

***MEXICO – TAX MEASURES ON SOFT DRINKS AND OTHER
BEVERAGES***

(WT/DS308)

**FIRST SUBMISSION OF
THE UNITED STATES OF AMERICA**

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SHORT TITLE	FULL TITLE AND CITATION
<i>Argentina – Hides and Leather</i>	Panel Report, <i>Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather</i> , WT/DS155/R and Corr.1, adopted 16 February 2001
<i>Border Tax Adjustments (GATT)</i>	GATT Working Party Report, <i>Border Tax Adjustments</i> , L/3464, adopted 2 December 1970
<i>Canada – Autos</i>	Panel Report, <i>Canada – Certain Measures Affecting the Automotive Industry</i> , WT/DS139/R, WT/DS142/R, adopted 19 June 2000
<i>Canada – Periodicals</i>	Appellate Body Report, <i>Canada – Certain Measures Concerning Periodicals</i> , WT/DS31/AB/R, adopted 30 July 1997
<i>Chile – Alcoholic Beverages</i>	Panel Report, <i>Chile – Taxes on Alcoholic Beverages</i> , WT/DS87/R, WT/DS110/R, adopted 12 January 2000
<i>Chile – Alcoholic Beverages</i>	Appellate Body Report, <i>Chile – Taxes on Alcoholic Beverages</i> , WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000
<i>EC – Asbestos</i>	Appellate Body Report, <i>European Communities – Measures Affecting Asbestos and Asbestos-Containing Products</i> , WT/DS135/AB/R, adopted 5 April 2001
<i>EC – Bananas III (US)</i>	Panel Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas – Complaint by the United States</i> , WT/DS27/R/USA, adopted 25 September 1997
<i>EC – Bananas III</i>	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997
<i>EEC – Parts and Components (GATT)</i>	GATT Panel Report, <i>EEC – Regulation on Imports of Parts and Components</i> , L/6657, adopted 16 May 1990, BISD 37S/132
<i>India – Autos</i>	Panel Report, <i>India – Measures Affecting the Automotive Sector</i> , WT/DS146/R, WT/DS175/R and Corr.1, adopted 5 April 2002
<i>Indonesia – Autos</i>	Panel Report, <i>Indonesia – Certain Measures Affecting the Automobile Industry</i> , WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1, 2, 3, and 4, adopted 23 July 1998

<i>Italy – Agricultural Machinery (GATT)</i>	GATT Panel Report, <i>Italian Discrimination Against Imported Agricultural Machinery</i> , L/833, adopted 23 October 1958, BISD 7S/60
<i>Japan – Alcoholic Beverages II</i>	Panel Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996
<i>Japan – Alcoholic Beverages II</i>	Appellate Body Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996
<i>Korea – Alcoholic Beverages</i>	Panel Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/R, WT/DS84/R, adopted 17 February 1999
<i>Korea – Alcoholic Beverages</i>	Appellate Body Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999
<i>Korea – Various Measures on Beef</i>	Appellate Body Report, <i>Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef</i> , WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001
<i>Mexico – Corn Syrup</i>	Panel Report, <i>Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States</i> , WT/DS132/R and Corr.1, adopted 24 February 2000
<i>Mexico – Corn Syrup (Article 21.5 – US)</i>	Panel Report, <i>Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS132/RW, adopted 21 November 2001
<i>Mexico – Corn Syrup (Article 21.5 – US)</i>	Appellate Body Report, <i>Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS132/AB/RW, adopted 21 November 2001
<i>US – FSC (Article 21.5 - EC)</i>	Panel Report, <i>United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS108/RW, adopted 29 January 2002
<i>US – FSC (Article 21.5 - EC)</i>	Appellate Body Report, <i>United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS108/AB/RW, adopted 29 January 2002

*US – Malt Beverages
(GATT)*

GATT Panel Report, *United States – Measures Affecting
Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992,
BISD 39S/206

I. INTRODUCTION

1. As the name of this dispute suggests, it concerns tax measures on soft drinks and other beverages as well as syrups, concentrates, powders, essences and extracts that can be diluted to produce such beverages (hereinafter collectively referred to as “soft drinks and syrups”). At a more fundamental level, however, this dispute concerns sweeteners and, in particular, Mexico’s discriminatory treatment of high-fructose corn syrup (“HFCS”), a corn-based sweetener produced in the United States.

2. Since January 1, 2002, Mexico has imposed discriminatory tax measures on soft drinks and syrups that favor its domestic cane sugar industry, in violation of its obligations under Article III of the *General Agreement on Tariffs and Trade 1994* (“GATT 1994”). These measures have essentially terminated exports of HFCS and damaged exports of HFCS-sweetened soft drinks and syrups from the United States to Mexico.

3. Specifically, in December 2001, the Mexican Congress approved an amendment of the *Ley del Impuesto Especial sobre Producción y Servicios* (“IEPS”, or Law on the Special Tax on Production and Services) adding a 20 percent tax on soft drinks and syrups that use HFCS or any sweetener other than cane sugar (“HFCS soft drink tax”), as well as a 20 percent tax on the representation, brokerage, agency, consignment and distribution of such products (“distribution tax”). In Mexico, cane sugar is almost entirely a domestic product, with very small volumes of imports entering the Mexican market. The structure of this tax makes clear that it is targeted to protect the Mexican cane sugar industry, and to stop the displacement of domestic cane sugar by imported HFCS and soft drinks and syrups sweetened with HFCS. HFCS was developed with soft drinks as its major market, and has already displaced sugar in soft drink and syrup production in Canada and the United States; the Mexican sugar industry and its representatives in Congress wished to prevent a similar displacement in Mexico. Mexico’s discriminatory tax has succeeded in terminating the use of HFCS in soft drinks and syrups in Mexico and terminating almost all import of HFCS. It has also significantly disadvantaged imports of HFCS-sweetened soft drinks and syrups.

4. The HFCS soft drink and distribution tax continues to this day, and is embodied in the following measures, which are the measures at issue in this dispute:

- (1) The IEPS, as amended effective January 1, 2002,¹ and its subsequent amendments published on December 30, 2002,² and December 31, 2003,³ and
- (2) Related or implementing measures, contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* published on May 15, 1990,⁴ the *Resolución Miscelanea Fiscal Para 2003* (Title 6) published on March 31, 2003,⁵ and the *Resolución Miscelanea Fiscal Para 2004* (Title 6) published on April 30, 2004,⁶ which identify, *inter alia*, details on the scope, calculation, payment, and bookkeeping and recording requirements of the IEPS.

5. These measures are inconsistent with Mexico's obligations under Articles III:2 and III:4 of the GATT 1994. The United States respectfully requests this Panel to recommend that Mexico bring its measures into conformity with its obligations under GATT 1994.

II. PROCEDURAL BACKGROUND

6. On March 16, 2004, the United States requested consultations with the Government of Mexico pursuant to Articles 1 and 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Article XXII:1 of GATT 1994, regarding Mexico's tax measures on soft drinks and other beverages that use any sweetener other than cane sugar. This request was circulated to WTO Members on March 18, 2004 (WT/DS308/1). Pursuant to this

¹ *Ley del Impuesto Especial Sobre Producción y Servicios, Diario Oficial de la Federación* (Mexican official gazette, referred to below as "Diario Oficial"), Jan. 1, 2002, Segunda Sección at 32-45, text at http://www.segob.gob.mx/dof/2002/enero/dof_01-01-2002.pdf, Exh. US-1. (Where the United States is submitted both Spanish and English versions of the same exhibit, these are labelled 'A' and 'B' respectively. Thus, the Spanish version of this exhibit is submitted as Exhibit US-1A; the English version is submitted as Exhibit US-1B.)

² *Se Reforman Y Adicionan Diversas Disposiciones de la Ley del Impuesto Especial sobre Producción y Servicios*, Diario Oficial, Dec. 30, 2002, Cuarta Sección at 324-330, text at http://www.segob.gob.mx/dof/2002/diciembre/dof_30-12-2002.pdf, Exh. US-2.

³ *Se Reforman, Adicionan y Derogan Diversas Disposiciones de la Ley Del Impuesto Al Valor Agregado, de la Ley Del Impuesto Sobre La Renta, de la Ley Del Impuesto Especial Sobre Producción y Servicios, de la Ley Del Impuesto Sobre Tenencia o Uso De Vehículos, de la Ley Federal Del Impuesto Sobre Automóviles Nuevos y de la Ley Federal De Derechos* (Dec. 31, 2003), Exh. US-3. The full text of the IEPS as amended on Dec. 31, 2003 is available from Chamber of Deputies, Mexican Congress, at <http://www.diputados.gob.mx/leyinfo/index.htm>; Exh. US-4. All citations to the IEPS, unless otherwise specified, are to the IEPS as effective January 1, 2004 and contained in Exh. US-4.

⁴ Text available from website of Mexican government Servicio de Administración Tributario (SAT), at ftp://ftp2.sat.gob.mx/asistencia_servicio_ftp/publicaciones/legislacion04/RLIEPS.pdf, Exh. US-5.

⁵ Text available from SAT at http://www.sat.gob.mx/sitio_internet/informacion_fiscal/legislacion/52_3496.html, Exh. US-6.

⁶ Text available from SAT at http://www.sat.gob.mx/sitio_internet/informacion_fiscal/legislacion/52_3971.html; Exh. US-7.

request, the United States and Mexico held consultations on May 13, 2004. Canada participated as a third party to the consultations. These consultations failed to reach a mutually satisfactory resolution to this dispute.

7. On June 10, 2004, the United States requested the establishment of a panel pursuant to Article 6 of the DSU (WT/DS308/4). The Dispute Settlement Body (“DSB”) considered this request at its meetings of June 20 and July 7, 2004, and established the Panel on July 7 with standard terms of reference as follows:

To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.⁷

III. FACTUAL BACKGROUND

A. Sweeteners and Soft Drinks and Syrups

8. The products at issue in this dispute are sweeteners, as well as the soft drinks and syrups that utilize them. Although three principal sweeteners – HFCS, sugar, and high-intensity sweeteners – can be used to produce soft drinks and syrups, the present dispute concerns only HFCS and cane sugar and the soft drinks and syrups sweetened with them. Sweeteners with a caloric content (*i.e.*, sugar and HFCS) are often referred to as “nutritive sweeteners.”

1. Sweeteners

(a) HFCS

9. HFCS is a corn-based liquid sweetener made using a sophisticated, multi-stage production process. HFCS derives its name from the fact that it is “high” in fructose in relation to ordinary corn syrup, which contains no fructose.

10. HFCS was developed as a low-cost replacement for sugar in the beverage and food industry. Research in the 1970s led to the discovery of a process that allowed for the efficient

⁷ WT/DS308/5/Rev.1.

commercial production of corn syrups with fructose-glucose⁸ ratios comparable to that of sugar.⁹ This led to the transformation of the sweetener market.

