Court found the foreign arbitration clause enforceable.[123] On appeal, the First Circuit affirmed the order to arbitrate.[124] The Supreme Court also affirmed the order to arbitrate holding that COGSA does not forbid selection of a foreign forum.[125]

In its analysis, the Supreme Court looked to in *Indussea Corp v. S.S. Ranbord*, where the Second Circuit struck down a down foreign forum selection clause.[126] In *Indussea*, the court found that COGSA invalidated the use of a foreign forum selection clause because of the difficulty enforcing liability in a foreign forum. As a result, selection of a foreign forum is an effective means for carriers to secure lower settlements.[127] Further, the *Indussea* court expressed concern over a foreign court's ability to apply COGSA in the

[112] *Id*. at *22-28.
[113] *Id*. at *29.
[114] *Id*.
[115] *Vimar Seguros y Reaseguros, S.A. v. M/B Sky Reefer*, 515 U.S. 528 (1995).
[116] *Id.* at 530.
[117] *Id.*
[118] *Id.*
[119] *Id.*
[120] *Id.* at 531.
[121] 46 U.S.C. App. § 1303(8)(2012).
[122] *Sky Reefer,* 515 U.S. at 533 (1995).
[123] *Id.* at 532.
[124] *Id.*
[125] *Id.* at 530.
[126] *Id.* at 533.
[127] *Id.*

same way as a U.S. court.[128] Based on the similarity of foreign forum selection clause to foreign arbitration clauses, the *Indussa* holding has been extended and analogized to foreign arbitration clauses.[129]

Further, the Supreme Court concluded that the liability imposed on carriers under the COGSA is defined by explicit standards of conduct, and it is designed to correct specific abuses by carriers.[130] Nothing in this section of COGSA, however, suggests that the statute prevents the parties from agreeing to enforce these obligations in a particular forum.[131] In drawing this conclusion, the Supreme Court found its reasoning consistent with the reasoning in *Shute* where it concluded that utilizing a forum selection clause does not purport to limit liability for negligence.[132]

Last, in *Sky Reefer*, the Supreme Court noted that contemporary global trade requires international comity.[133] Skepticism over the ability of foreign arbitrators to apply U.S. laws is inconsistent with promotion of international comity and modern commercial practice.[134] The Supreme Court recalled that the historical judicial resistance to foreign forum selection clauses in *Bremen* had little place in an era with world markets.[135] Additionally, discouragement of American business and industry will result if the U.S. insists on a promulgating a parochial concept that all disputes must be resolved under U.S. laws and in U.S. courts.[136]

PROCEDURE UNDERLYING FORUM SELECTION CLAUSE ENFORCEMENT

Atlantic Marine Construction

While the Supreme Court held forum selection clauses as presumptively valid in the *Bremen*, until recently, the Supreme Court was silent as to the proper procedural mechanism for forum selection clause enforcement. In *Atlantic Marine Construction*, the Supreme Court examined what standards are to be applied when adjudicating a 28 U.S.C. §1404(a) motion when the underlying contract has a forum selection clause.[137] 28 U.S.C. §1404(a) states "for the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought or to any district or division to which all parties have consented" ("§1404(a)").[138] The Court's holding requires that when case is filed in a different court from that named in the forum selection clause, the case should be transferred to the forum selected in the forum selection clause, unless extraordinary circumstances unrelated to the convenience of the parties, clearly disfavor a transfer.[139]

[128] *Id.* at 534.
[129] *Id.*
[130] *Id.*
[131] *Id.*
[132] *Id.*
[133] *Id.* at 537.
[134] *Id.*
[135] *Id.* at 535.
[136] *Id.* at 538.
[137] *Atlantic Marine Construction Co., Inc. v. U.S. Dist. Ct. for the W.D. of Tex.*, 134 S. Ct. 568, 575 (W.D. Tex. 2013).
[138] *Id.*
[139] *Id.* at 576.

Facts & Procedural History

In *Atlantic Marine Construction*, Atlantic Marine, a Virginia corporation, entered into a subcontract for a construction project with J-Crew Management, a Texas corporation.[140] The contract contained a forum selection clause requiring litigation in the Norfolk, Virginia, state or federal court.[141] A dispute about payment arose and J-Crew filed suit in the Western District of Texas based on diversity jurisdiction.[142] In response, Atlantic Marine moved to dismiss under 28 U.S.C. §1406 ("§1406"), wrong venue, and Rule 12(b)(3), improper venue, and moved to transfer the case to Eastern District of Virginia under §1404(a).[143] The District Court concluded that §1404(a) was the exclusive mechanism for evaluating forum selection clauses.[144] According to the district court, §1404(a) requires a weighing of factors to determine if a case should be transferred.[145] Upon weighing the factors, specifically the expense for witnesses to testify, the District Court found that Atlantic Marine failed to meet its burden showing that a transfer would be in the interest of justice or increase the convenience to the parties and their witnesses and denied the motion.[146]

Atlantic Marine petitioned the Fifth Circuit for a writ of mandamus directing the District Court to dismiss under §1406(a) or order a transfer under §1404(a).[147] The Fifth Circuit determined that the District Court had not clearly abused its discretion and that Atlantic Marine did not establish a clear and indisputable right to relief.[148] The Fifth Circuit agreed that §1404(a) was the proper mechanism for forum selection but specified that if the forum selection clause was for a non-federal forum, Rule 12(b)(3) would be the correct mechanism because §1404(a) does not permit transfer outside the federal court system; the Supreme Court granted certiorari on this distinction.[149]

Supreme Court Analysis

§1406(a) and Rule 12(b)(3)

The Supreme Court started by evaluating the interaction between §1406(a) and Rule 12(b)(3) with 28 U.S.C. §1391 ("§1391").[150] The Court found §1406(a), instructs a court to either dismiss or transfer an action brought in the wrong venue.[151] Under 12(b)(3), "a party may move to dismiss a case for improper venue," whereas §1391 provides, "this section shall govern the venue of all civil actions brought in District Court of the US."[152] A civil action under §1391 may be brought in, first, a judicial district in which any defendant resides, if all defendants are residents of the State in which the district is

[140] *Id.*
[141] *Id.*
[142] *Id.*
[143] *Id.*
[144] *Id.*
[145] *Id.*
[146] *Id.*
[147] *Id.*
[148] *Id.*
[149] *Id.* at 577.
[150] *Id.*
[151] *Id.*
[152] *Id.*

located, second, a judicial district in which a substantial part of the events or omissions giving rise to the claim occurred, or a substantial part of property that is the subject of the action is situation; or, third, if there is no district in which an action may otherwise be brought as provided in this section, any judicial district in which any defendant is subject to the court's personal jurisdiction with respect to such action.[153] Therefore, if a case falls within one of the three categories in §1391, venue is proper.[154] If a case does not fall within one of these categories, venue is improper and the action is dismissed or transferred under §1406(a).[155] Whether the parties entered into a contract containing a forum selection clause does not impact whether a case falls into one of the categories of §1391.[156] Thus, a case that falls within §1391 can't be dismissed under §1406(a) or Rule 12(b)(3).[157]

In its explanation of the applicability of §1391, the Supreme Court found that the meaning of venue and forum had been incorrectly combined.[158] While venue and forum are used synonymously sometimes, §1391 only applies to venue.[159] According to Supreme Court, the language of §1391 is indicative of Congress' intent that venue should always lie in some federal court and creates a fallback option where if no other venue is proper, venue can be in any judicial district as long as the defendant is subject to personal jurisdiction of the court.[160] In sum, the Supreme Court found venue is proper as long as the requirements of §1391 are met.[161]

Next, the Supreme Court looked at previous case law on transfers.[162] In *Van Dusen v. Barrack*, the Supreme Court evaluated if a transfer is allowed to a district in which venue is proper under §1391, but in which the case could not have been pursued in light of substantive state law limitations.[163] In *Van Dusen* the Supreme Court found transfer is permissible because the language in §1391 "where it might have been brought" does not narrow the range of permissible federal forums.[164] Therefore, if an action is in a court where the action could have been brought under §1391, that court is not the wrong court. Meaning, a contractual bar can't render venue in a § 1391 permissible district wrong.[165] The Supreme Court also looked at a footnote in *Stewart Organization, Inc. v. Ricoh Corp.,* which stated that if §1391 made venue proper, venue could not be wrong for the purposes of §1406(a).[166] Recognizing the analysis in *Van Dusen* and *Stewart*, the Supreme Court determined in Atlantic Marine Construction that unlike §1406(a), §1404(a) does not condition transfer on the initial forum being wrong.[167] §1404(a) permits transfer to any district where venue is also proper or to any district the parties agreed by contract or stipulated as proper.[168]

[153] *Id.*
[154] *Id.*
[155] *Id.*
[156] *Id.*
[157] *Id.*
[158] *Id.*
[159] *Id.*
[160] *Id.* at 578.
[161] *Id.*
[162] *Id.*
[163] *Id.*
[164] *Id.*
[165] *Id.*
[166] *Id.* at 579.
[167] *Id.*
[168] *Id.*

