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MEMORANDUM

From: Gary Jay Kushner
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RE: AMS Releases Proposed Revisions to Country of Origin Labeling Rule

The U.S. Department of Agriculture's (USDA's) Agricultural Marketing Service (AMS) recently published in the *Federal Register* a proposed rule revising the country of origin labeling (COOL) regulations. 1/ The proposed rule would require that muscle cuts of beef, lamb, chicken, goat, and pork be labeled to declare the country or countries in which the animal was born, raised, and slaughtered and would prohibit comingling these products from different countries. The proposed rule would also clarify that any retailer subject to licensing under the Perishable Agricultural Commodities Act (PACA) would be subject to COOL.

The proposed rule results from a World Trade Organization (WTO) decision declaring the existing COOL program for certain whole muscle cuts in violation of international trade agreements and giving the U.S. until May 23, 2013, to revise its regulations. The WTO ruled that COOL as applied to beef and pork muscle cuts violated WTO rules because the labeling scheme discriminated against imported livestock.

A copy of the proposal is attached. AMS will accept comments until April 11, 2013.

The Proposed Revised COOL Scheme

The proposed rule would require that muscle cut covered commodities (beef, lamb, chicken, goat, and pork) be labeled to declare the country or countries in which "all of the production steps" took place. Current COOL regulations identify three production steps for muscle cuts: the locations where the animal was born, raised, and slaughtered. The proposed rule identifies several different country of origin scenarios:

- Animals currently eligible to be labeled "Product of the U.S." would be labeled under the proposed rule "Born, Raised, and Slaughtered in the United States."
- Animals born, raised, and slaughtered in different countries would need labels declaring the country for each stage of the process (e.g., "Born and Raised in Country X, Slaughtered in the United States").
- For animals raised in both a foreign country and the U.S., the label usually would be able to omit the foreign country from the raising step. For example, a product from an animal born in

1/ Proposed Rule, Mandatory Country of Origin Labeling of Beef, Pork, Lamb, Chicken, Goat Meat, Wild and Farm-Raised Fish and Shellfish, Perishable Agricultural Commodities, Peanuts, Pecans, Ginseng, and Macadamia Nuts, 78 Fed. Reg. 15645 (March 12, 2013).

Country X, raised in Country X for a period of time, raised in the U.S. for a period of time, and slaughtered in the U.S. could be labeled "Born in Country X, Raised and Slaughtered in the United States."

- The proposed rule provides two exceptions that would require the foreign country be declared for the raising step:
    - When the animal is raised in another country and the animal is imported into the U.S. for immediate slaughter, the foreign country must be declared as the place of raising.
    - When omitting the foreign country would make it appear as though the product was entirely of U.S. origin, the foreign country must be declared (e.g., if the animal was born the U.S., raised in Country X and in the U.S., and slaughtered in the U.S., Country X must be declared).
- Imported muscle cut covered commodities from an animal slaughtered in another country would retain their origin as declared to U.S. Customs and Border Protection (e.g., "Product of Country X").

The proposed rule would prohibit the commingling of muscle cut covered commodities with different countries of origin. For example, the current COOL regulation permits in certain situations mixed commodities to be declared as "Product of the United States, Country X, and Country Y." Such a practice would not be authorized under the proposed rule. AMS believes this change would benefit consumers by providing more specific information on labels.

Finally, the proposed rule would revise the definition of "retailer" to mean "any person subject to be licensed as a retailer under [PACA]." This revision would include as a "retailer" any party subject to licensing under PACA, even if that party were not actually licensed. This change in definition would apply to all covered commodities and to fish and shellfish.

AMS projects the rule would cost the economy between $16,989,000 and $47,326,500 to implement, with "comparatively small" incremental benefits compared to the 2009 final rule implementing COOL. In the proposal, AMS explains that it "expects that these changes will improve the overall operation of the program and also bring the current mandatory COOL requirements into compliance with U.S. international trade obligations."

Potential Challenges Before the WTO and Related International Trade Implications

The proposed rule results from a successful challenge by Mexico and Canada before the WTO, in which the WTO's Appellate Body determined the new U.S. COOL program for whole muscle cuts of beef and hogs from the 2008 Farm Bill violated WTO rules. The U.S. has until May 23, 2013, to revise its program to comply with the WTO decision. If the proposed rule is finalized, Canada and Mexico may challenge the revised rule again before the WTO using the compliance procedures in Article 21.5 of the WTO's Dispute Settlement Understanding (DSU). Under this expedited process, the WTO would issue a decision within 90 days of a challenge, although such reports can sometimes take much longer. If the WTO finds the U.S. regulation still violates the WTO's Technical Barriers to Trade Agreement ("TBT" or "Standards Agreement"), Canada and Mexico would be permitted to take retaliatory action against U.S. trade without regard to product category after obtaining authorization under Article 22 of the DSU.

Our preliminary analysis of the new rule suggests USDA's fix is very likely to be challenged in a WTO compliance proceeding. In the earlier proceeding, the Appellate Body found that because the COOL labels often conveyed inaccurate or incomplete information to U.S. consumers, the measure violated Article 2.1 of TBT. The Appellate Body found that the COOL measure had a detrimental impact on Mexican and Canadian livestock, and was not based on a "legitimate regulatory

distinction" because the labels often conveyed inaccurate or incomplete information as to the origin of pork and beef products.
USDA has tried to address the WTO's finding by increasing the amount of information required on the labels and limiting the scope for commingling. In effect, USDA has doubled down by making the COOL regulations even more burdensome and trade-disruptive. In addition, it did not address certain U.S. exceptions to COOL, for example, for restaurants, which is likely to be a future point of contention in any Article 21.5 proceeding.

Although USDA's fix may strengthen somewhat the U.S. case under Article 2.1, it also means that the new regulation may be even more vulnerable under TBT Article 2.2 which bars regulations that create "unnecessary obstacles to trade" and are "more trade restrictive than necessary to fulfill a legitimate objective." In the earlier WTO proceeding, the Appellate Body noted with respect to Article 2.2 that the U.S. COOL measure "makes some contribution to the objective of providing consumers with information on origin; that it has a considerable degree of trade restrictiveness; and that the consequences that may arise from non-fulfillment of the objective may not be particularly grave." (emphasis added). However, the Appellate Body found that the Panel failed to make a necessary examination of potential alternative approaches to providing country-of-origin information, and that it lacked the necessary factual findings from the Panel to complete its analysis of this issue. Accordingly, the Appellate Body did not make a finding under Article 2.2. Nevertheless, the Appellate Body's skepticism as to COOL's trade-restrictiveness suggests that USDA may have an uphill battle to sustain the new rule in the WTO.

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AMS is accepting comments until April 11, 2013. Affected parties should consider quickly how they would be affected by this proposal and the possible trade ramifications and whether they wish to file comments.

We will continue to monitor this and other trade and labeling developments. Please do not hesitate to contact us with any questions.