11. HFCS exists as a liquid and is composed of a monosaccharide mixture of varying amounts of glucose and fructose, as well as small amounts of other saccharides. HFCS exists in the following three grades:

HFCS-42	42% fructose, 52% glucose, 6% other saccharides
HFCS-55	55% fructose, 41% glucose, 4% other saccharides
HFCS-90	90% fructose, 7% glucose and 3% other saccharides

12. HFCS-55 is the primary grade of HFCS used in soft drink production.¹⁰ HFCS-42, while used in soft drink and juice production, is also used in the production of bakery products, canned goods, dairy products and other foods. HFCS-90 is typically blended with HFCS-42 to make HFCS-55, but it is also used as a sweetener in juice, candy, bakeries, and food processing. Another fructose product is crystalline fructose (also known as chemically pure fructose), which is a premium product used in dry mix beverages and pharmaceutical products as well as a few liquid soft drinks.

13. HFCS-55 was developed primarily for use in soft drinks and other beverages, and the development of cost-effective technology to commercially produce HFCS-55 led to its rapidly replacing sugar as the principal sweetener in the soft drink industry in the United States and Canada. Before the introduction of HFCS-55, sugar was the only sweetener used in non-dietetic soft drinks. Between 1977 and 1982, U.S. HFCS-55 production grew from 15,000 short tons to over 1.5 million short tons.¹¹ By the late 1980s, U.S. soft drink manufacturers relied almost exclusively on HFCS. The same near-complete replacement of sugar took place shortly thereafter in the Canadian market.¹² HFCS replaced sugar in the U.S. and Canadian soft drink markets because of its several competitive advantages over sugar.¹³

⁸ Glucose is also referred to as dextrose.

⁹ See *The History of High Fructose Corn Syrup*, 1996 Corn Annual, Exh. US-22.

¹⁰ See, e.g., *Beverage Digest Fact Book 2004: Statistical Yearbook of Non-Alcoholic Beverages* 163-64 (9th ed. 2004) (listing the soft drink brands and the grade of HFCS used).

¹¹ See U.S. Corn Sweetener Statistical Compendium (USDA, Economic Research Service (ERS), Tables 18 and 19, U.S. HFCS-55 supply and use, 1977-92, at <http://jan.mannlib.cornell.edu/data-sets/specialty/94002/>.

¹² See *The History of High Fructose Corn Syrup*, 1996 Corn Annual, Exh. US-22.

¹³ See *infra* 100 (discussing cost advantages and soft drink production with HFCS and sugar).

14. A similar transformation of the Mexican sweetener market¹⁴ was actually under way before the Mexican Government intervened to protect the Mexican cane sugar industry. Mexican imports of HFCS from the United States began in the early 1990s¹⁵ and grew rapidly until Mexico imposed antidumping duties on U.S.-produced HFCS.¹⁶ Mexican imports of HFCS from the United States peaked in 1997 at nearly 270 thousand metric tons, declining sharply from June 1997 onward after provisional antidumping duties were imposed.¹⁷ From 1998 through 2000, Mexican imports of HFCS from the United States remained stable although depressed, averaging 234 thousand metric tons per year.¹⁸

15. Almost immediately upon imposition of Mexico's tax on January 1, 2002, however, HFCS imports from the United States virtually ceased. In 2002, Mexican imports of HFCS totaled less than 30 thousand metric tons, falling again to just over 12 thousand metric tons in 2003.¹⁹ Imports of HFCS-55, the grade used most commonly in soft drinks and syrups, dropped from nearly 200 thousand metric tons in 2001 to barely 18 thousand metric tons in 2002, the year the HFCS soft drink and distribution taxes were imposed.²⁰

16. Production of HFCS began in Mexico in December 1995, shortly after the first HFCS imports, when a joint venture of two U.S. corporations opened operations in Guadalajara, Mexico. In November 1996 a second company also initiated production of HFCS, initially as a Mexican-US joint venture and later as a wholly-owned U.S. investment. These two companies are the only Mexican producers of HFCS.²¹ However, HFCS production in Mexico has always been much smaller than cane sugar production.²²

17. Unfortunately, the present dispute is not the first time Mexico has acted to protect its cane sugar industry from competition from other sweeteners. In August 2001, a binational panel under Chapter 19 of NAFTA rejected Mexico's antidumping duties on HFCS from the United States because Mexico had failed to show an imminent threat of material injury. As part of its analysis, this panel agreed with Mexico that HFCS and sugar are like products because "both

¹⁴ See *infra* para. 34 (recounting Mexican bottlers' use of sugar/HFCS blends prior to imposition of Mexico's discriminatory taxes).

¹⁵ See Mexico Secretary of Economy, HFCS Imports from the U.S., Exh. US-10.

¹⁶ The Mexicans imposed preliminary antidumping duties on HFCS-42 and -55 in June 1997, followed by final antidumping duties in January 1998. Mexico later imposed final antidumping duties on HFCS-90 in September 1997.

¹⁷ Mexico Secretary of Economy, HFCS Imports from the U.S., Exh. US-10.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ Production of HFCS in Mexico began in December 1995 when a joint venture of two U.S. corporations, began operations in Guadalajara, Mexico. In November 1996, a second company began production of HFCS in San Juan del Rio, Mexico. This company was initially a U.S.-Mexican joint venture, but has been owned entirely by the US partner since March 2002. These two companies are the only producers of HFCS in Mexico.

²² See *supra* para. 24.

products are finally sweeteners, with similar nutritional properties and similar sweetening power.”²³

18. In February 2000, the WTO concluded that Mexico’s imposition of antidumping duties on HFCS from the United States was inconsistent with Mexico’s obligations under the *Agreement on Implementation of Article VI of the GATT 1994* (“AD Agreement”).²⁴ In response to the DSB’s rulings and recommendations, Mexico issued a revised determination in September 2000 which the United States challenged before a DSU Article 21.5 panel. The 21.5 panel concluded that Mexico’s revised determination was inconsistent with the AD Agreement.²⁵ The Appellate Body affirmed the panel’s conclusion²⁶ and the DSB adopted both reports on November 23, 2001. However, by the time Mexico revoked the antidumping duties on May 2, 2002, Mexico’s tax had been in place for five months.

(b) Sugar

19. By far the dominant sweetener in the Mexican market is cane sugar. In 2003, for example, Mexico produced over 5.2 million metric tons of cane sugar.²⁷ As Mexico does not produce beet sugar, Mexico’s sugar production consists exclusively of cane sugar. The Government of Mexico has always been heavily involved in the cane sugar industry, through supports and price guarantees for cane sugar production. In fact, in August 2001 the Mexican Government expropriated 27 sugar mills, 13 of which it still owned as of April 2004.²⁸ Thus, the Mexican Government itself stands to benefit directly from the protection it accords to cane sugar. The principal representative of the Mexican sugar industry is the *Cámara Nacional de las Industrias Azúcarera y Alcohólera*, commonly known as the Sugar Chamber.

20. In Mexico, essentially all sugar consumed is of domestic origin. Mexico imports only very small quantities of sugar.²⁹ Even in 2003, when Mexico implemented an emergency tariff rate quota for sugar imports due to the sweetener shortage caused by the HFCS soft drink and

²³ *Review of the Final Determination of the Antidumping Investigation on Imports of High Fructose Corn Syrup, Originating from the United States of America*, Final Decision of August 3, 2001, Case: Mex-USA-98-1904-01 (hereinafter “NAFTA Chapter 19 Decision”), Exh. US-14, para 503.

²⁴ See Mexico – Corn Syrup, Panel Report.

²⁵ See Mexico – Corn Syrup (Article 21.5), Panel Report.

²⁶ See Mexico – Corn Syrup (Article 21.5), Appellate Body Report.

²⁷ See Sweetener Imports and Market Share, Exh. US-15; see also USDA FAS GAIN Reports 2000-2004, Exhs. US-11A through 11E.

²⁸ See USDA FAS GAIN Report 2004, at 3, Exh. US-11E; Stephen Haley *et al.*, *Sugar and Sweeteners Outlook 21* (ERS, USDA) (May 27, 2004), Exh. US-21; see also Presentation by *Cámara Nacional de Las Industrias Azúcarera y Alcohólera: Sugar and NAFTA* (Oct. 2003), Exh. US-12 (showing that as of September 2003, the Mexican Government owned 47 percent of Mexican sugar mills were government-owned).

²⁹ See Sweetener Imports and Market Share, Exh. US-42.

distribution tax,³⁰ Mexican world sugar imports totaled only 121 thousand metric tons, or just barely two percent of domestic cane sugar production.³¹ Relative to domestic sweetener consumption in 2003, Mexican world sugar imports comprised less than two percent of the 4.6 million metric tons of sugar consumed in Mexico that year.³² In other words, 98 percent of the cane sugar available in the Mexican market is domestically-produced cane sugar.³³

21. The Mexican soft drink industry consumed approximately 1.6 million tons of sugar or roughly 30 percent of Mexican cane sugar production in 2003.³⁴ Thus, the soft drink industry is a key market for sweeteners in Mexico, a major customer for the Mexican sugar industry, and a key former and potential customer for HFCS importers.

22. On the technical side, cane sugar is a form of sucrose. Although derived from different sources, cane sugar in its refined form is both chemically and functionally identical to beet sugar, which is, likewise, a form of sucrose. Sucrose is a disaccharide composed of 50 percent glucose (also called dextrose) and 50 percent fructose bonded together. When dissolved in a liquid with the proper pH level, sucrose hydrolyzes (or breaks its bond) into the monosaccharides glucose and fructose. The process of hydrolyzing is called inversion. Invert sugar is, thus, sucrose that has undergone the process of breaking down into glucose and fructose. Soft drinks' pH level is such that sucrose will typically hydrolyze or invert, depending on storage and temperature conditions, within three to four weeks of bottling, or the typical delivery time from the production floor to the soft drink customer. Thus, in a soft drink where sugar has inverted, the sweetener is indistinguishable from HFCS.

³⁰ See Decreto por el que se crean, modifican y suprimen diversos aranceles de la Tarifa de la Ley de los Impuestos Generales de Importación y Exportación (Decree creating, modifying and eliminating various duties under the Tariff Schedule of the General Law on Importation and Exportation), Diario Oficial, Sept. 26, 2003 Segunda Sección at 47-54; tariff quota on sugar established at p. 52-54, in force through Dec. 31, 2003; Exh. US-9. The quota was set at the maximum amount of 112,000 MT (or approximately 2 percent of domestic production). *Id.* However, the tariff quota announcement provided expressly that the amount actually allocated would be determined by the availability of refined sugar in the domestic market, its supply requirements, and national consumption needs for refined sugar. In short, this tariff quota was only to be available for imports that did not compete with domestic production. No private organization could apply for quota allocation, as the announcement designated the sole eligible quota applicant as the Fondo de Empresas Expropiadas en el Sector Azúcarero (FEESA), the government entity that holds and manages the sugar mills expropriated in 2001. *Id.*, at 53-54; see *infra* para. 25 (quoting explanation of reason for TRQ).