Then, in Atlantic Marine Construction, the Supreme Court address whether §1404(a) was the appropriate mechanism to enforce a transfer when a clause provides for a state or foreign tribunal instead of a federal forum.[169] The Fifth Circuit found Rule 12(b)(3) as the proper mechanism when the forum selection clause requests a state or foreign tribunal.[170] To the contrary, however, the Supreme Court found the appropriate way to enforce a forum selection clause pointing to a state or foreign forum is through the doctrine of forum non conveniens.[171] §1404(a) codifies the doctrine of forum non coveniens for the subset of cases in which the transferee forum is federal.[172] For the remaining set of cases calling for a nonfederal forum, §1404(a) has no application, but the residual doctrine of forum non conveniens does apply.[173] Accordingly, because both §1404(a) and forum non conveniens doctrine entail balancing of interest, a court should evaluate a forum selection clauses pointing to a nonfederal forum in the same way they evaluate those pointing to a federal forum.[174]

In terms of the argument that Rule 12(b)(6) was the proper procedural mechanism, the Supreme Court found even if Rule 12(b)(6) could apply, §1404(a) and forum non conveniens doctrine are the appropriate enforcement mechanisms when transferring a case due to a forum selection clause.[175]

§1404(a)

To dissuade the negative connotations associated with forum shopping, the Supreme Court pointed out that in a case such as *Atlantic Marine Construction* where the contract contains a forum selection clause is different than a typical forum selection case.[176] In a commercial context, enforcing the choice of forum facilitates the parties receiving the basis of the bargain, protects legitimate expectations, and furthers the vital interests of the justice system.[177] Therefore, pursuant to §1404(a), when parties have agreed to a valid forum selection clause, the Supreme Court found that a District Court should transfer the case to the specified forum unless there are extraordinary circumstances present, unrelated to the convenience of the parties.[178]

Recognizing the commercial nature of forum selection clause, the Supreme Court stated that when there is a forum selection clause courts should adjust their §1404 analysis.[179] First, the plaintiff's choice of forum does not matter and receives no weight.[180] Effectively, only the forum reflected in the agreement receives deference.[181] This places the burden on the party defying the forum selection clause to establish that the transfer is warranted.[182] Second, there are no private interests that require consideration.[183] The

[169] *Id.*
[170] *Id.*
[171] *Id.*
[172] *Id.*
[173] *Id.*
[174] *Id.*
[175] *Id.* at 579-580.
[176] *Id.* at 580.
[177] *Id.*
[178] *Id.*
[179] *Id.*
[180] *Id.*
[181] *Id.*
[182] *Id.*
[183] *Id.*

parties private interests are to weigh entirely in favor of forum reflected in the forum selection clause.[184] Public interest factors, however, may be considered.[185] Third, a §1404(a) transfer will not carry with it the choice of law of the original venue where suit was filed. Therefore, the law of the court in which the plaintiff inappropriately filed suit does not follow the case to the forum contractually selected by the parties.[186]

1404(a) applied to Atlantic Marine Construction

Based on the previously recited analysis, the Supreme Court reversed and remanded *Atlantic Marine Construction* because the District Court did not properly apply §1404(a).[187] The District Court stated that Atlantic Marine had the burden to show that the case should be transferred.[188] Under §1404(a), however, J-Crew actually had the burden to show public interest factors overwhelmingly disfavored a transfer, not Atlantic Marine.[189] The District Court also should not have consider private interest factors such as J-Crew's ability to litigate the action in Virginia.[190] J-Crew knew at the time of contract formation that having a Virginia forum selection clause might impede its ability to call witness and impose other litigation burdens.[191] Also, the District Court incorrectly thought Texas law would apply, which would have made a Texas court better equipped to handle the case.[192] Because Virginia law would apply under proper transfer choice of law rules, this conclusion is incorrect.[193]

Subsequent Application of *Atlantic Marine Construction*

Very recently, the holding in *Atlantic Marine Construction* was applied in *PNC Bank, N.A. v. Akshar Petroleum, Inc.*, Case. No. 3:13-cv-436-J-34PDB (M.D. Fla. March 14, 2014). In *Akshar*, the defendants moved for dismissal pursuant to Rule 12(b)(3).[194] At the time defendant's filed its Motion to Dismiss, Eleventh Circuit case precedent provided that when considering a forum selection clause, a Rule 12(b)(3) motion constituted the proper vehicle to request dismissal of a complaint.[195] The Supreme Court issued its opinion in *Atlantic Marine* during the pendency of the *Akshar* defendants Motion to Dismiss.[196] Accordingly, upon evaluating the Motion to Dismiss the *Akshar* court denied the defendants Motion and stated that Rule 12(b)(3) authorizes dismissal only when venue is wrong or improper under the requirement of federal venue laws.[197] The *Akshar* court further found that regardless of a forum selection clause, a case filed in a district that falls within 28 U.S.C. §1391 may not be dismissed under Rule 12(b)(3).[198] Instead, the forum

[184] *Id.*
[185] *Id.*
[186] *Id.* at 581.
[187] *Id.* at 584.
[188] *Id.* at 583.
[189] *Id.*
[190] *Id.*
[191] *Id.* at 584.
[192] *Id.*
[193] *Id.*
[194] *PNC Bank, N.A. v. Akshar Petroleum, Inc.*, Case. No. 3:13-cv-436-J-34PDB, 2014 U.S. Dist. LEXIS 39151 (M.D. Fla. March 14, 2014).
[195] *Id.*
[196] *Id.*
[197] *Id.*
[198] *Id.*

selection clause requires enforcement.[199] The proper procedural mechanism to enforce the forum selection clause a Motion to Transfer under 28 U.S. §1404 or a Motion to Dismiss under the Doctrine of Forum Non Conveniens.[200] Interestingly, however, despite the *Akshar* court's denial of the defendant's Motion to Dismiss based on its improper use of Rule 12(b)(3), the court went on to considered the issue of if the forum-selection clause warranted the dismissal of the case under the forum non conveniens doctrine based on concerns for judicial economy.[201]

CONCLUSION: WHAT TO EXPECT FROM MARITIME FORUM SELECTION CLAUSES

In *Atlantic Marine Construction,* the Supreme Court noted the distinction between commercial contracts with forum selection clauses and other forum selection cases. This distinction of the commercial context has provided much of the rationale behind enforcement of forum selection clauses in past maritime Supreme Court cases. Overwhelmingly, the recent Supreme Court opinions seem to indicate that courts should enforce forum selection clauses to ensure the parties receive the benefit of the bargain and to protect legitimate business expectations. For example, in *Bremen*, the Supreme Court upheld a private international agreement containing a forum selection clause between two commercial parties because the forum selection clause was a freely negotiated term. Likewise, in *Shute*, the Supreme Court upheld the forum selection clause because the clause was fundamentally fair and to protect Carnival's legitimate business interest rationalizing that the Shute's benefited from a lower ticket fair as a result of Carnival not being subjected to the expense of litigation in various jurisdictions. Similarly, in *Sky Reefer* the Supreme Court focused on the consequence that if foreign forum selection clauses are not enforced it would discourage international business. Finally, in *Atlantic Marine Construction*, the Supreme Court found again that the bargained for forum selection clause was enforceable and created a valuation system in which the factors for not enforcing the clause heavily favor the pre contracted forum.

As a result of the significant body of law defined by the Supreme Court, except in the case of a Jones Act seaman, parities to maritime contracts can expect with certainty not only on the enforceability of forum selection clauses, but also certainty that when a case is initially filed with the wrong court it will be transferred and heard under the law provided for in the forum selection clause.

4836-8662-3260, v. 1

[199] *Id.*
[200] *Id.*
[201] *Id.*

THE EU'S SEAL PRODUCTS BAN TESTS THE WTO'S PUBLIC MORALS EXCEPTION

Heather Cook

Introduction

This article explores the European Union's attempt to justify its ban on seal products as necessary to protect the moral welfare of its citizens. Part I will explore the evolution and background of the rule. Part II explains the structure of the rule and the effect of that structure on determining compliance with WTO requirements. Part III explores the public morals exception within the WTO rules in light of the *EC-Seal Products* panel decision. Part IV recommends a procedural solution to mitigate the difficulties in applying the public morals exception under the WTO Agreements.

I. Evolution of the Rule

In September 2009, the European Parliament adopted Regulation (EC) No. 1007/2009 banning the sale of seal products in the European Union.[1] A year later, implementing regulations, Commission Regulation (EU) No. 737/2010, followed.[2] The ban was a surprise to no one: sentiment against the trade in seal products had been building in the EU for decades. In 2007, Belgium and Holland were the first two European countries to entirely ban the import of seal products,[3] but the European Union had started down this road in 1983 with Council Directive 83/129/EEC, a ban on the import of products derived from whitecoats (harp seals less than 12 days old) and bluebacks (hooded seals less than a year old).[4] After several short term extensions, the measure was extended indefinitely in 1989.[5] The main reasons given by the panel for the extension were "Doubts about the effects of non-traditional hunting on the conservation of harp seals in the East Atlantic, the Barents Sea and the White Sea; renewed public pressure; [and] the negative consequences that could be expected should the Directive not be extended."[6] Banning the killing of young seals was generally uncontroversial: Canada, outlawed the practice itself in 1987.[7]

[1] Regulation (EC) No 1007/2009 Of The European Parliament And Of The Council of 16 September 2009 On Trade In Seal Products, 2009 O.J. (L286).
[2] Commission Regulation (EU) No 737/2010 of 10 August 2010 Laying Down Detailed Rules For The Implementation Of Regulation (EC) No 1007/2009 Of The European Parliament And Of The Council On Trade In Seal Products, 2010 O.J.(L216).
[3] In fact, Canada's original complaint was against the Belgian and Dutch rules, which were later subsumed by the EU regulation. *See* Panel Report, *European Communities—Certain Measures Regarding the Importation and Marketing of Seal Products,* WT/DS369/R (Oct. 1, 2007).
[4] Council Directive 83/129/EEC of 28 March 1983 concerning the importation into Member States of skins of certain seal pups and products derived therefrom, 1983 O. J. (L 091), 30,31.
[5] Council Directive 89/370/EEC of 8 June 1989, concerning the importation into Member States of skins of certain seal pups and products derived therefrom, 1989 O.J. (L153), 37.
[6] See "Background Information on Seal Pups Directive" at http://ec.europa.eu/environment/biodiversity/animal_welfare/seals/index_en.htm. Updated 02/14/14.
[7] For a brief time line of major country bans, see http://www.ifaw.org/united-states/our-work/seals/ending-trade-seal-products.