³¹ See Sweetener Imports and Market Share, Exh. US-42; Sugar Production and Imports, Exh. US-15. In 2003, Mexican sugar imports from the United States totaled less than 4 thousand metric tons, or less than 0.1 percent of domestic cane sugar production. *Id.* See also USDA FAS Reports 2000-2004, Exhs. US-11A through 11E, which puts Mexican world imports of sugar in 2000 and 2001 at zero and at 52 and 63 thousand metric tons in 2002 and 2003 respectively. Use of Mexico Secretary of Economy data is thus a conservative approach to gauging the extent to which the HFCS soft drink and distribution taxes protect Mexico's domestic cane sugar industry.

³² See Sweetener Imports and Market Share, Exh. US-42; USDA ERS Model, Exh. US-8.

³³ See Sweetener Imports and Market Share, Exh. US-42; USDA ERS Model, Exh. US-8.

³⁴ See USDA ERS Model, Exhibit US-8; Sugar Production and Imports, Exh. US-15.

(c) Sweetener Market Share

23. Although sugar has always represented the lion's share of sweetener consumption by the Mexican soft drink industry, prior to imposition of the HFCS soft drink and distribution taxes, HFCS had been rapidly gaining market share in Mexico, peaking at nearly 30 percent of nutritive sweetener consumption by the soft drink industry in 2001.³⁵ This trend abruptly ended in 2002 with imposition of Mexico's discriminatory taxes. By 2003, the Mexican soft drink industry's consumption of HFCS had ceased, as the industry switched rapidly back to 100 percent cane sugar.³⁶ Mexican juice producers continue to consume some amounts of HFCS-42 for use in their fruit and vegetable juices – products that are not subject to the HFCS soft drink and distribution tax.³⁷

24. Mexican production of HFCS had also been on the rise prior to the enactment of Mexico's tax. Again, cane sugar has always constituted the bulk of sweetener production in Mexico, but the share of HFCS production in the Mexican sweeteners market had risen from 0 percent in 1995 to somewhere between five and ten percent in 2001. In 2002, with imposition of Mexico's tax, HFCS's share of Mexican production dropped significantly to under four percent where it remains today. These percentages account for all grades of HFCS produced in Mexico. With respect to HFCS-55, the principal grade used to sweeten soft drinks, its share of the Mexican sweeteners production dropped from somewhere between five and two percent in 2001 to less than one percent in 2002 and 2003.³⁸ Therefore, relative to cane sugar, HFCS production in Mexico has always been modest, dropping to minimal after imposition of Mexico's tax.

25. Prior to imposition of the HFCS soft drink and distribution tax, sweeteners from the United States consisted largely of HFCS. As recalled above, after the tax was imposed imports of HFCS plummeted to less than six percent of their pre-tax volume by 2003³⁹ and a sweetener

³⁵ ERS Model, Exh. US-8.

³⁶ ERS Model, Exh. US-8; USDA FAS GAIN Report 2003, at 4, Exh. US-11E; USDA FAS GAIN Report 2003, at 4, Exh. US-11D; *see also infra* para. 34.

³⁷ *See* USDA FAS GAIN Report 2003, at 4, Exh. US-11E; USDA FAS GAIN Report 2003, at 4, Exh. US-11D.

³⁸ Numbers are ranged to avoid revealing business confidential data concerning HFCS production in Mexico. At the organizational meeting, the United States anticipated that BCI procedures might be necessary and we now plan to make a proposal on BCI procedures as soon as possible. The United States will submit the confidential data on HFCS production when those procedures are in place. The United States further notes that there are also publicly available data on HFCS production in Mexico, albeit based on less comprehensive information, in the USDA FAS Reports. The data indicate the production of HFCS in Mexico as follows: approximately 250 to 300 thousand metric tons in 2000, approximately 250 to 350 thousand metric tons in 2001, approximately 100 thousand metric tons in 2002 and approximately 130 thousand metric tons in 2003. *See* USDA FAS Report 2001 at 4, Exh. US-11B; USDA FAS Report 2002 at 2, Exh. US-11C; USDA FAS Report 2003, at 4, Exh. US-11D; USDA FAS Report 2004 at 3, Exh. US-11E.

³⁹ Mexico Secretary of Economy, HFCS Imports from the U.S., Exh. US-10; Sweetener Imports and Market Share, Exh. US-42. Because US imports comprise almost all imports of HFCS into Mexico, the six percent figure above holds for both US imports and world imports of HFCS into Mexico. *Id.*

shortage developed in Mexico, such that in 2003 the Mexican Government authorized an emergency sugar tariff rate quota for sugar.⁴⁰ Because of the drop-off of HFCS imports and the consequential rise in sugar imports, the share of sweetener imports held by HFCS and sugar flipped in 2003.

	Share of Mexican Sweetener Imports (World) (Percent)						
	1997	1998	1999	2000	2001	2002	2003
Sugar	< 1	< 1	< 1	< 1	< 1	24	91
HFCS	100	100	100	100	100	76	9

Source: Sweetener Imports and Market Share, Exh. US-42.

Despite this rise in sugar imports relative to HFCS, 98 percent of the cane sugar in Mexico remains domestically-produced Mexican cane sugar.⁴¹

26. Data regarding the share of Mexican imports from the United States of HFCS-sweetened soft drinks and syrups relative to sugar-sweetened soft drinks and syrups are hard to come by because neither the Mexican nor U.S. tariff schedules separately break out soft drinks and syrups made with HFCS from soft drinks and syrups made with cane sugar. Thus, it is not possible to specify the relative share of Mexican imports comprised by one or the other. However, since nearly all U.S. produced soft drinks and syrups are sweetened with HFCS, the share of Mexican imports from the United States of soft drinks and syrups sweetened with HFCS must approximate somewhere close to 100 percent of all soft drinks and syrups imported from the United States.

2. Soft Drinks and Syrups

27. The soft drinks and syrups relevant to this dispute comprise a variety of products that all have in common the fact that they are non-alcoholic beverages, or products that when diluted with water produce a beverage – such as concentrates, syrups, or powders – and are made with water, sweeteners, and other ingredients including flavorings and other additives. In practical terms, these products comprise carbonated and non-carbonated soft drinks (*e.g.*, Coke, Pepsi, Nestea), hydrating and rehydrating drinks (*e.g.*, Gatorade), powdered drink mixes (*e.g.*, Kool-Aid, Crystal Light), juice concentrates and cocktails containing less than 20 percent real juice (*e.g.*, CapriSun), bar mixers and other flavored mixers (*e.g.*, margarita mix), and syrups for fountain drinks.

⁴⁰ See *supra* 30.

⁴¹ See *supra* para. 20.

28. Mexico is a large consumer of soft drinks. In fact, Mexicans drink over 15 billion liters of soft drinks, or about 150 liters per capita, annually, and the soft drink market has been growing every year.⁴² Mexico is the second largest per capita consumer of soft drinks in the world, and the second largest per capita consumer of cola drinks in the world.⁴³ It has the highest per capita consumption of Coca-Cola in the world.⁴⁴

29. Soft drinks and syrups may be sweetened with nutritive or non-nutritive sweeteners. HFCS and cane sugar fall in the former category; high-intensity sweeteners fall in the latter. Use of a nutritive sweetener rather than a non-nutritive sweetener generally marks the distinction between a “regular” and a “diet” or “light” soft drink or syrup, respectively.

30. Since imposition of the HFCS soft drink and distribution taxes, in Mexico virtually all regular soft drinks are sweetened with cane sugar.⁴⁵ Diet soft drinks comprise only a small share of the overall Mexican soft drink market, about two to three percent.⁴⁶

31. The Mexican soft drink market is dominated by two key players: Coca-Cola and Pepsi-Cola. Coca-Cola is by far the dominant bottler of soft drinks in Mexico, controlling 71.9% of the Mexican soft drink market. Coca-Cola's market share is divided between its three major bottlers, Femsa (37.7%), Arca (16.3%) and Contal (13.6%). Pepsi, through its two main bottlers, Pepsi Bottling Group (9.8%) and Geusa (3.8%), controls 15.1% of the market.⁴⁷

32. In the United States, on the other hand, nearly all regular soft drinks are sweetened with HFCS.⁴⁸ Sugar-sweetened soft drinks are generally limited to niche markets such as kosher and

⁴² *The Fruit Juice and Soft Drink Market in Mexico*, Market Research Centre and the Canadian Trade Commissioner Service, Agri-Food Trade Service, July 2003, Exh. US-48.

⁴³ *Mexicans are second-largest soft drink consumer in world*, Corporate Mexico, September 4, 2003, Exh. US-23.

⁴⁴ Coca-Cola Femsa, Annual Report 2001 at 30, Exh. US-24; *see also* Coca-Cola Femsa, *Coca-Cola Femsa Announces 16.0% Operating Profit Growth for First-Quarter 2002* (First-Quarter 2002 Press Release) (April 25, 2002), Exh. US-25.

⁴⁵ As recalled above even in the three years prior to imposition of Mexico's tax, HFCS comprised less than 30 percent of the nutritive sweeteners consumed by the Mexican soft drink industry as a whole, with cane sugar making up the remaining share. In 2002, the first year of Mexico's tax, HFCS consumption dropped dramatically and HFCS comprised only seven percent of nutritive sweeteners consumed by the Mexican soft drink industry in 2002. By 2003 that share had shrunk to zero. *See* ERS Model, Exh. US-8.

⁴⁶ Mexico: Food, beverages and tobacco background (Exec. Briefing No. 310, Economist Intelligence Unit Ltd.) (Mar. 1, 2004), *available at* <<http://mutex.gmu.edu:2144/en/arch/display.asp>>, Exh. US-16; *see also* Peter Buzzanell, *Sugar and Sweeteners Outlook* 32 (June 30, 1995), Exh. US-17 (stating that diet products represent less than 5 percent of Mexico's total soft drink market); Contal, *Soft Drink Industry*, *available at* <http://www.contal.com/our_business05.html> (estimating diet drinks at two percent), Exh. US-19.

⁴⁷ The Peruvian-owned cola, Kola Real, holds 4% of the market and Cadbury Schweppes holds 2% of the market. *See* Ben Cooper, *Mexico a growing jewel in soft drink crown*, Just-Drinks (May 17 2004), Exh. US-18.

⁴⁸ *See, e.g., The Coca-Cola Company Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, Form 10-K (for the fiscal year ended Dec. 31, 2003) at 11, Exh. US-20 (“In the United States, the principal nutritive sweetener is high-fructose corn syrup, a form of sugar...”).

organic products and, according to industry participants, make up a negligible share of the U.S. soft drink market. Of the 25 best selling carbonated soft drinks in the United States in 2003, diet drinks comprised about a fifth of the U.S. market with the remainder – or about 80 percent – made up of regular soft drinks⁴⁹ – almost all of which were sweetened with HFCS.⁵⁰

33. Prior to the 1980s, however, sugar was the dominant sweetener used in the U.S. market. As discussed above, HFCS was developed primarily for the beverage and food industries. After being perfected in the 1970s and then winning acceptance by bottlers, it rapidly replaced sugar in the U.S. soft drink industry by the mid-1980s.⁵¹ Coca-Cola began using 25 percent HFCS-42 in its Fanta label in 1975.⁵² In early 1980, it announced that it would use 25 percent HFCS-55 in its cola.⁵³ Finally, on October 24, 1984, both Coca-Cola and Pepsi Cola announced they would use 100 percent HFCS-55 as their sweeteners,⁵⁴ and much of the rest of the U.S. soft drink industry followed suit.⁵⁵ A similar transition occurred in Canada.

34. Like the U.S. and Canadian markets, the Mexican market had begun a transition to HFCS use in the 1990s. In the mid- to late 1990s, Mexican soft drink producers began increasingly to substitute HFCS for a portion of the sugar used to produce soft drinks. By 2001, the Mexican bottler Emvasa used a 50/50 sugar/HFCS mixture for its soft drinks,⁵⁶ Femsa utilized a 60/40 sugar/HFCS ratio, and many other Coca-Cola bottlers used a 70/30 sugar/HFCS blend.⁵⁷ In 2001, the Mexican soft drink industry consumed approximately 480 thousand metric tons of HFCS, totaling between 75 and 80 percent of Mexican HFCS consumption.⁵⁸ Imposition of Mexico's tax halted and reversed this transition, such that by mid-2002 all Mexican bottlers subject to the tax used exclusively cane sugar in the production of regular soft drinks.⁵⁹ For example, Femsa, the largest soft drink bottler in Mexico, in its 1999 annual report, explained that

⁴⁹ See *Beverage Digest Fact Book 2004: Statistical Yearbook of Non-Alcoholic Beverages* 44-45 (9th ed. 2004). The top 25 best selling soft drinks in the United States comprised over 80 percent of the total carbonated soft drink market in the United States. Of the total U.S. carbonated soft drink market, diet soft drinks comprised approximately 27 percent. *Id.*

⁵⁰ See *id.* at 163-64 (table listing all the grades of HFCS used by the various soft drink brands).

⁵¹ See Stephen Haley *et al.*, *Sugar and Sweeteners Outlook 19* (Economic Outlook Report from the Economic Research Service (ERS), USDA) (May 27, 2004) (showing sweetener deliveries to beverage manufacturers 1977 to 2002), Exh. US-21.

⁵² See *The History of High Fructose Corn Syrup*, 1996 Corn Annual, Exh. US-22.

⁵³ See *id.*

⁵⁴ See *id.*

⁵⁵ See Stephen Haley, *et al.*, *Sugar and Sweeteners Outlook 19* (USDA)(May 27, 2004), Exh. US-21 (graphically showing consumption of HFCS by the U.S. beverage industry and a sharp up take in HFCS in 1982).

⁵⁶ *Emvasa usa mezcla azúcar y fructosa por partes iguales*, Reuters (September 22, 1997) Exh US-26.

⁵⁷ See *Embotelladores Coca-Cola México abandonan fructosa por azúcar*, Reuters (Jan. 11, 2002), Exh. US-27.

⁵⁸ USDA ERS Model, Exh. US-8; see also Stephen Haley, *et al.*, *Sugar and Sweeteners Outlook 23* (USDA), Exh. US-21.

⁵⁹ USDA ERS Model, Exh. US-8; see also Stephen Haley, *et al.*, *Sugar and Sweeteners Outlook 23* (USDA), Exh. US-21.

“lower dollar-denominated raw material prices, including high fructose corn syrup” had contributed to “greater fixed cost adjustments.”⁶⁰ In 2002, however, the company reported converting its Mexican bottling facilities to sugar cane-based production.⁶¹

35. Due to relatively high transportation costs and territorial licensing agreements, soft drinks and other beverages tend to be bottled locally. The more significant trade volumes relevant to soft drinks and syrups concern their ingredients, in general, and, as discussed above, their sweeteners, in particular. Nevertheless, U.S. soft drink and syrup producers have shipped significant volumes to Mexico in past years. Overall, the volume of U.S. soft drink exports to Mexico has declined since imposition of the HFCS soft drink tax.⁶² For example, Mexican imports of soft drinks under tariff item 2202.10.01 declined from 73 thousand kiloliters in 2001 to 54 thousand kiloliters in 2003.⁶³ In the year prior to imposition of the tax, however, Mexican imports of soft drinks under tariff item 2202.10.01 had increased by 54 percent (from 47 thousand kiloliters in 2000 to 73 thousand kiloliters in 2001).⁶⁴ Soft drink bottlers near the U.S.-Mexico border have been particularly affected by Mexico’s tax. In addition, the tax inherently affects the ability of prospective U.S. exporters of soft drinks and syrups to expand and develop a market for their products in Mexico.

B. The HFCS Soft Drink Tax

36. The Mexican Congress approved the tax on soft drinks and syrups sweetened with HFCS on December 30, 2001, with an effective date of January 1, 2002. The legislation enacting this tax was part of the fiscal and budget package for 2002, and took the form of an amendment to the pre-existing IEPS. The IEPS itself was first enacted in 1980, as a collection of excise taxes on transfers of goods and services at differing rates, including gasoline, tobacco products, alcoholic beverages, telecommunications and, since 2002, the soft drinks and syrups relevant to this dispute. Since inclusion of the tax as applicable to soft drinks and syrups, the IEPS has been renewed and amended on two occasions: December 30, 2002 (for application in 2003) and

⁶⁰ Coca-Cola Femsa, Annual Report 1999 at 27 (“In both Mexico and Buenos Aires, the Company benefited from improved volumes leading to greater fixed cost adjustments, and lower dollar-denominated raw material prices, including high fructose corn syrup...”), Exh. US-44.

⁶¹ Coca-Cola Femsa, Annual Report 2001 at 30, Exh. US-24; *see also* Coca-Cola Femsa, Coca-Cola Femsa Announces 16.0% Operating Profit Growth for First-Quarter 2002 (First-Quarter 2002 Press Release) (April 25, 2002), Exh. US-25 (“[W]e modified all our production facilities to use sugar-cane based sweetener in order to minimize the impact of the new excise tax on high-fructose corn syrup (“HFCS”) imposed by the Mexican government in January 2002.”)

⁶² *See* Secretary of Economy, Soft Drink Imports from the U.S., Exh. US-13. Neither the U.S. nor Mexican tariff systems separately identify soft drinks based on the type of nutritive sweetener used. Therefore, the figures below represent all regular soft drinks imported by Mexico from the United States. However, because U.S. produced regular soft drinks are sweetened almost exclusively with HFCS, presumably so too are U.S. exports.

⁶³ Secretary of Economy, Soft Drink Imports from the U.S., Exh. US-13.

⁶⁴ *Id.*

December 31, 2003 (for application in 2004). Neither of these amendments change the discriminatory nature of Mexico’s tax.

1. The HFCS Soft Drink Tax and Its Operation

37. The IEPS as effective on January 1, 2004 provides as follows with respect to soft drinks and syrups:

Article 1

Physical and legal persons engaged in the following actions and activities are required to pay the tax established in this Law:

- I. The final transfer in national territory or, as applicable, the final importation, of goods identified in this Law.
- II. The provision of services indicated in this Law.

The tax shall be calculated by applying the rate established in Article 2 herein to the value of each good or service.

...

Article 2

The rates given below shall apply to the value of the acts or activities indicated:

- I. On the transfer, or, as applicable, the importation of the following goods:

...

- (G) Soft drinks, hydrating and rehydrating beverages, as well as concentrates, powders, syrups, flavor extracts or essences, which may be diluted to produce soft drinks, hydrating and rehydrating beverages 20%
- (H) Syrups or concentrates for preparing soft drinks sold in open containers, using mechanical or automatic equipment 20%

...

- II. On the provision of the following services:

(A) Agencies, representation, brokerage, consignment, and distribution⁶⁵ for the purpose of transferring goods indicated in Article 2(I)(A), (B), (C), (G), and (H), in which case, the applicable rate shall be the rate for the domestic transfer of that particular good set forth under the terms of this Law. The tax shall not be paid when the services referred to in this subparagraph are for the transfer of goods exempt from this tax, in accordance with article 8 herein.

...

Article 3

For purposes of this Law, the following definitions apply:

...

XV. Soft drinks, non-alcoholic flavored beverages produced by dissolving synthetic, artificial, or natural sweeteners or flavorings, among others, in water. Such beverages may or may not also contain fruit or vegetable juice, pulp or nectar, the concentrate or extracts thereof, as well as other additives and may or may not be carbonated.

In addition, this includes concentrates, powders, syrups, flavor extracts or essences for preparing soft drinks, added to the product with or without sugars, sweeteners, or flavorings be they synthetic, artificial or natural, that may or may not contain fruit or vegetable juice, pulp, nectar, and other food additives.

Fruit and vegetable juices and nectars are not considered soft drinks. For such purposes, fruit and vegetable juices and nectars are defined as having at least 20% fruit or vegetable juice or pulp or 2% Brix of solids from the same fruit or vegetable. When juices or nectars referred to in this paragraph are a mixture of several fruits or vegetables, such mixture must have at a minimum the values stipulated herein for all fruits and vegetables.

⁶⁵ The Spanish refers to “[c]omisión, mediación, agencia, representación, correduría, consignación y distribución.” The terms “comisión” and “mediación” as used in the IEPS do not have perfect translation into English. As the United States understands, the term “comisión” in Spanish (“commissions” translated literally into English) is, in general terms, a concept used in Mexico to refer to the services of representation in commercial activities. The term “mediación” (“dealers” as translated literally into English) is, in general terms, a concept used in Mexico to refer to activities akin to a distribution agreement where the owner of the goods maintains the risk. Thus, for purposes of this submission, “[c]omisión, mediación, agencia, representación, correduría, consignación y distribución” have been translated into English as “agencies, representation, brokerage, consignment, and distribution” with the understanding that the Spanish terms “comisión” and “mediación” are subsumed in the English terms “representation” and “distribution” respectively.

XVI. Hydrating and rehydrating beverages are beverages or solutions containing water, carbonated water, and variable amounts of carbohydrates or electrolytes.

Article 8

The tax set forth in this Law shall not be paid:

I. On the following transfers:

...

(f) Those for goods referred to in Article 2(I)(G) and (H) of this Law, provided only sugarcane is used as a sweetener.