Russia was the last major sealing nation to outlaw the practice; it finally acted in 2009.[8] Not long after, in 2011, Russia also banned the import and export of harp seal skins altogether, a reflection of the growing world sentiment against seal hunting exemplified by the EU regulation.[9]

Recognizing the trend in international opinion and hoping to protect its large sealing industry, Canada turned to the international trade forum. In July 2007, it launched consultations with Belgium and Holland in order to protest their individual seal bans.[10] Alerted that a similar ban was in the works in the European Parliament, Canada voiced its concerns to the European Council, but was rebuffed. By 2009, Canada had decided to take formal action in the World Trade Organization (WTO), declaring that the EU's ban was based on neither science nor fact.[11] Gail Shea, the Canadian Minister of Fisheries and Oceans was quoted as saying that Canada had "made representations at all levels of the EU to inform them that the Canadian seal hunt is sustainable, humane and closely monitored." Further, the government would "continue to counter the misinformation campaign by the anti-seal hunt lobby groups, and [we will] continue to defend the interests and livelihoods of Canadian sealers."[12] Similar concerns were voiced by Norway and Denmark. Norway subsequently joined in protesting the EU rule.[13]

Inuit populations also expressed concern that the ban would damage their ability to hunt seals for subsistence and economic survival. Although the proposed EU rule included an exception for indigenous peoples, native populations in Greenland and Canada, among others, expressed concern that the ban would collapse the market for seal products entirely, leaving them with no way to supplement their subsistence livelihood. The Inuit Circumpolar Councils in both countries submitted letters to that effect at the EU "stakeholder meeting" held as the regulation went into effect in November 2009.[14] At the same meeting, the EU unveiled a study which it had commissioned from COWI, a Danish engineering and environmental consulting firm.[15] The study showed that, between the economic downturn and the anticipated ban, Norway's seal trade had dropped by half from 2006 to 2010, while Canada's trade in 2010 was only a quarter of the volume in 2006. Greenland showed no drop in trade, but its government-run tanneries were stockpiling seal skins in anticipation of implementation of the rule.[16]

II. Structure of the rule

Although the structure of the EU rule may reflect the priorities of its authors, it lacks clarity in the WTO context. The WTO contains several agreements, and a challenged

[8] Id.
[9] Id.
[10] Request for Consultations by Canada, *European Communities – Certain Measures Prohibiting the Importation and Marketing of Seal Products,* WT/DS369/1 (Oct. 1, 2007).

[11] Request for Establishment of a Panel by Canada, *European Communities – Certain Measures Prohibiting the Importation and Marketing of Seal Products,* WS/DT369/2 (Feb. 14, 2011).
[12] Foreign Affairs, Trade, and Development Canada. News release No. 327. Available at http://www.international.gc.ca/media_commerce/comm/news-communiques/2009/327.aspx?lang=eng.
[13] Request for Consultations by Norway, *European Communities—Certain Measures Regarding the Importation and Marketing of Seal Products,* WT/DS401/1 (Nov. 10, 2009).
[14] See Response from the Inuit Circumpolar Council (Greenland) and Statement of Chester Reimer, Senior Policy Advisor, Inuit Circumpolar Council (Canada) available at http://ec.europa.eu/environment/biodiversity/animal_welfare/seals/seal_hunting.htm.
[15] COWI, Study on implementing measures for trade in seal products: Final Report (2010). Commissioned by the European Union Directorate-General Environment.
[16] COWI, Traceability Schemes for Trade in Seal Products: Briefing Note for Workshop Participants, 16 (2010).

trade measure such as the EU rule may be considered under more than one agreement at a time.[17] Rules that contain multiple restrictions on access to a member nation's market must be evaluated to determine whether the measure complies with the requirements of the various agreements. This evaluation is based on both the plain language of the agreements and the reasoning in prior cases.[18] It is important to note that although WTO cases are not seen as having precedential value, the reasoning that they contain is often used as a model for the reasoning in subsequent cases.[19]

A. Interpreting the EU rule

> The language of the EU rule is fairly straightforward. It begins with this brief paragraph:
>
> The placing on the market of seal products shall be allowed only where the seal products result from hunts traditionally conducted by Inuit and other indigenous communities and which contribute to their subsistence. These conditions shall apply at the time or point of import for imported products.[20]

The rule goes on to say that derogation from this paragraph will be allowed where seal products are imported by travelers for their personal use or are derived from a seal hunt overseen by a national government and conducted solely for the sustainable management of marine resources.[21] The rule further states that the products obtained through such a marine resource management hunt must be sold on a non-profit basis and "the nature and quantity of such products shall not be such as to indicate that they are being placed on the market for commercial reasons."[22]

Because of this wording, the structure of the EU rule can be interpreted in more than one way. In their complaints to the WTO, Canada and Norway characterized the rule as a comprehensive regime laying down three sets of market access conditions that allow certain seal products entry into the EU market.[23] Under this interpretation, each set of market conditions can be viewed as a limitation on access to the EU market which must be WTO compliant. By contrast, the EU urged that the rule should be viewed as a complete ban with three exceptions: for seal products from Inuit hunts, for items imported by individual travelers for their personal use and for marine resource management hunts.[24] They urged that the rule's language - "the placing on the market of seal products shall be allowed only where" – should be interpreted as meaning that seal products are banned generally with the exceptions noted.[25] Although no party articulated its reasons for advocating a particular interpretation of the rule's structure, the differences had the

[17] Consider, e.g., *EC-Asbestos* and *US-Tuna(II),* which were both evaluated under the GATT and the TBT Agreement.
[18] John H. Jackson, William J. Davey & Alan O. Sykes, Legal Problems of International Economic Relations: Cases, Materials and Text on the National and International Regulation of Transnational Economic Relations, 306-21 (5th ed. 2008).
[19] Laura Nielsen, The WTO, Animals and PPMs, 115-6 (2007).
[20] Regulation (EC) No 1007/2009, 2009 O.J. (L286).
[21] Council Directive 83/129/EEC, 1983 O. J. (L 091), Art. 3 2(a) and 2(b).
[22] Id. at Art. 3 2(b).
[23] Panel Report, *European Communities – Measures Restricting the Importation and Marketing of Seal Products,* para 7.32-7.34, WT/DS400/R (25 Nov. 2013)[hereinafter *EC-Seal Products*].
[24] *EC-Seal Products*, ¶7.36.
[25] Id.

potential to change the criteria under which the EU rule was considered, and thus, the potential to affect the final finding of WTO compliance. To understand the importance of the rule's structure, one must understand the operation of the applicable WTO agreements.

B. Exceptions to WTO obligations

Trade negotiations known as the "Uruguay Round."[26] The Uruguay Round brought together the elements necessary to form the first truly functional international trade liberalization regime. The basis of the system was the General Agreement on Tariffs and Trade (GATT), originally negotiated in 1947, supplemented by several "Annexes."[27] The Dispute Settlement Understanding (DSU), which created the Dispute Settlement Body (DSB) and governs mediation and adjudication of disputes between members, was included as Annex 2.[28] Also included in the annexes were several specialized trade agreements, such as the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) and the Agreement on Technical Barriers to Trade (TBT Agreement). GATT 1994 and its accompanying annexes set forth substantive obligations that have been agreed to by every member of the WTO.[29] If a trade measure is found to violate these obligations, the measure at issue is determined to be WTO non-compliant.[30] However, the defending party can put forth one of several defenses found in the GATT or its annexes.

1. Exceptions under the GATT

Nondiscrimination is the cornerstone of the GATT; it is embodied by the extension of most-favored nation status and national treatment to trading partners.[31] Most-favored nation treatment requires that a country grant equivalent trade privileges to each of its trade partners, here fellow WTO members. It is designed to promote more efficient use of resources and minimize trade disputes arising from unequal treatment of trading partners.[32] By contrast, national treatment prohibits discrimination between domestic goods and like goods from trading partners. It is designed to prevent governments from evading tariff and other market access obligations.[33] By acceding to the WTO, members have agreed to abide by these principles; however, the GATT provides for special circumstances under which nations may avoid this obligation. Article XX contains these exceptions.