38. Through this rather circuitous route, the IEPS applies a 20 percent tax to soft drinks or syrups made with any sweetener other than cane sugar. The IEPS accomplishes this by initially taxing the internal transfer, or if imported, the final importation, of all soft drinks and syrups (Articles 1 and 2) and then providing an exemption for internal transfers of soft drinks and syrups “provided only cane sugar is used as a sweetener” (Article 8). Imports of soft drinks and syrups, regardless of sweetener used, do not enjoy this exemption.⁶⁶

39. Accordingly, the IEPS applies a 20 percent tax on the internal transfer of soft drinks and syrups sweetened with HFCS or any sweetener other than cane sugar and a 20 percent tax on the importation of soft drinks and syrups sweetened with any sweetener, including HFCS or cane sugar (“HFCS soft drink tax”).⁶⁷ The IEPS also applies a 20 percent tax on the representation, brokerage, agency, consignment and distribution of soft drinks and syrups sweetened with HFCS (“distribution tax”).⁶⁸

40. With respect to the HFCS soft drink tax, the IEPS requires the “physical and legal person” transferring (*i.e.*, alienating) the good, or in the case of an import, importing the good, subject to the IEPS to pay the tax.⁶⁹ As applied to soft drinks and syrups, the “individual or entity” responsible for payment of the tax will in the first instance be the Mexican producer (*i.e.*, bottler) of the soft drink or syrup, or in the case of imports, the importer of record. The IEPS

⁶⁶ Compare IEPS as amended, Art. 8 (exempting only “transfers” of the products identified) with IEPS as amended, Art. 1.1 (applying the tax to the “final transfer in national territory or, as applicable, the final importation, of goods identified by this Law”).

⁶⁷ IEPS as amended, Art. 1.I, Exh. US-4.

⁶⁸ *Id.*, Arts. 1.II, 2.II, 4.

⁶⁹ *Id.*, Art. 1.I. In the IEPS the individual or entity responsible for payment of the tax is referred to as the “taxpayer”. Accordingly, in this submission the United States refers to “physical and legal persons” obligated to pay the IEPS as “IEPS taxpayers”.

applies on each transfer of a soft drink or syrup, such that subsequent transfers of a soft drink or syrup, for example from a distributor to retailer, also trigger application of the IEPS.

41. The IEPS exempts from payment of the tax, internal transfers of soft drinks and syrups to the general public by persons other than the “manufacturer, producer, bottler, distributor, or importer” (“public sales exemption”).⁷⁰ Imported soft drinks and syrups do not enjoy the same exemption.⁷¹ In certain circumstances, the IEPS provides that a transfer of a good shall be deemed to have occurred.⁷² In such circumstances, the taxpayer is obligated to pay the IEPS as if the goods had been transferred.

42. With respect to the distribution tax, the IEPS requires manufacturers, producers, bottlers and importers who transfer their goods through representatives, brokers, consignment agents or distributors to pay the distribution tax.⁷³ Manufacturers, producers, bottlers and importers who do not separately contract or charge for the transfer of their goods through representatives, brokers, consignment agents or distributors are not required to pay the distribution tax.⁷⁴ Thus, for example, if a bottler separately contracted for a broker to distribute its products to various retailers, under the IEPS, the bottler would be responsible for payment of both the HFCS soft drink tax and the distribution tax.

43. The IEPS requires that the tax be paid to Mexico’s tax authority (the *Servicio de Administración Tributaria* or “SAT”) at the latest on the 17th day of the month following the date on which the taxpayer received payment for the taxed activity (*i.e.*, the transfer of the good or the provision of a service in connection with its transfer). However, in the case of imports, the tax must be paid upon importation.

44. The HFCS soft drink tax is calculated by applying the 20 percent tax rate on the remuneration received for the transfer of the soft drink or syrup. The distribution tax is

⁷⁰ *Id.*, Art. 8(I)(d). This exemption has been provided since 2002; according to the December 30, 2001 Report of the Committee on Tax and Public Credit on the IEPS changes proposed at that time, the reason was to exempt the large number of small retailers in Mexico from payment of this tax and avoid substantial costs of tax collection. (“Tomando en consideración que la comercialización al público en general de cervezas; bebidas refrescantes; aguas naturales y minerales gasificadas; refrescos; bebidas hidratantes o rehidratantes; concentrados, polvos, jarabes, esencias o extractos de sabores, que al diluirse permitan obtener refrescos, bebidas hidratantes o rehidratantes, se realiza en un gran número de tiendas pequeñas y misceláneas, esta Dictaminadora considera necesario establecer una exención para la venta al público de dichos bienes. Con ello, se reducirían importantes costos administrativos en que incurrirían al ser ahora contribuyentes por esos bienes.”) Gaceta Parlamentaria, Cámara de Diputados, no. 911-IV, Dec. 30, 2001, Exh. US-28.

⁷¹ See *supra* note 66 (comparing Article 1.1 with Article 8).

⁷² IEPS as amended, Art. 23, Exh. US-4. Article 23 provides that when a taxpayer fails to record the purchase of raw materials, or their loss or deterioration, it shall be assumed, unless proven otherwise, that these materials were used to produce products subject to the IEPS and that these products were transferred without payment of the tax.

⁷³ *Id.*, Art. 5-A.

⁷⁴ *Id.*, Art. 5-A.

calculated by applying the 20 percent tax rate on the remuneration received for the representation, brokerage, consignment or distribution of the soft drink or syrup. With respect to subsequent transfers, the IEPS owed is calculated on the value of the mark-up (*i.e.*, on the value of the difference between the bottler's and the distributor's sales price).⁷⁵

45. It is important to note that the 20 percent tax is calculated on the value of the finished soft drink or syrup. The effective rate of the tax on the value of the sweetener in the soft drink or syrup is, thus, much higher than 20 percent. In fact, as the example below demonstrates, a 20 percent tax on the value of the finished soft drink or syrup actually results in a tax that is four times the value of the HFCS in the soft drink.

- The wholesale price of a 12 ounce can of Coca Cola in Mexico is about 5 pesos, or 43.8 U.S. cents.
- At a 20 percent tax rate, the tax on this can of soda is 1 peso, or 8.8 U.S. cents.
- The cost of HFCS for one 12 ounce can of soda is approximately 0.24 pesos, or 2.1 U.S. cents.
- Therefore, the beverage tax equals over four times the cost of the HFCS in the can, making the use of HFCS in beverage production prohibitively expensive. With a tax liability of 400 percent, the HFCS producer cannot even provide HFCS to its customer for free: the producer would have to pay the customer to take it.

46. In addition to requiring payment of a 20 percent tax on the transfer of soft drinks and syrups made with HFCS as well as the representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS, the IEPS also subjected producers who use HFCS to several bookkeeping and reporting requirements.⁷⁶ These include, *inter alia*:

⁷⁵ In this respect, the IEPS has a structure similar to that of the Value Added Tax; that is, the tax paid by the bottler, distributor or importers when they sell or import the soft drink or syrup can be credited against the tax owed by their customers when their customers, in turn, sell the soft drink or syrup. *See* IEPS as amended, Art. 4. As mentioned, sales by individuals or entities other than the manufacturer, producer, bottler, distributor, or importer (e.g., small retailers) are not required to pay the tax. *See* IEPS as amended, Art. 8(d). In fact, since Mexico's Value Added Tax applies to the price of the goods plus the IEPS, the effect of the tax discrimination by the IEPS may be magnified by an otherwise-neutral VAT.

⁷⁶ IEPS as amended, Art. 19, Exh. US-4. These requirements are incurred by producers who use HFCS as only producers who use exclusively cane sugar are exempt from payment of the tax.

- annual listing of the goods “produced, transferred or imported in the previous year, as regards consumption by state and the corresponding tax, as well as the services provided by establishment in each state”;⁷⁷
- quarterly reporting of “information regarding [taxpayers’] 50 main clients and suppliers”;⁷⁸
- quarterly reporting of the “monthly reading registered by devices used to carry out [physical] inspection” of the volume of goods manufactured, produced, or bottled;⁷⁹
- quarterly reporting of the price, value and volume of goods transferred in the previous quarter;⁸⁰
- reporting of their complete inventory of taxable products as of December 31, 2001;⁸¹ and
- registry by importers and exporters of soft drinks and syrups with the Ministry of Finance and Public Credit.⁸²

47. Implementation of the IEPS is guided by the Implementing Regulations to the Law on the Special Tax on Production and Services and the Miscellaneous Tax Decisions for 2003 and 2004 published on March 31, 2003, and April 30, 2004.⁸³ These measures, *inter alia*, provide details on the scope, calculation, payment, and bookkeeping and recording requirements of the IEPS but do not change the overall application of the IEPS to soft drinks and syrups made with sweeteners other than cane sugar.

2. Enactment and Amendment of the HFCS Soft Drink Tax

48. The HFCS soft drink tax emerged during the consideration by the Mexican Congress of the government’s proposed package of fiscal measures for 2002. This fiscal package included changes to the IEPS. The Committee on Treasury and Public Credit (Comisión de Hacienda y Crédito Público) of the Chamber of Deputies sent its report on the proposals for IEPS changes,

⁷⁷ *Id.*, Art. 19.VI.

⁷⁸ *Id.*, Art. 19.VIII.

⁷⁹ *Id.* Art. 19.X.

⁸⁰ *Id.* Art. 19.XIII.

⁸¹ IEPS Disposiciones Transitorias (transitional provisions), Jan. 1, 2002, Art. 2, para. I(a). The transitional provisions were enacted as part of the IEPS on December 30, 2001 and thus form a component of that measure. *See* Exh. US-4A.

⁸² IEPS as amended, Art. 19.XI, Exh. US-4.

⁸³ *Supra* para. 4(2).

including its proposal for the HFCS soft drink tax, to the plenary session of the Deputies with a report stating that a tax on carbonated water, soft drinks, rehydrating drinks, syrups, concentrates and powders would be necessary in order to extend the tax base. However, said the report, “[i]n order to not cause a major injury to the sugar industry, it is proposed that the tax on soft drinks apply exclusively to those which for their production utilize fructose in substitution for cane sugar.”⁸⁴ When the Chamber of Deputies considered this proposal, Representative Raúl Ramírez Avila, representing the Committee, urged the Chamber to adopt it, stating that “[w]e legislators, however, have the commitment to protect the domestic sugar industry because a great number of Mexicans’ subsistence depends on it. To that effect, a tax on soft drinks that applies only to those which for their production utilize fructose in substitution for cane sugar is proposed.”⁸⁵ These two statements have been referred to by Mexican courts as indications of what Congress intended when it voted for these tax provisions.

49. Responding to strong concerns voiced by the United States immediately after enactment of the HFCS soft drink tax, the Fox Administration issued a Presidential Decree on March 5, 2002, which temporarily suspended collection of the tax until September 30, 2002.⁸⁶ Soon afterward, the Chamber of Deputies launched a constitutional challenge to this Decree. On July 12, 2002, Mexico’s Supreme Court, the Suprema Corte de Justicia de la Nación, ruled that the decree was *ultra vires*, constitutionally invalid and void.⁸⁷ As discussed below, the Supreme Court’s decision was based on its finding that the purpose of the HFCS soft drink tax was to “protect the national sugar industry.” The HFCS soft drink tax was thus reinstated.