Article XX consists of an introductory clause followed by a list of specific subject areas which allow exceptions to GATT obligations.[34] It functions in the manner of an affirmative defense, as codified in the Dispute Settlement Understanding:

> There is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such

[26] John H. Jackson, et al, Legal Problems of International Economic Relations, 224-5 (5th ed. 2008).
[27] Id. at 226-7.
[28] Id. at 227.
[29] Id. at 226.
[30] Id. at 268.
[31] Id. at 467 and 537.
[32] Id. at 470.
[33] Id. at 537.
[34] Id. at 591.

> cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge.[35]

Once the defense is raised, analysis begins with a determination as to whether a measure at issue is a type covered by the list of specific subject areas.[36]

GATT Art. XX essentially represents a laundry list of issues which concerned the trade negotiators of the day. Drafted in the 1940s, Art. XX does not directly address many of the issues we might include as trade exceptions today, particularly environmental concerns, but it has proved surprisingly adaptable in stretching to address new issues. Art. XX includes provisions (a) necessary to protect public morals; (b) necessary to protect human, animal or plant life; (c) relating to import/export of gold or silver; (d) necessary to secure compliance with national laws; (e) relating to products of prison labor; (f) imposed for the protection of national treasures; (g) relating to the conservation of exhaustible natural resources; and a few more.[37] Although these exceptions are not invoked on a regular basis, Art. XX(d) has been raised as a defense most often, seven times. The article at issue in *EC-Seal Products,* Art. XX(a), has been raised only twice, once under the GATT and once under its twin, the General Agreement on Trade in Services (GATS) Art. XIV(a).[38] The defense was not successful in either case.[39]

In evaluating whether a measure falls within one of the enumerated subject areas, the panel must evaluate a party's stated policy goal, then determine whether the measure in question is, in fact, designed to accomplish it. This will generally entail application of either a "necessity" test, as required by Art. XX(a), or a "related to" test, such as required by Art. XX(g).

If a measure is provisionally justified under the enumerated exceptions, it must next be evaluated under the *chapeau*.[40] It can only stand as long as the measure is not "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination …or a disguised restriction on international trade."[41] This takes into account both the application and actual effect of the measure in determining whether it is discriminatory.[42] A number of trade measures that qualify for the Art. XX exception have been found to be WTO non-compliant under the *chapeau* because their implementation is not perceived to be fair to all affected nations. In *US-Shrimp,* a U.S. measure requiring shrimp fishermen to use certain devices known to exclude turtle by-catch was found to comply with the Art. XX(g) requirements, but was deemed non-compliant because it was implemented inconsistently among the shrimp-fishing nations and its opaque licensing requirements favored more-developed countries.[43]

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[35] Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Art. 3.8, Apr. 15, 1994, 1869 U.N.T.S. 401 [hereinafter DSU].
[36] John H. Jackson, et al. Legal Problems of International Economic Relations, 592.
[37] Id. at 592.
[38] World Trade Organization. WTO Dispute Settlement: One Page Case Summaries, 1995-2012 (2013 ed).
[39] See *China-Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products,* WT/DS363/AB/R (Dec. 21, 2009) [hereinafter *China-Publications and Audiovisual Products*] and *US-Measures Affecting the Cross-Border Supply of Gambling and Betting Services,* WT/DS285/AB/R (April 7, 2005) [hereinafter *US-Gambling*].
[40] John H. Jackson, et al. Legal Problems of International Economic Relations, 592 fn.36.
[41] Id. at 592-3.
[42] Id. at 627.
[43] Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products,* WT/DS58/AB/R ¶172 (12 Oct. 1998) [hereinafter *US-Shrimp*].

2. Exceptions under the TBT Agreement

The TBT Agreement functions as a sort of per se exception to WTO obligations, enjoying a presumption that a rule that qualifies as a technical barrier to trade (TBT) and complies with the requirements in the TBT Agreement is WTO compliant.[44] The TBT Agreement, like the SPS Agreement evaluated in *EC-Hormones*,[45] sets forth specific obligations that, if complied with, allow member nations to enact a measure that would otherwise be considered a barrier to trade.[46]

The TBT Agreement adopts the nondiscrimination philosophy of the GATT, echoing its foundational doctrines, most-favored nation and national treatment, in Article 2.1:

> Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.[47]

However, a TBT is presumed to be an exception to these obligations in and of itself, so the agreement lacks an exceptions clause that echoes Art. XX of the GATT. Instead, it relies on the statement in Article 2.5 that technical regulations adopted for a legitimate objective are "presumed not to create an unnecessary obstacle to international trade."[48] Whereas the GATT requires a respondent to defend its measure by invoking an exception, under the TBT, the defense is already made. In challenging a TBT, the initial burden is thus on the complainant to overcome the presumption of WTO compliance.[49]

In order to gain the advantage of this burden shifting, a measure must be found to be a technical barrier to trade. The definition of a TBT is laid down in Annex 1.1 (the TBT Agreement) as a:

> Document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.[50]

Imposition of such technical standards has an inherent outward effect. WTO members are sovereign nations which have agreed, as equals, to be bound by the trade agreement. Internal measures designed to uphold a nation's principles and belief system are inherently non-discriminatory in the trade context, since no other nation is required to adhere to the particular belief system.[51] It is only when the sovereign nation resorts to trade measures that have an external effect that it will impinge on the rights of its trade partners.[52] In the earliest TBT case, *EC-Asbestos*, Canada challenged a French ban on asbestos imports

[44] Nielsen, The WTO, Animals, and PPMs, 133.
[45] Panel Report, *European Communities – Measures Concerning Meat and Meat Products,* WT/DS 48/R ¶8.42 (Aug. 18, 1997) [hereinafter *EC-Hormones* panel report].
[46] Nielsen, supra, 132.
[47] The Agreement on Technical Barriers to Trade, 1868 U.N.T.S. 210, Art. 2.1 [hereinafter TBT Agreement]
[48] TBT Agreement, Art. 2.5.
[49] Nielsen, The WTO, Animals, and PPMs, 141.
[50] See also *EC-Asbestos* AB Report, ¶12.
[51] Nielsen, The WTO, Animals and PPMs, 274.
[52] Id.

which allowed the use of domestically produced substitutes such as cellulose and glass fibers.[53] Initially, the DSB panel found that because it was a ban of all asbestos products, France's regulation could not qualify as a TBT. The panel reasoned that the ban, on its own, did not qualify as a TBT because it did not lay down characteristics for products that might contain asbestos nor identify administrative provisions affecting them; it was simply a straightforward ban.[54]

Upon review, the Appellate Body disagreed, finding that the measure could be viewed as an integrated whole in determining whether it qualified as a TBT.[55] The exceptions which modified the general ban, though limited and temporary, provided the missing administrative and process requirements.[56] The *EC-Seal Products* panel followed this procedure, viewing the EU measure as an integrated whole and determining that it qualified as a TBT: "The fact that the measure is phrased in a positive form does not change the substantive character of the measure as both prohibiting seal products and allowing them upon meeting certain specific conditions."[57]

C. Relationship of TBT compliance requirements and GATT Art. XX exceptions

In order to qualify for the presumptive exception contained in the TBT Agreement, a measure that is found to fit the definition a TBT must also comply with the requirements of the Agreement.[58] An analysis of compliance with the TBT Agreement has much in common with an analysis of exception under GATT Art. XX.

1. Legitimate Objectives

According to Article 2.2 of the TBT Agreement

> …technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objectives are, *inter alia:* national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment.[59]

In contrast to the exceptions in GATT Article XX, the TBT Article 2.2 list is non-exhaustive. In fact, public morals is not listed as an example of a legitimate objective. However, the *EC-Seal Products* panel held that it did qualify. Borrowing the practice of the *US-Tuna II* and *US-COOL* Appellate Body reports, the panel set forth factors to be used "in assessing the legitimacy of a non-listed objective: (a) objectives provided in Article 2.2 of the TBT Agreement; (b) objectives listed in the sixth and seventh recitals of the preamble of the TBT Agreement; and (c) objectives recognized in other provisions of the covered agreements."[60] Finding no help within Article 2.2 or the preamble of the TBT

[53] Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos Related Products,* WT/DS135/R, ¶2.3-2.7 (18 Sept. 2000) [hereinafter *EC-Asbestos* Panel Report].
[54] *EC-Asbestos* Panel Report ¶8.51.
[55] *EC-Asbestos,¶63-64.*
[56] Id.
[57] *EC-Seal Products,* ¶7.52.
[58] Nielsen, The WTO, Animals and PPMS, 133-4.
[59] TBT Agreement, Art. 2.2.
[60] *EC-Seal Products,* ¶7.416.

Agreement itself, the panel turned to GATT Art. XX and its mirror in the agreement on trade in services, GATS Art. XIV. The Panel noted that the provisions in these covered agreements should be given strong weight because they explicitly allow public morals as an exception to WTO obligations.[61]

In assessing the validity of a claimed exception under Art. XX, DSB panels defer to a nation's own explanation of its goals in enacting a measure, as well as to its evaluation of the level of importance that the nation attaches to a particular goal.[62] Any attempt by the panel to make a value judgment as to the validity or importance of the goal necessarily would impinge on the nation's sovereignty. Each nation is free to develop its own principles, morals and priorities based on its own needs and beliefs, modified only by accepted international legal principles or participation in an international agreement.[63]

2. Legitimate Regulatory Distinctions

As the objectives of a measure must be legitimate, so must be the regulatory distinctions used to distinguish between products which are allowed under the measure and those which are disallowed.[64] Under TBT Agreement Art. 2.1, an imbalance in the actual effect of a trade measure is prohibited only if it cannot be justified by a legitimate regulatory distinction. This is meant to ensure that regulations are not used simply as a means of "discrimination against the group of imported products."[65]

Continuing its reliance on the GATT, the *EC-Seal Products* Panel cited "the close relationship between the TBT Agreement and GATT 1994, including the similarity in their texts"[66] in determining the full scope of a TBT analysis. Such an analysis must evaluate first whether the legitimate regulatory distinctions set forth in the measure are rationally connected to its objective; second, if there is any other cause or rationale which might justify it based on the peculiar circumstances of the current dispute; and third, whether the distinction is designed or applied in a manner which constitutes arbitrary or unjustifiable discrimination.[67]

We have already noted the influence of the GATT in determining which objectives are acceptable for use in the first step of that analysis. The borrowing of the GATT Art. XX *chapeau* language in the third step is also intentional. The panel reasoned that a regulatory distinction cannot be legitimate if it is not "designed or applied in an even-handed manner,"[68] equating a "lack of even-handedness" to "arbitrary and unjustifiable discrimination."[69] This seems consistent with the long-standing view of the GATT *chapeau* analysis as a test of the application of a measure.[70]

Step 2 of the analysis also has a GATT Art. XX parallel, but this comes, not from the language of the Agreement, but from previous Appellate Body decisions. For this step,

[61] Id. at ¶7.418.
[62] Nielsen, The WTO, Animals, and PPMs, 228-9.
[63] Id. at 233-5.
[64] *EC-Seal Products* at ¶7.131.
[65] Id. at ¶7.132.
[66] Id. at ¶7.258, based on the Appellate Body's analysis in *US-Clove Cigarettes, ¶91-101.*
[67] Id. at ¶7.259.
[68] *EC-Seal Products,* ¶7.259.
[69] Id.
[70] Nielsen. The WTO, Animals and PPMs, 168.

the Panel draws on the TBT analysis in *US-Clove Cigarettes*[71] in which the Appellate Body declined to accept any of the United States' justifications for its regulatory distinctions as legitimate, whether related to the measure's objective or not. In addition, the Panel cites the Appellate Body's Art. XX analysis in *Brazil-Retreaded Tires*:

> …we have difficulty understanding how discrimination might be viewed as complying with the chapeau of Article XX when the alleged rationale for discriminating *does not relate to the pursuit of* or *would go against the objective* that was provisionally found to justify a measure under a paragraph of Article XX. (emphasis added)[72]

The *EC-Seal Products* Panel used this negative reasoning to allow for the possibility that a regulatory distinction unrelated to a measure's objective might still be legitimate, relying on the simple fact that the parties were allowed to make such arguments. Although the Appellate Body did not accept these arguments in either *US-Clove Cigarettes* or *Brazil-Retreaded Tires,* the previous panels followed a general policy of hearing them. This leaves open the possibility that such an unrelated argument might someday be successful in another case.

III. The Public Morals Analysis in Light of *EC-Seal Products*

The *EC-Seal Products* case is unusual in that the EU invokes the rarely-used public morals clause to defend its measure. Because of the TBT Agreement's reliance on the GATT as a gap filler, public morals figures prominently in assessing not only the validity of the products at issue, but also the specifications used to define them (i.e. TBTs). This poses several problems.

A. Legitimate Objective

There is little doubt that the EU seal products regulation fits the definition under GATT Art. XX's public morals exception. However, determining the appropriate scope of a measure defined in subjective terms is particularly difficult.

1. Definition

In considering GATT XX(a)'s public morals exception, the Appellate Body in *US-Gambling* acknowledged that "Members should be given some scope to define and apply for themselves the concepts of "public morals" and "public order" in their respective territories, according to their own systems and scales of values."[73] The lack of objective criteria with which to judge the validity of public morals makes it very difficult to define the validity of such a measure. DSB panels have considered internal evidence that the nation adheres to a particular moral belief and has taken measures to uphold it.[74] Theoretically, international practice and scholarship could bolster a finding that a nation holds a particular moral value or belief, but by themselves could not be dispositive, since a

[71] *United States-Measures Affecting the Production and Sale of Clove Cigarettes,* WT/DS406/AB/R, ¶225, (4 Apr. 2012) [hereinafter *US-Clove Cigarettes*].
[72] *Brazil-Measures Affecting Import of Retreaded Tyres,* WT/DS332/AB/R, ¶226-234 (3 Dec. 2007) [hereinafter *Brazil-Retreaded Tires*] as cited in *EC-Seal Products,* fn 416.
[73] *US-Gambling,* Panel Report, ¶6.461.
[74] *US-Gambling,* Appellate Body Report, ¶296.

nation may legitimately hold a value that is out of the international mainstream. However, neither the *US-Gambling* nor the *China-Publications and Audiovisual Products* panels considered anything other than domestic factors.[75]

In the case of the EU seal products measure, the EU did show that concerns about the killing of seals stretched back several decades and that individual members of the EU (e.g. Belgium and Denmark) had implemented a general ban against the import of seal products even before the EU as a whole did. Additionally, the EU has a history of acting on its animal welfare concerns[76] and surveys submitted to the panel showed that EU citizens were concerned with the killing of seals.[77] This was enough for the panel to accept the EU's contention that distaste for seal-killing methods was a highly important matter of public morals within its territory.

2. Scope

The reliance upon a nation's own estimation of the definition and scope of public morals has its drawbacks. A moral imperative can be found for almost every measure, especially those relating to human health and the environment. In defense of a hypothetical limitation on cigarette imports such as that in *US-Clove Cigarettes*, a nation might invoke Art. XX(a) because citizens have a moral obligation to themselves, their families and society to maintain good health, along with Art. XX(b), protection of human health. In *US-Tuna(I)*, the United States defended its measure requiring that tuna fishermen use turtle exclusion devices in order to reduce the turtle bycatch under GATT Art. XX(b), "necessary to protect human, animal, or plant life or health," and Art. XX(g), "relating to the conservation of exhaustible natural resources…"[78] But in its third-party submission, Australia noted that "Article XX(a)…could justify measures regarding inhumane treatment of animals."[79]

These difficulties in pinning down an appropriate scope for public morals leave significant room for protectionist abuse. A dispassionate assessment of the EU seal products ban can certainly raise this concern, as the rule's exceptions seem perfectly designed to fit the needs of European countries. The Inuit hunt (IC) exception to the EU seal products rule seems tailor-made for Greenland. Though not itself an EU member, it is a self-governing region still partly dependent on Denmark, an EU member.[80] Greenland's majority Inuit population places more than half of the seal skins caught into the commercial market through Great Greenland, its vertically integrated seal hunting, processing and seal product manufacturing system.[81] In other countries where Inuit hunters place some of their seal products into the economy, they do so through the existing seal processing infrastructure.[82] The numbers of Inuit hunters are generally too small to

[75] Id. at ¶296-318.
[76] Among others, Council Directive 2010/63 2010 O.J. (L276) (EU) implements measures for the protection of animals used for scientific purposes, and Commission Regulation 98/2003 (L18) (EC) regulates the animal health requirements applicable to the non-commercial movement of pet animals.
[77] The EU takes regular surveys of its citizens' attitudes toward animal welfare. The most recent ones can be found at http://ec.europa.eu/food/animal/welfare/survey/index_en.htm.
[78] Panel Report, *United States-Restriction on Imports of Tuna,* WT/DS21/R, ¶3.5 (Sept. 3, 1991) [hereinafter *US-Tuna* I]
[79] Nielsen, The WTO, Animals, and PPMs, 230.
[80] *Statsministeriet,* Act on Greenland Self-Government (Act No. 473 of 12 June, 2009), available at http://www.stm.dk/_a_2957.html (May 31, 2014).
[81] For more on the development of Greenland's economic strategy in the 1980s, see Graham Poole, *Fisheries Policy and Economic Development in Greenland in the 1980s,* 26 Polar Record (157) 109-18 (1990).
[82] COWI, Study on Implementing Measures for Trade in Seal Products, 84 (2010).

allow for a separate processing industry in other countries, so that Inuits outside of Greenland will have a difficult time taking advantage of the IC exception.[83]

In addition, the marine resource management (MRM) exception particularly benefits European countries because the EU has already adopted ecosystem-based marine management in its 2009 Integrated Marine Policy.[84] Sweden and Finland, the only EU members with significant seal populations already manage their hunts in accordance with EU policies.[85] Canada and Norway both use sustainable management policies and require compliance with rules designed to promote humane killing,[86] but even if the practices met the European ecosystem-based standards, they would still not fit the MRM exception because of their hunts' commercial nature.

Finally, as the *EC-Seal Products* panel noted, there is an unmentioned exception allowed by the EU rule: seal products may transit the EU for processing and export.[87] Thus, the EU regulation does not foreclose any economic advantage garnered within the EU from existing or future seal product processing and export activity. When viewed in this way, the EU seal ban seems less an even-handed moral statement and more a rule designed to promote current European practices at the expense of its trading partners.