50. As mentioned, the IEPS was renewed and amended on December 30, 2002, effective January 1, 2003, and on December 31, 2003, effective January 1, 2004. In November 2003, the Fox Administration proposed elimination of the HFCS tax, stating:

⁸⁴ “Con el objeto de no ocasionar una afectación mayor a la industria azucarera, se propone que el impuesto a los refrescos se aplique exclusivamente a aquellos que para su producción utilizan la fructosa en sustitución del azúcar de caña.” (unofficial English translation) Gaceta Parlamentaria, Cámara de Diputados, No. 911-IV, Dec. 30, 2001, at <http://gaceta.cddhcu.gob.mx/Gaceta/58/2001/dic/Anexo-IV-30Dic.html>, Exh. US-28 .

⁸⁵ “Tenemos los legisladores, sin embargo, el compromiso de proteger a la industria azucarera nacional, ya que de ella depende la subsistencia de gran número de mexicanos. Para tal efecto se propone que el impuesto a los refrescos se aplique solamente a aquellos que para su producción utilicen la fructuosa en sustitución del azúcar de caña.” Stenographic record of debate by Deputies, at <http://cronica.diputados.gob.mx/PDF/58/2001/dic/011229-4.pdf>, at pp. 711-712 (unofficial English translation), Exh. US-29.

⁸⁶ Decreto por el que se exime el pago de los impuestos que se indican y se amplia el estímulo fiscal que se menciona, Diario Oficial, March 5, 2002, Primera Sección at 1-3, Exh. US-30. The suspension was by a decree issued under Article 39 of the Fiscal Code, which authorizes the President to provide temporary tax relief where particular branches of the economy have been adversely treated.

⁸⁷ Supreme Court de Justicia de la Nación, Sentencia relativa a la controversia constitucional 32/2002, promovida para la Cámara de Diputados del Congreso de la Unión, en contra del Titular del Poder Ejecutivo Federal, published in Diario Federal, July 17, 2002, Primera Sección, 44-82, (hereinafter “Supreme Court Decision re Fox Suspension”), Exh. US-31.

With the objective of resolving the problem of overproduction and foreign trade barriers which confronted Mexican sugar producers, a tax was established on soft drinks that do not contain cane sugar. Today, the problem of overproduction has been overcome, and there are even imports of cane sugar.⁸⁸

The Congress however rejected this request. The HFCS soft drink and distribution tax as amended in December 2003 is still in effect.

3. Interpretation of the HFCS Soft Drink Tax

51. The Mexican Supreme Court has interpreted the IEPS provisions applicable to soft drinks and syrups, and in particular has authoritatively interpreted the purpose of the HFCS tax adopted in December 2001. The court has considered the HFCS soft drink tax in two contexts: first during its consideration of the 2002 constitutional challenge referred to above, and then in *amparo* appeals. In both contexts the Supreme Court has definitively characterized the purpose of the HFCS tax as protection of Mexican sugar producers.

52. With respect to the 2002 constitutional challenge,⁸⁹ the Chamber of Deputies argued *inter alia* that President Fox's suspension of the HFCS soft drink and distribution tax failed to faithfully execute the laws enacted by Congress, in violation of Article 89 of the Mexican Constitution. On July 12, 2002, the Supreme Court ruled that the President's suspension decree was unconstitutional and void.⁹⁰

53. The Supreme Court's July 2002 decision authoritatively characterized the purpose of the HFCS soft drink and distribution tax as protectionism. Examining the purpose of the HFCS tax, the court quoted from the Committee report and plenary speech referred to above,⁹¹ and found that from those citations, it could be seen that the intention of the legislature, in extending the tax to soft drinks only when their production used fructose instead of cane sugar, was "to protect the sugar industry."⁹² The Supreme Court ruled that Article 39 of the Fiscal Code only authorized tax relief when a branch of industry was adversely affected by extraordinary events which the Congress could not take into account, and that the President could not use this provision where the adverse effect resulted simply from applying a federal tax law. Providing an exemption from

⁸⁸ "Con el propósito de resolver el problema de sobreproducción y restricciones de mercado en el extranjero que enfrentaban los productores mexicanos de azúcar, se estableció un gravamen a los refrescos que no contuvieran azúcar de caña. Hoy día el problema de sobreproducción está superado, incluso ya se están realizando importaciones de azúcar de caña." *Gaceta Parlamentaria*, November 6, 2003, at <http://gaceta.cddhcu.gob.mx/Gaceta/59/2003/nov/Anexo-I-06nov.html> (unofficial English translation), Exh. US-32.

⁸⁹ Stephen Zamora et al., *Mexican Law 274-82 (2004)* (discussing *controversias constitucionales*), Exh. US-33.

⁹⁰ See Supreme Court Decision re Fox Suspension, Exh. US-31.

⁹¹ See *supra* notes 87, 88 5 (recounting reports and speeches).

⁹² See Supreme Court Decision re Fox Suspension at 79, Exh. US-31.

tax payment merely because a tax would affect a particular branch of industry would negate the will of Congress expressed in the law that established the tax, and it would nullify this law by temporarily eliminating payment of the tax on non-sugar sweeteners. Moreover, it would contradict the “extra-fiscal objective” of the HFCS tax, as expressed during the legislative process – that is, protection of the Mexican sugar industry.⁹³ On that basis the Court annulled the temporary suspension of the tax, and reinstated the tax effective July 16, 2002.

54. Mexican law permits individuals to bring *amparo* petitions to the courts to challenge the constitutionality of legal provisions, although the resulting *amparo* judgment applies only to the individual claimant.⁹⁴ Many *amparo* challenges have been brought under domestic law arguing that provisions of the HFCS soft drink and distribution tax infringe, *inter alia*, the principles of equity and proportionality of taxation guaranteed by Article 31(IV) of the Mexican Constitution. In February 2002, a Baja California soft drink importer, La Perla de la Paz, S.A. de C.V., brought an *amparo* challenge arguing *inter alia* that this principle of tax equity and proportionality was breached by the tax’s different treatment of soft drinks and syrups that use cane sugar, and soft drinks and syrups that use other sweeteners. This *amparo* claim was referred to the Supreme Court, which ruled on February 7, 2003 that this different treatment would not breach the tax equity principle if it was based on objective reasons. The Supreme Court then proceeded to analyze the motivation of the Congress when it enacted the HFCS soft drink and distribution tax, relying on the same committee report cited in its July 2002 decision relating to the same tax, as well as a government decree asserting the public interest as a basis for expropriating sugar mills. The court determined that it was clear that the HFCS soft drink and distribution tax established different treatment for soft drinks and syrups depending on use or not of cane sugar, and that “the legislator sought with it to protect and not affect the domestic sugar industry, since many Mexicans depend on it to make a living.” Because this discrimination was intentional on the part of the legislature, and the tax was consistent with those intentions, it was not contrary to the principle of tributary equity.⁹⁵

55. The Supreme Court followed the *La Perla de la Paz* ruling in four later cases, ruling by four or five votes in one of the *salas* (chambers) of the Supreme Court.⁹⁶ As a result, this ruling

⁹³ *Id.* at 80.

⁹⁴ Stephen Zamora *et al.*, *Mexican Law* 268-69 (2004), Exh. US-33.

⁹⁵ Amparo in review 797/2002, La Perla de la Paz, S.A. de C.V., Feb. 7, 2003 (opinion unanimously by four votes), Exh. US-34A; Jurisprudencia 57/2004, Exh. US-34B.

⁹⁶ Amparo in review 1029/2003, Embotelladora de Tampico, S.A. de C.V. and others, January 23, 2004 (unanimously by four votes); Amparo in review 505/2003, Supermercados Internacionales Heb, S.A. de C.V., Feb. 27, 2004 (unanimously by four votes); Amparo in review 2168/2003, Embotelladora Tarahumara, S.A. de C.V., Mar. 26, 2004 (five votes); Amparo in review 165/2004, Refresquera Internacional, S.A. de C.V., Mar. 26, 2004 (five votes), Exh. US-35 (containing brief summaries in English translation of the aforementioned amparos); Jurisprudencia 57/2004 from Supreme Court, Exh. US-34B.

has become binding on lower courts as *jurisprudencia obligatoria*.⁹⁷ Thus, the highest interpretative authority in Mexico, the Supreme Court, has definitively and conclusively characterized this tax scheme as designed to protect Mexican domestic production of cane sugar.

IV. SUMMARY OF LEGAL ARGUMENT

56. This dispute concerns the taxation on soft drinks and syrups made with any sweetener other than cane sugar. For purposes of sweetening soft drinks and syrups, cane sugar is directly competitive and substitutable with HFCS. In Mexico, cane sugar is the overwhelmingly dominant sweetener, with the vast majority of soft drinks and syrups produced in Mexico being sweetened with cane sugar. Conversely, in the United States the sweetener of choice for soft drink and syrup production is HFCS. Further, cane sugar comprises over 95 percent of Mexican sweetener production; whereas HFCS before the discriminatory tax comprised nearly 100 percent of Mexican sweetener imports from the United States. Because the tax exempts cane sugar and soft drinks and syrups sweetened with cane sugar, it clearly favors domestic cane sugar production over imports.

57. Such discriminatory taxation is inconsistent with the obligations under GATT Article III. Specifically, Mexico's HFCS soft drink tax and distribution tax, as embodied in the IEPS and its implementing regulations, are:

(1) inconsistent with GATT Article III:2, first sentence as a tax applied on imported soft drinks and syrups "in excess of those applied to like domestic products" (HFCS soft drink tax);

(2) inconsistent with GATT Article III:2, first sentence as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS "in excess of those applied to like domestic products" (distribution tax);

(3) inconsistent with GATT Article III:2, second sentence as a tax applied on imported HFCS which is "directly competitive or substitutable" with Mexican cane sugar which is "not similarly taxed" (HFCS soft drink tax);⁹⁸

⁹⁷ A judgment of the Supreme Court is binding as *jurisprudencia obligatoria* if five consecutive judgments applying the same rule are decided by a vote of at least eight of eleven ministers in cases decided by the entire Supreme Court in plenary session, or by four of five ministers in cases decided in one of the chambers (*salas*) of the Supreme Court. Zamora *et al.*, at 192, Exh. US-33.