3. Blocking Protectionist Measures

Nations have rarely invoke Article XX(a) and, thus far, have not been successful in persuading a panel that a public morals rule fulfills the Art. XX requirements. Only two DSB panels have dealt with this issue. In *US-Gambling*, the panel upheld a U.S. claim that its measure prohibiting online gambling was designed to protect public morals, but found that the measure did not survive GATS Art. XIV's *chapeau* test.[88] The panel found that the measure did not apply equally to U.S. and foreign gambling because the Interstate Horseracing Act allowed remote operators to supply certain betting services. In *China-Publications and Audiovisual Products*, the panel again accepted China's definition of its own public morals, but found that the import restrictions in question were not "necessary" to protect those morals.[89] The measure appeared aimed at protecting China's book publishing industry, since content restrictions or other less restrictive means could have been used to accomplish the goal.[90]

Thus far, the practice of allowing nations to define their own morality has not resulted in the approval of protectionist measures by DSB panels. But with Article XX(a)'s

[83] Id.
[84] See the EU's 2009 Integrated Marine Policy and related documents at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009DC0536:EN:NOT (May 30, 2014)
[85] See, e.g. the Management Plan for the Finnish Seal Populations in the Baltic Sea, 2007. Available at www.mmm.fi/attachments/mmm/.../4b_Hylkeen_enkku_nettiin.pdf (May 30, 2014).
[86] Canada's most recent seal management plan and seal stock reports are available at http://www.dfo-mpo.gc.ca/fm-gp/seal-phoque/report-rapport-eng.htm (May 31, 2014). A description of Norway's marine resource management program and seal stock evaluations is available at http://www.fisheries.no/resource_management/Resource-management/#.U4oGvP0o8u4 (May 31, 2014).
[87] See *EC-Seal Products*, ¶7.638. "The implicit exceptions provided under the measure through certain commercial activities such as transit and inward processing for export were also found to undermine the measure's fulfilment of the objective."
[88] General Agreement on Trade in Services (GATS), 1869 U.N.T.S. 183, Art. XIV provides a public morals exception that encompasses rules that are "necessary to protect public morals or to maintain public order" and is preceded by a chapeau that mirrors that of GATT Art. XX.
[89] WTO Dispute Settlement: One-Page Case Summaries, 148.
[90] *China-Publications and Audiovisual Products,* ¶5.15.

increased usage and incorporation as a legitimate objective in the TBT Agreement and possibly other covered agreements with similar language, it is important to address these issues of definition and scope. In her book, The WTO, Animals, and PPMs, Laura Nielsen suggests a way of limiting the scope of the public morals exception. She outlines an approach based on the precautionary principle described in Rio Declaration Principle 15:

> In order to protect the environment, the precautionary approach shall be widely applied by States according to their capability. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.[91]

The principle suggests that environmental measures must be subject to a kind of risk assessment based on scientific factors. Nielsen carries this into the area of public morals, urging that "if a risk to either human health or to a species can be presented in either conclusive or inconclusive scientific material, the issues can safely be labeled as either environmental or human health"[92] and thus outside the realm of public morals. If a measure cannot be quantified in such a way, then it could be considered under GATT Article XX(a). Such a solution would serve to prevent issues that allow objective, data-driven consideration from being considered under the more expansive and subjective parameters of Article XX(a).

B. Regulatory Distinction and the TBT Agreement

If anything, it is more difficult to evaluate a morals-based measure under the TBT Agreement than it is under the GATT. The requirement for a legitimate regulatory distinction, rather than placing an additional burden on the proponent of a measure, can instead add leeway by allowing the proponent to state alternative justification. This leeway is amplified by the fact that a regulatory distinction can be justified even by a third objective, not related to either the legitimate objective of the overall measure or to the legitimate regulatory distinction made within the measure.

1. Burden of Proof

From the very beginning, the proponent of a TBT measure has the advantage. As discussed above, only a *prima facie* case of WTO non-compliance is required to bring a complaint to the DSB; the burden of proof lies with a respondent who asserts the defense of a GATT Art. XX exception. Under the TBT, a measure is assumed to be WTO-compliant, so the burden of proof lies with the complainant to show that it is not. This advantage is enhanced by the proponent's ability to justify the regulatory distinctions, both those that contribute to the legitimate objective of the measures, and those that work against it.

The *EC-Seal Products* panel analogized the allowance of legitimate regulatory distinctions to the general exceptions in GATT Art. XX:

> The additional element (i.e. legitimate regulatory distinction) that the Appellate Body considered as necessary to complete an analysis under

[91] Nielsen, The WTO, Animals and PPMs, 236.
[92] Id.

> Article 2.1 of the TBT Agreement reflects the Appellate Body's earlier observation regarding the absence in the TBT Agreement of a general exceptions clause equivalent to Article XX in the GATT 1994.[93]

But this is inaccurate. Article 2.1 is the TBT Agreement's statement of most-favored nation and national treatment for like products, similar to Art I and Art III of the GATT. Article 2.2 provides a mechanism for determining whether technical regulations which are already presumed to be WTO-compliant have claimed a legitimate objective, just as GATT Art. XX provides the list of subject areas that allow a suspect measure to claim WTO-compliance. As discussed above, the *EC-Seal Products* panel had already recognized a legitimate objective that applied to the measure under TBT Article 2.2, an objective whose legitimacy was determined by resort to GATT Art. XX. Indeed, Article 2.2 has other parallels to GATT Art. XX. It also borrowed language used in analyzing GATT Art. XX's necessity test, requiring that a technical regulation be "no more trade-restrictive than necessary"[94] to achieve its objective. However, the panel has no need for this justification. Regulatory distinctions are part and parcel of a TBT; if there are no exceptions or distinctions, then the measure is a straightforward ban. As mentioned above, a ban is a purely internal measure that cannot be considered as violating WTO principles.

It also makes sense that TBTs would need something beyond a legitimate overall objective to prevent discriminatory practice. Often, the reason for including an exception to a TBT is that there is an area where it is difficult or inappropriate to implement the measure. Making the exception actually detracts from the overall goal of the measure, but in the end, is necessary for it to work. The exceptions to the ban on asbestos products in *EC-Asbestos* allowed the sale of asbestos products already imported and paid for, and gave owners of asbestos-containing products time to remediate or dispose of the products.[95] Although these exceptions did not promote the measure's overall objective of protecting human life and health, they helped to mitigate the injury that the implementation of the ban might have caused to business. Legitimate regulatory distinctions must be allowed for a TBT measure to be effective, and, as in *EC-Asbestos,* they will often be justified based on a concern unrelated to the overall goal of the measure. But TBT Art. 2.1 requires that even these distinctions be subject to the foundational principles, and TBT Art. 2.2 requires that their application and effect be non-discriminatory.

The mere existence of regulatory distinctions, justified though they may be, gives a measure's proponent a chance to state additional goals that are outside of the scope of the legitimate objectives allowed by the TBT Agreement. Recall that the proponent can articulate a goal either related to the overall objective or unrelated to the overall objective but justified by some other legitimate concern. Thus, the validity of a TBT hinges not only on the legitimacy of the measure's overall objective, but also on the panel's evaluation of the reasons behind its exceptions. This may initially appear to be a high hurdle, but in the right circumstances, it could allow nations a back door to impose standards outside the universe of the measure's state objective upon their trading partners. Thus, not only is there a shifted burden of proof for the proponent of a TBT in relation to the GATT, but there is a wider universe of legitimate objectives for the measure and,

[93] *EC-Seal Products,* ¶7.585.
[94] TBT Agreement, Art. 2.2.
[95] *EC-Asbestos,* ¶63-4.

beyond that, an even wider universe of justifications for the exceptions to the measure. An analysis of the EU seal ban's IC exception illustrates how this might work to the detriment of the trade regime.

2. The Example of the IC Exception

An analysis of the "IC Exception" for Inuit hunts illustrates many of the potential problems raised by consideration of public morals problems under the TBT Agreement. Even though the *EC-Seal Products* panel disallowed the EU's stated regulatory distinction – commercial vs non-commercial hunts, a separate justification of support for subsistence hunting by indigenous peoples was allowed in the case of the IC Exception. International opinion generally supports indigenous rights; however, its application in this area may step outside the bounds agreed upon by nations and indigenous peoples themselves.

a. Acceptable regulatory distinctions

As explained above, the EU's seal products ban was found to be a technical barrier to trade, so that the regulatory distinctions must be examined for compliance with the rule. The regulatory distinction articulated by the EU was that of commercial versus non-commercial hunts.[96] Objections to the commercial hunts were based on the premise that inhumane killing could not be avoided because the hunting conditions and time limitations in commercial hunts caused participants to be less careful and use less precise killing methods.[97] Thus, the question to be answered was whether the IC hunts, by their non-commercial nature, furthered that same goal of reducing inhumane killing.[98] The distinction between commercial and IC hunts is not, however, absolute. Some IC seal hunts may contain commercial components and all IC hunts employ at least some of the same killing methods as the commercial hunts.

The Greenland seal hunt stands alone in the world as an Inuit seal hunt that contains a large commercial component.[99] Although all of the seals in the Greenland hunt are caught by Inuit hunters, over 50% of the catch is sold commercially. The remaining seals products are retained by the hunters or sold locally for subsistence purposes.[100] Greenland's conscious decision in the 1990s to develop a vertically integrated seal product processing industry has resulted in an ability to extend the traditional industry beyond its subsistence origins for the commercial benefit of the nation.[101] The strong commercial aspect of the industry is not debated. However, the DSB panel accepted that "the commercial aspect of IC hunts is [thus] not the same in its extent as that associated with commercial hunts."[102] This because the hunters participate in commerce due to the need to adjust to modern society, but the hunts can still be seen as based in a subsistence tradition. Thus, the panel found that the cultural origin of the hunt and its continued participation in a subsistence tradition are enough to justify its inclusion as an IC hunt.