⁹⁸ The IEPS is also inconsistent as a tax on HFCS with GATT Article III:2, first sentence. However, because the IEPS so clearly taxes a directly competitive or substitutable imported product in a manner so as to afford protection to domestic production, the United States, in the interest of brevity, has chosen to focus its submission on

(4) inconsistent with GATT Article III:2, second sentence as a tax applied on imported soft drinks and syrups which are directly competitive or substitutable with domestic soft drinks and syrups which are “not similarly taxed” (HFCS soft drink tax);

(5) inconsistent with GATT Article III:2, second sentence as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS which are directly competitive or substitutable with domestic soft drinks and syrups which are “not similarly taxed” (HFCS soft drink tax); and

(6) inconsistent with GATT Article III:4 as a law that affects the internal use of imported HFCS and accords HFCS “treatment ... less favorable than that accorded to like products of national origin” by

(a) taxing soft drinks and syrups that “use” HFCS as a sweetener (HFCS soft drink tax),

(b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS (distribution tax), and

(c) subjecting soft drinks and syrups sweetened with HFCS to various bookkeeping and reporting requirements (reporting requirements).⁹⁹

V. LEGAL ARGUMENT

A. The IEPS Is An Internal Tax

58. GATT Article III ensures that internal taxes, among other measures, are not applied in a manner that discriminates against imported products. The Ad Note to GATT Article III clarifies that an internal tax that applies to imported products at the time of importation is, nonetheless, an internal tax within the meaning of GATT Article III.

the second sentence.

⁹⁹ The IEPS is also inconsistent with GATT Article III:4 as a law that affects "the internal sale, offering for sale, purchase, transportation, [and] distribution" of imported soft drinks and syrups and accords them "treatment ... less favorable than that accorded to like products of national origin" by taxing their agency, representation, brokerage, consignment and distribution (distribution tax). However, because the IEPS also so plainly violates GATT Article III:2, the United States, in the interest of brevity, has chosen to focus this submission on analysis under GATT Article III:2 with respect to the distribution tax as applied to soft drinks and syrups.

Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III.

59. The IEPS taxes the “final transfer in the national territory, or as applicable, the final importation” of soft drinks and syrups sweetened with any sweetener other than cane sugar.¹⁰⁰ The HFCS soft drink tax, thus, applies to imported soft drinks and syrups at the time of importation and like domestic products upon their internal transfer. As clarified by the Ad Note, the HFCS soft drink tax’s application to imported soft drinks and syrups at the time of importation,¹⁰¹ does not change its status as an internal tax within the meaning of GATT Article III.¹⁰² Moreover, because the HFCS soft drink tax applies upon each transfer (with the exception of the public sales exemption), it also applies to subsequent transfers of imported soft drinks and syrups in Mexico.¹⁰³

60. The IEPS also taxes the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS in Mexico. This distribution tax is, thus, an internal tax within the meaning of GATT Article III.

61. In addition, as explained more below, the IEPS (HFCS soft drink tax and distribution tax) by its nature is also an internal tax on the use of the imported sweetener, HFCS. As a tax on the use of HFCS, the tax applies vis-a-vis imported HFCS upon its internal use in soft drinks and syrups produced in Mexico. Therefore, the HFCS soft drink and distribution tax as a tax on the use of HFCS falls within the scope of GATT Article III as an internal tax.

¹⁰⁰ IEPS as amended, Art. 1.I.

¹⁰¹ IEPS as amended, Art. 12.

¹⁰² See, e.g., *Argentina – Hides and Leather* Panel Report, para. 11.145; *EC – Bananas III* Panel Report, para. 7.175 (issue not appealed to AB).

¹⁰³ Thus, for example, if a soft drink or syrup is imported and then subsequently transferred to a wholesaler or other distributor, the importer is responsible for payment of the tax on importation of the soft drink or syrup as well as upon its transfer to the wholesaler or other distributor.

**B. The HFCS Soft Drink Tax and Distribution Tax Are Inconsistent with
GATT Article III:2, First Sentence**

62. The first sentence of GATT Article III:2 provides:

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.

63. As confirmed by the Appellate Body in *Japan – Alcoholic Beverages II*, a determination of an internal tax’s inconsistency with GATT Article III:2, first sentence is a two step process: First, the imported and domestic products at issue must be “like.” Second, the internal tax must be applied to imported products “in excess of” those applied to the like domestic products.¹⁰⁴ “If the imported and domestic products are ‘like products’, and if the taxes applied to the imported products are ‘in excess of’ those applied to the like domestic products, the measure is inconsistent with Article III:2, first sentence.”¹⁰⁵

**1. Soft Drinks and Syrups Sweetened with HFCS and Soft Drinks and
Syrups Sweetened with Cane Sugar Are Like Products**

64. Although a determination of likeness is to be made on a case-by-case basis, panels and the Appellate Body have followed a consistent approach to the determination based on a handful of key criteria: (1) the properties, nature and quality of the products; (2) the end-uses of the products; (3) consumers’ tastes and habits; and (4) the tariff classification of the products.¹⁰⁶ This is not an exhaustive list, but as the Appellate Body has stated, provides helpful guidance for examining the likeness of two products.¹⁰⁷

65. On several occasions, the Appellate Body has explained that the term “like products” should be construed narrowly for the purposes of the first sentence of GATT Article III:2. Yet, “like” products need not be *identical* in all respects.¹⁰⁸ For example, although vodka and shochu differed with respect to alcohol content and filtration, in *Japan – Alcoholic Beverages II* the

¹⁰⁴ *Japan – Alcoholic Beverages II*, AB Report, Section H.1.

¹⁰⁵ *Japan – Alcoholic Beverages II*, AB Report, Section H.1; *see also Canada – Periodicals*, AB Report, Section V.

¹⁰⁶ *See, e.g., EC – Asbestos*, AB Report, para. 101; *Japan – Alcoholic Beverages II*, AB Report, Section H.1 and H.1(a); *Canada – Periodicals*, AB Report, Section V.A; *Border Tax Adjustments*, Working Party Report, para. 18.

¹⁰⁷ *See Japan – Alcoholic Beverages II*, AB Report, Section H.1(a) (“This approach should be helpful in identifying on a case-by-case basis the range of “like products” that fall within the narrow limits of Article III:2, first sentence in the GATT 1994.”).

¹⁰⁸ *Japan – Alcoholic Beverages II*, Panel Report, para. 6.21.

panel (as affirmed by the Appellate Body), nonetheless determined vodka and shochu were like products within the meaning of GATT Article III:2, first sentence.¹⁰⁹

66. As demonstrated below, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are like products because they have virtually identical physical properties, end-uses and tariff classifications and are equally preferred by consumers.

67. On a methodological note, although the IEPS taxes a variety of different types of soft drinks and syrups, it applies the same tax to the entire category of these products, exempting only those products sweetened with cane sugar. In other words, the IEPS makes no distinction between particular types or brands of soft drinks or syrups when it comes to application of the HFCS soft drink tax and distribution tax but, rather, draws a line between, on the one hand, soft drinks and syrups sweetened only with cane sugar and, on the other hand, soft drinks and syrup sweetened with any other sweetener.¹¹⁰ The like product analysis below, therefore, proceeds along this same basis – namely, examining whether soft drinks and syrups sweetened with HFCS are like soft drinks and syrups sweetened with cane sugar.¹¹¹

(a) Physical Characteristics

68. Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are physically identical in virtually all respects. First, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are identical in physical appearance. Both products are varying mixtures of water (whether carbonated or not), sweeteners and other flavorings and colorings. Because HFCS and cane sugar are both colorless and appear in a soft drink or syrup as a solution, the use of HFCS, as opposed to cane sugar, does not change a soft drink or syrup's physical appearance.

69. Second, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are virtually indistinguishable by the human body. Both contain the same number of calories and are digested and absorbed by the human body in the same manner.¹¹² Once they are absorbed, the body has no way of knowing whether a molecule of

¹⁰⁹ *Japan – Alcoholic Beverages II*, Panel Report, para. 6.23. With the exception of some of its findings concerning tariff bindings, the Appellate Body affirmed the panel's like product findings and conclusion "in all other respects." *Japan – Alcoholic Beverages II*, AB Report, Section H.1(a).

¹¹⁰ In other words, the question is not whether Coca-Cola, Gatorade or any other variety of soft drinks or syrups are "like," but whether a soft drink or syrup of a particular type and brand sweetened with HFCS is "like" a soft drink or syrup of the same particular type and brand sweetened with cane sugar.

¹¹¹ *Cf. Korea – Alcoholic Beverages* Panel Report, paras. 10.59-10.61, as affirmed by *Korea – Alcoholic Beverages* AB Report, paras 142-45 (upholding the panel's "analytical tool" of grouping imported alcoholic beverages for purposes of its directly competitive or substitutable analysis).

¹¹² See Guy H. Johnson, Ph.D., *Facts on High-Fructose Corn Syrup and Obesity*, available at <http://www2.coca-cola.com/ourcompany/hal_facts_fructose_include.html>, Exhibit US-36. The body's digestive system breaks down a soft drink's sweetener into individual glucose and fructose molecules. The molecules are then

fructose or glucose came from a soft drink or syrup sweetened with cane sugar or one sweetened with HFCS.¹¹³

70. Third, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar have nearly the same chemical composition. As explained above, HFCS-42 and HFCS-55 are the two grades of HFCS most commonly used in soft drinks and syrups. As their names indicate, HFCS-42 contains 42 percent fructose and HFCS-55 contains 55 percent fructose. Glucose comprises all but three to five percent of the remainder of both grades. Cane sugar is similarly a mixture of fructose and glucose in a 50-50 ratio. Thus, regardless of whether HFCS or cane sugar is used, a soft drink or syrup's sweetener component consists of a mixture of fructose and glucose – the only difference being the *exact* ratio of the mixture.^{114 115}

71. Fourth, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are indistinguishable on the basis of their ingredient labels. In fact, per Mexican regulation, a soft drink or syrup sweetened with HFCS and one sweetened with cane sugar bear the same ingredient on the label: “azúcares”(“sugars”). “Azúcares,” per Mexico’s regulation, is defined as all mono- or disaccharide sugars.¹¹⁶ This definition captures both the monosaccharide sugar, HFCS, and the disaccharide sugar, cane sugar. A similar situation exists in the United States where an ingredient label on a soft drink or syrup typically reads “high-fructose corn syrup and/or sugar.”

(b) End-Uses and Channels of Distribution

72. Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar share identical end-uses and channels of distribution. A soft drink or syrup’s

absorbed into the body’s bloodstream. *Id.*

¹¹³ See *id.*

¹¹⁴ HFCS’ structure as monosaccharides and cane sugar’s structure as disaccharides do not distinguish the two sweeteners when used in a soft drink or syrup. This is because, when contained in a soft drink or syrup, cane sugar (a form of sucrose) inverts or breaks its bond to form separate fructose and glucose molecules, typically within three to four weeks of bottling (depending on the soft drink or syrup’s pH and temperature). Thus, the “cane sugar” used in a soft drink or syrup exists as a monosaccharide mixture of fructose and glucose molecules, just as the HFCS used in a soft drink or syrup does. See *supra* paras. 10-11 and 22 (discussing the molecular structure of HFCS and sugar).

¹¹⁵ While the exact ratio of fructose to glucose is perhaps enough to make a soft drink or syrup sweetened with HFCS not identical to a soft drink or syrup sweetened with cane sugar, the standard under GATT Article III:2, first sentence, is likeness, not physical identity. See, e.g., *Japan – Alcoholic Beverages II*, Panel Report, para. 6.23. The panel’s finding on this point was adopted by the DSB unmodified by the Appellate Body. See *Japan – Alcoholic Beverages II*, AB Report, Section H.1(a).