[96] *EC-Seal Products,* ¶7.251.
[97] Id. at ¶7.260-7.271.
[98] Id. at ¶7.256.
[99] The Greenland Home Rule Department of Fisheries, Hunting and Agriculture, Management and Utilization of Seals in Greenland,11, 25 (Exhibit JE-26), (Rev. Jan. 2009).
[100] *EC-Seal Products,* 7.285.
[101] Graham Poole, *Fisheries Policy and Economic Development in Greenland in the 1980s,* 26 Polar Record (157) 109-18 (1990).
[102] *EC-Seal Products* ¶7.288.

Having established that a hunt may still qualify for the IC exception even where it includes a commercial element, the panel continued by examining the non-commercial, IC element in relation to the EU's goal. As noted above, the characteristic of the commercial hunt which relates to the EU's regulatory goal is its connection to inhumane killing. Even discounting the commercial aspect of some Inuit hunts, however, the non-commercial component of the IC hunts suffer from much the same problems. The panel noted:

> IC hunts are no different [from commercial hunts]; they are conducted in a similar physical environment often using similar hunting methods…Thus, similar challenges to effecting humane killing of seals exist in IC hunts. Further, evidence shows that hunting methods used by Inuit or indigenous communities such as "trapping and netting" are not consistent with humane killing methods.[103]

The panel acknowledged that the IC exception has no rational connection to the EU's stated goal in enacting the seal products measure; however, it declined to invalidate the IC exception because it is justified on other grounds, saying that

> the cause or rationale for the exception granted under the EU Seal Regime to products derived from IC hunts is justifiable despite the rational disconnection to protecting seal welfare, because it is founded on the unique interests of Inuit and indigenous communities, which are and have been recognized broadly.[104]

In support of this position, the panel noted that the EU has long voiced this concern in relation to its seal products rules, and the importance of indigenous rights is supported by international agreements, such as the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) as well as the International Labor Organization's Convention Concerning Indigenous and Tribal Peoples in Independent Countries (ILO Convention). UNDRIP is the more widely accepted agreement, as it was adopted by the United Nations General Assembly on Sept. 13, 2007,[105] with a strong majority of 144 members.

b. WTO and international agreements

The relationship between the WTO and other international agreements has never been entirely clear. The TBT Agreement requires that members use "relevant international standards" if they exist, "as a basis for [their] technical regulations" unless they would be "an ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued."[106] However, establishment of an appropriate standard is not easy, as panels have been inconsistent in their requirements for international bodies that promulgate such standards. In *US-Tuna II*[107] the panel opined that the standards of the Agreement on the International Dolphin Conservation Program (AIDCP) could not be used by the US as the basis for its regulation because the agreement was not open to all WTO members. This

[103] *EC-Seal Products* ¶7.273.
[104] Id. at ¶7.298.
[105] United Nations Declaration on the Rights of Indigenous Peoples, G.A. Res. 60/295, U.N. Doc. A/RES/60/295 (Sept. 13, 2007) [hereinafter UNDRIP].
[106] TBT Agreement Article 2.4.
[107] Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products,* WT/DS231/AB/R (16 May 2012). [hereinafter *US-Tuna II*].

despite the opinion of the *EC-Sardines* panel that a standard need not be adopted by a recognized body in order to qualify as an international standard.[108]

The WTO's relationship with the international bodies that promulgate standards is similarly uncertain. In *Argentina – Textiles and Apparel*, the panel refused to consider evidence of Argentina's obligations to the International Monetary Fund (IMF), saying that there was no justification to conclude that Argentina's IMF commitments could supersede its WTO obligations.[109] But in other situations, panels have suggested that participation in an international agreement could help a member fulfill its WTO obligations. The panel in *US-Shrimp* suggested that the U.S. could avoid a finding that its measure constituted arbitrary and unjustifiable discrimination by engaging in a serious attempt to negotiate an international agreement regarding the fishing standards it wished to put into place[110] This led to the conclusion amongst many scholars and environmentalists that a multilateral environmental agreement, previously thought incompatible with WTO rules, would allow a member to protect migratory species that occur within its territorial limits.[111] Over time, this belief became a reality, so that, now, the WTO maintains a matrix detailing measures included in 20 multilateral environmental agreements that include provisions to control trade in order to benefit the environment.[112]

If an environmental agreement could be used in such a way, is it possible that a moral agreement could have a similar use? UNDRIP provisions do not easily fit into the definition of relevant international standards under the TBT Agreement, because a standard must provide "rules, guidelines or characteristics for products or related processes and production methods."[113] However, a broad interpretation might accept UNDRIP and even the ILO Convention as international standards outlining requirements for the treatment of indigenous peoples who participate in the processes and production methods that define a TBT. At a minimum, the rights of indigenous peoples include "maintenance and protection of their cultural sites, compliance with international and domestic labor laws, maintenance of their means of subsistence and free engagement in traditional economic activities, and the conservation of their traditional medicines and environment.[114] But such requirements lack technical specificity, making application difficult. Judgments as to which indigenous rights are implicated and the definition and scope of such rights would be complicated.

c. UNDRIP as a multilateral agreement

Rather than considering UNDRIP an international standard, it could instead be interpreted as a sort of "MMA" or multilateral moral agreement that applies to members' WTO obligations. As long as its provisions do not contradict or attempt to supersede WTO obligations and rules, such an agreement could allow member nations to accomplish common goals. However, even this interpretation has several problems.

[108] WTO Dispute Settlement: One-page case summaries, 1997-2012, p.92.
[109] Panel Report, *Argentina – Measures Affecting Footwear, Textiles, Apparel and Other Items,* WT/DS56/R (Nov. 25, 1997)
[110] *US-Shrimp* ¶73.
[111] Bradley Condon. *Multilateral Environmental Agreements and the WTO: Is the Sky Really Falling?* 9 Tulsa J. Comp. & Int'l L. 533, 552. (2002).
[112] See the matrix at http://www.wto.org/english/tratop_e/envir_e/envir_matrix_e.htm.
[113] TBT Agreement Article 1.2.
[114] George K. Foster, *Foreign Investment and Indigenous Peoples: Options for Promoting Equilibrium Between Economic Development and Indigenous Rights*, 33 Mich. J. Int'l L. 627, 687 (2012).

First, the terms of the UNDRIP are entirely aspirational. The preamble ends with the proclamation that the signatories "*Solemnly proclaim[s]* the following United Nations Declaration on the Rights of Indigenous Peoples as a standard of achievement to be pursued in a spirit of partnership and mutual respect."[115] To this author's knowledge, the WTO has never before acknowledged members' obligations under an aspirational instrument, but rather only under standards recognized by treaty or as customary international law (CIL).

As an agreement amongst sovereign nations, UNDRIP might qualify as a treaty[116], but the question arises whether any state has consented to be bound, as required by the Vienna Convention on the Law of Treaties.[117] Aspirational statements, even those adopted by the U.N. General Assembly, can hardly be considered binding, because a state has committed only to attempting to move toward the principles articulated in the instrument. This interpretation is reinforced by the statements of intent made by States when voting on the adoption of the Declaration.[118] For example, the representative of the government of Guyana stated that UNDRIP is "political in character as opposed to being a legally binding document."[119]

Some commentators have attempted to get around the aspirational character of the instrument by interpreting it as an elaboration "upon fundamental rights in the specific cultural, historical, social and economic circumstances of indigenous peoples."[120] However, such soft law arguments have been shown to be weak[121] and the WTO's commitment to state sovereignty quite strong.

A second difficulty is that the lack of specificity in the instrument also serves to make the agreement difficult, if not impossible, to enforce. Not only does UNDRIP lack specific pledges by the parties, but it is entirely lacking in penalties for parties who do not move toward its aspirational standards. Broad, moralistic pledges are notoriously difficult to enforce in international law. The Kellogg-Briand Pact is a well-known example of treaty with a broad, moral pledge by its parties to renounce war as an instrument of national policy and a lack of penalty for non-compliance.[122] The contrary result of the Pact was that nations continued to use force against each other, but refrained from declaring war. Indeed, the last formal declaration of war in the United States took place during World War II.[123]

[115] United Nationals Human Rights Council. Resolution 2006/2. Preamble: United Nations Declaration on the Rights of Indigenous Peoples.
[116] The Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331, (1969) Article 2.1(a) defines a treaty as "an international agreement concluded between States in written form and governed by international law…"
[117] See, e.g. Vienna Convention, Article 7.1 requiring that a nation send a representative with full powers for the purpose of expressing the State's intention to be bound by the treaty.
[118] Stephen Allen, *The UN Declaration on the Rights of Indigenous Peoples and the Limits of the International Legal Project*, in Reflection on the U.N. Declaration on the Rights of Indigenous Peoples 227 (Stephen Allen and Alexandra Xanthaki, eds. 2012).
[119] Ibid at 229.
[120] Ibid at 231.
[121] See, e.g. J. d'Aspremont, *Softness in International Law: A Self-Serving Quest for New Legal Materials*, 19 Eur. J.Int'l Law 1075 (2008).
[122] Treaty Between the United States and Other Powers Providing for the Renunciation of War as an Instrument of National Policy, 94 L.N.T.S. 57 (1928).
[123] Jennifer K. Elsea and Matthew C. Weed. "Declarations of War and Authorizations for the Use of Military Force: Historical Background and Legal Implications." April 18, 2014. RL31133, p.6. Congressional Research Service. Available at http://fpc.state.gov/c60720.htm (June 1, 2014).

A third stumbling block is that Canada is not a signatory to the UNDRIP. Although only four nations voted against passage of UNDRIP, they are influential nations in the areas of trade, law and international politics: Canada, the United States, Australia, and New Zealand.[124] Not surprisingly, these are also nations with large populations of indigenous minority citizens. The express rejection of UNDRIP by major nations likely forecloses the possibility that its provisions will evolve into CIL in the foreseeable future.[125]

Proponents might hope that, just as the Kellogg-Briand Pact became one of the bases for the prosecution of modern war crimes,[126] UNDRIP could ripen into a basis for international acceptance of a set of indigenous rights. The signatories to the Declaration appeared to agree that it was not a legally binding document, but the nations that declined to sign the instrument still took pains to foreclose the possibility entirely. Australia explicitly noted that

> …the text…was not legally binding or reflective of international law. As the Declaration did not describe current State practice or actions considered themselves obligated to take as a matter of law, it could not be cited as evidence of the evolution of customary international law.[127]

Such clear statements of disagreement and express rejection of an instrument would certainly exempt a nation from the UNDRIP provisions under the persistent objector doctrine. The EU would be hard pressed to argue that Canada, as a persistent objector, is subject to UNDRIP.

Finally, the purpose of UNDRIP and the indigenous rights movement in general do not fit easily into this context. Although UNDRIP contains no definition of indigenous peoples, the U.N. Economic and Social Council advanced the following:

> Five distinct criteria have been advanced by the Working Group to classify peoples as indigenous peoples: (1) traditional lands, (2) historical continuity, (3) distinct cultural characteristics, (4) non-dominance, and finally (5) self-identification and group consciousness.[128]

Instruments intended to benefit indigenous peoples have long been couched in terms of allowing self-determination in order to protect the human rights of indigenous peoples.[129] Concerns are often for indigenous peoples' ability to retain ownership of ancestral property, participate in decisions regarding their land and culture, and improve their own economic and social conditions.[130] These are all important goals, but the indigenous peoples affected by the EU regulation span the continuum from disadvantaged populations

[124] In addition, 11 states abstained from the Agreement. See the UN Office of the High Commissioner for Human Rights web site at http://www.ohchr.org/en/Issues/IPeoples/Pages/Declaration.aspx.
[125] For a discussion of how rules ripen into CIL, see Cassese, et al, International Criminal Law, 7-14.
[126] France et al v Göring et al., 22 IMT 411 443-46, 38 (Int'l Mil. Trib. 1946).
[127] Stephen Allen, *The UN Declaration on the Rights of Indigenous Peoples and the Limits of the International Legal Project*, 228.
[128] **U.N**. Econ. and Soc. Council, Comm'n on H.R. Sub-Comm. on Prevention of Discrimination and Protection of Minorities, 11, **U.N.** Doc E/CN.4/Sub.2/AC.4/1995/3 (1995).
[129] See, e.g. Stefaan Smis, Dorothée Cambou, Genny Ngende, *The Question of Land Grab in Africa and the Indigenous Peoples' Right to Traditional Lands, Territories and Resources*, 35 Loy. L.A. Int'l & Comp. L. Rev. 493, 513 (2013). "Self-determination, instead of being seen exclusively as a means to gain sovereignty or an attribute of it, must rather be considered as an aspect of a human right with all its underpinning values and connotations."
[130] See UNDRIP Art. 20, 21, 29.

to one that is fully engaged in modern commerce. Further, the EU regulation gives the indigenous people of Greenland an advantage over those in other countries. Very little consideration has been given to appropriate treatment for indigenous peoples who fully participate in modern commerce.[131] In addition, it seems unlikely that the authors of UNDRIP ever contemplated its use to create an advantage for one indigenous people over another. These issues, highlighted by the *EC-Seal Products* dispute, have only recently begun to surface in the discussion of indigenous rights.

By the time the *US-Shrimp* appeal reached the Appellate Body, the U.S. measures which the panel had found discriminatory had been rehabilitated, partly by U.S. efforts to negotiate an international agreement. The Appellate Body did not require an actual international agreement, but only good faith efforts to create one. Nevertheless, U.S. trading partners who wanted to sell shrimp in the U.S. market were essentially bound by to comply with its requirements. By allowing the use of the UNDRIP as justification for the IC Exception, the panel has followed a similar path. Essentially, in the trade context, Canada is bound by an Agreement to which it has expressly objected.

IV. Conclusion and Recommendation

In the end, the *EC-Seal Products* panel accepted as the overall justification for the ban concern regarding EU citizens' moral repugnance at participating in and being exposed to economic activity that supported the inhumane killing of seals,[132] but determined that the design of the rule had a much greater negative impact on Canada than on the EU. As previously discussed, both the GATT Art. XX *chapeau* and TBT Agreement Art. 2.1 prohibit the discriminatory design or application of a measure. The preamble to the TBT Agreement sets forth a general statement of the concept:

> …no country should be prevented from taking measures…subject to the requirement that they are not applied in a manner which would constitute an arbitrary or unjustifiable discrimination between countries where the same conditions prevail…and are otherwise in accordance with this Agreement.[133]

As all trade measures discriminate in some way for or against a particular product or product characteristic, the WTO Agreements do not prohibit discrimination per se, but only discrimination that puts one member country at a disadvantage in relation to another without justification. If the EU can cure the unequal application and effects of the measure, then like the measure in *US-Shrimp*, it is likely to be found WTO-compliant.

The WTO is hardly the institution to answer questions of animal welfare and indigenous rights. Its mission is to promote free trade and to uphold the rights of sovereigns, rather than interest groups of any type. But the WTO's responsibility to uphold Art. XX(a)'s morals exception puts DSB panels in a precarious position. Under the GATT, the difficulty is simply evaluating whether a member's statement of its own morality is supported by its actual practice. But because of the peculiar character of TBTs,

[131] Stefaan Smis, et al., *The Question of Land Grab in Africa and the Indigenous Peoples' Right to Traditional Lands, Territories and Resources*, 35 Loy. L.A. Int'l & Comp. L. Rev. 493, 513 (2011) citing Endorois Welfare Council v. Kenya, "it is relevant to note that for the Commission, even if some of the community members have joined the mainstream, the community does not lose its indigenous nature."
[132] *EC-Seal Products,* 7.274.
[133] TBT Agreement preamble, ¶ 6.

public morals are even more difficult to evaluate in the context of the TBT Agreement. Proponents have an advantage in the presumption of WTO-compliance that is accorded to TBTs. In addition, they have the ability to propose justifications for regulatory distinctions that are not related to a measure's overall objective. This greater leeway makes the TBT Agreement even less appropriate for evaluation of moral measures than the GATT.

A possible solution is to use a slightly different procedure in dealing with public morals measures. The TBT Agreement was designed "to ensure that technical regulations and standards, including packaging, marking and labelling requirements and procedures for assessment of conformity with technical regulations and standards do not create unnecessary obstacles to international trade."[134] Such a description seems to contemplate science-based regulations, size and content requirements, and other standards that can be defined with some precision. In choosing an Agreement under which to consider WTO complaints, we might expand Prof. Nielsen's approach to determining which exception to choose under GATT Art. XX. Measures which have a concrete or quantitative basis would be eligible for consideration under the TBT Agreement. Those which cannot be concretized and which depend upon a principle defined solely by its proponent would instead be considered under the GATT.

This proposal would require that in choosing the appropriate Agreement under which to evaluate a measure, panels consider first the content of the measure, rather than relying solely on its structure. There is nothing in the GATT which requires a measure to take a certain form, so that a measure that fits the TBT requirements could just as easily be assessed under the GATT. Indeed, the *EC-Seal Products* measure was considered under both. The advantage of considering the measure only under the GATT is that the initial burden is on the proponent of the rule. In addition, there is no previous GATT practice on whether a measure would be considered as a whole, as in the TBT Agreement, or as individual parts. In fact, a measure with both concrete and non-concrete elements might be considered as separate rules under separate Agreements, if appropriate. Finally, the rules of the game would be clear: terms and interpretations would not be imported from the GATT – or anywhere else – into another covered Agreement with a different structure.

In the current climate, nations should be extremely cautious in using the public morals exception to justify a trade measure. Public morals can be very individual and no nation wishes to have the morals of others imposed upon it.[135] Consideration of public morals measures under the TBT Agreement leaves open too many avenues for extraterritorial imposition of national values. *EC-Seal Products* gives us a glimpse of the slippery slope that may await if nations begin to justify their non-concrete trade measures on a moral basis.

[134] TBT Agreement preamble.
[135] Consider the host of debated questions in various domestic legal systems – At what age should juveniles be tried as adults? Is the death penalty defensible? What is the definition of rape?

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