¹¹⁶ Mexican Official Norm, NOM-51-SCFI-1994, General Specifications of Labels for Prepackaged Foods and Non-Alcoholic Beverages, Exhibit US-37 (in Spanish original “Especificaciones generales de etiquetado para alimentos y bebidas no alcohólicas preenvasados”).

sweetener does not affect its end-use.¹¹⁷ Whether sweetened with HFCS or sugar, a soft drink may be:

- drunk for the purpose of quenching thirst, providing energy or nourishment, or socialization;
- drunk "straight" or mixed with other beverages (both alcoholic or non-alcoholic);
- consumed before, after or during meals; and
- consumed at home or in public places such as restaurants, sporting events or bars.

Similarly, whether sweetened with HFCS or sugar, a syrup (or concentrate, powder, flavor extract or essence) when diluted to produce a soft drink or a hydrating and rehydrating beverage, may be:

- drunk for the purpose of quenching thirst, providing energy or nourishment, or socialization;
- drunk "straight" or mixed with other beverages (both alcoholic or non-alcoholic);
- consumed before, after or during meals; and
- consumed at home or in public places such as restaurants, sporting events or bars.

There is no evidence that, when Mexican bottlers, such as Coca-Cola Femsa, switched to a blend of HFCS and sugar (or when U.S. bottlers switched in the 1980s), these end-uses in any way changed.

73. For similar reasons,¹¹⁸ whether a soft drink or syrup is sweetened with HFCS or sugar does not affect its channels of distribution. For example, in its most recent annual report, Coca-

¹¹⁷ Coca-Cola describes soft drinks as follows:

Because they are predominately water, they can help quench thirst and meet the body's fluid requirement – about two quarts of liquid a day. In addition, soft drinks sweetened with sugar provide carbohydrates, which are readily available to the body for quick energy. Although soft drinks make these nutritional contributions to the diet, the Company markets them as a source of simple refreshment.

The Coca-Cola Company, Frequently Asked Questions *available at* <http://www2.coca-cola.com/contactus/faq/ingredients_include.html>, Exh. US-38. Also notable in this passage, is Coca-Cola's use of the word "sugar" when soft drinks produced by Coca-Cola in the United States are sweetened with HFCS. Use of the word "sugar" suggests that neither Coca-Cola nor its consumers consider the type of sweetener used as relevant to its functional qualities.

¹¹⁸ As the panel in *Korea – Alcoholic Beverages* remarked, "[t]here is a considerable degree of overlap between the questions of common end-uses and common channels of distribution. Often, consumer products will be distributed in a manner that reflects their intended end-uses." *Korea – Alcoholic Beverages* Panel Report, para. _.

Cola – the largest manufacturer, distributor and marketer of soft drink syrups and concentrates¹¹⁹ in the world (as well as in the United States and Mexico) – discussed *inter alia* the distribution channels for its products.¹²⁰ Nowhere in this discussion is a soft drink or syrup’s sweetener mentioned as in any way affecting the channels through which the soft drink or syrup is distributed. Instead, Coca-Cola identified retailers and “in some cases, wholesalers” as the primary means of distributing soft drinks produced by its authorized bottlers,¹²¹ regardless of whether those bottlers are located in the United States, where HFCS is the sweetener of choice, or in other countries where the company notes that most soft drinks are made with sugar.¹²² Pepsi Bottling Group, the world’s largest manufacturer, seller and distributor of Pepsi-Cola soft drinks, similarly reports no difference between the distribution channels that exist in the United States, where its soft drinks and syrups are sweetened with HFCS, and in Mexico, where its soft drinks and syrups are sweetened with cane sugar.¹²³

74. Moreover, in Mexico the sector identified as the primary distribution channel for soft drinks is retail.¹²⁴ This is the same sector identified as the primary distribution channel for soft drinks in the United States, where soft drinks are made with HFCS.¹²⁵ Thus, whether a market’s

¹¹⁹ Coca-Cola typically manufactures soft drink concentrates and syrups which it then sells to bottling and canning operations, distributors, fountain wholesalers and some fountain retailers. The company also directly manufactures some finished soft drinks including carbonated soft drinks, sport drinks, teas, juice drinks and certain waters. The company defines “concentrates” as flavorings used to prepare a soft drink syrup or a finished soft drink and “syrups” as the soft drink ingredient produced by combining concentrates, sweetener and water. The company sells its concentrates to authorized bottlers who combine the concentrate with sweeteners, water and carbonated water to produce a finished soft drink. See *The Coca-Cola Company Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, Form 10-K (for the fiscal year ended Dec. 31, 2003) at 1-3, Exhibit US-20.

¹²⁰ See *id.*

¹²¹ *Id.* at 3. The company identifies fountain wholesalers and some fountain retailers as the primary distribution channels for fountain drink syrups. *Id.*

¹²² *Id.* at 11 (stating that in the United States “the principal nutritive sweetener is high-fructose corn syrup, a form of sugar” and that the “principal nutritive sweetener used by our business outside the United States is sucrose, another form of sugar”).

¹²³ See, e.g., *Pepsi Bottling Group: At a Glance*, available at <http://www.pbg.com/01_02.asp>Exh. US-39 (“In the U.S., Canada and Mexico, our sales people interact directly with most customers to sell and promote Pepsi products (‘direct store delivery’). In other international territories, PBG goes to market with a combination of direct store delivery and third-party distributors.”). *Id.*

¹²⁴ See *Mexico: Food, beverages and tobacco background*, Economist Intelligence Unit – Executive Briefing No. 310 (2004) at 4, Exhibit US-16 (reporting that in Mexico “[a]lmost three-quarters of the entire volume sales of carbonated drinks is sold through small independent retailers”); Ben Cooper, *Mexico a growing jewel in soft drink crown*, Just-Drinks (May 17, 2004) at 1, Exhibit US-18 (“According to figures from Coca-Cola Femsa, small retailers account for 72% of total [carbonated soft drink] sales, while supermarkets and hypermarkets only account for 7% . Restaurants and bars represent 10% of sales. Meanwhile, [Pepsi Bottling Group] puts the small retailers’ share at 65%, with supermarkets and hypermarkets accounting for 10%.”); Contal, *The Soft Drink Industry*, available at <http://http://www.contal.com/our_business05.html>, Exhibit US-19 (“The main marketing channels for this industry are grocery stores and home outlets, with 75% of the sales. Restaurants, schools, clubs, hotels and places of entertainment have 22% of sales, with super markets with only 3%.”).

¹²⁵ See *Beverage Digest Fact Book 2004: Statistical Yearbook of Non-Alcoholic Beverages* 45 (9th ed., 2004) (showing distribution channels for carbonated soft drinks in 2003).

soft drinks are sweetened with sugar or HFCS would appear to be irrelevant to the channels of distribution used.

75. Further, as with end-uses, there is no evidence that channels of distribution for soft drinks or syrups in Mexico changed in the period from the late 1990s through 2001 when bottlers such as Coca-Cola Femsa had switched to a blend of HFCS and sugar for soft drink production, nor that they changed again when, because of the HFCS soft drink tax and distribution tax, bottlers switched back to 100 percent cane sugar.¹²⁶

76. This identity of end-uses and channels of distribution, of course, make sense given that one cannot physically distinguish between soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar, even by reading their labels.

(c) Consumer Preferences

77. Prior to switching to use of HFCS, U.S. soft drink bottlers undertook extensive consumer surveys to determine the consumer acceptability of soft drinks sweetened with HFCS. These surveys had consumers rate soft drinks on a variety of attributes such as sweetness, tartness, “cola” or “fruit” flavor and after taste. The ratings collected from the surveys revealed that, while some consumers noted mild differences between HFCS-sweetened and sugar-sweetened soft drinks, no one attribute stood out as differentiating the two and that overall HFCS-sweetened and sugar-sweetened soft drinks were equally acceptable to consumers.¹²⁷ Other surveys conducted were based on head-to-head comparisons of HFCS- and sugar-sweetened soft drinks. Tasters participating in these surveys showed no consistent pattern of preference for sugar-sweetened soft drinks versus HFCS-sweetened soft drinks. Today, Coca-Cola reports on its web site: “Because there is no noticeable taste difference, bottlers have the option of using either high fructose corn syrup (HFCS), beet sugar or cane sugar, depending on availability and cost.”¹²⁸

78. Evidence from the Mexican market proves similar. For example, in the course of its antidumping determination on HFCS from the United States, the Mexican Government noted a taste test, performed by a panel of 30 tasters, indicating that the panel did not detect any significant difference in sweetness or any pattern of preference for HFCS-55, refined sugar or

¹²⁶ Femsa’s annual reports from 1996 through 2003 are available on the Internet at <http://www.cocacola-femsa.com.mx/ireye/ir_site.zhtml?ticker=kof&script=750&layout=8>. These reports generally discuss channels of distributions for soft drinks bottled by Femsa. None mention the soft drinks’ sweetener as a basis for distribution channels for its products. Femsa’s 2001 annual report does mention, however, that it “converted our Mexican bottling facilities to sugar-cane-based production.” See Coca-Cola Femsa, Annual Report 2001, Exh. US-24.

¹²⁷ Panel Report, *Korea – Alcoholic Beverages*, para. 10.78 (explaining that if two products also compete in another market where choices are less affected by government tax policies, that competition is at least relevant in determining whether the two products might potentially be competitive in the market at issue).

¹²⁸ The Coca-Cola Company, *Frequently Asked Questions available at* <http://www2.coca-cola.com/contactus/faq/ingredients_include.html>, Exh. US-38.

invert sugar¹²⁹ – sweeteners used primarily in soft drink production. In that same determination, the Mexican Government also considered evidence of slight differences in taste but concluded overall: “These possible differences in products manufactured with the two sweeteners in question may prove that these sweeteners are not identical, but this does not mean that they do not have an extremely similar taste.”¹³⁰

79. As a result of positive consumer testing, U.S. manufacturers of soft drinks and syrups switched from sugar to 100 percent HFCS by the mid-1980s.¹³¹ Similarly, in the late 1990s in Mexico, Mexican soft drink producers began increasingly to substitute HFCS for cane sugar. As recalled above, by 2001 the major Mexican soft drink bottlers were increasingly using blends of HFCS and sugar to sweeten their products.¹³² Had these bottlers not been assured of the marketability of HFCS-sweetened soft drinks to the Mexican consumer, they would not have adopted its use. As recounted above, Coca-Cola Femsa had switched to a 40/60 blend by 2001 without any apparent impairment of its position as the leading soft drink bottler in Mexico.¹³³

80. Product marketing¹³⁴ also demonstrates the lack of any perceived consumer preference for soft drinks and syrups sweetened with sugar versus soft drinks and syrups sweetened with HFCS. With the exception of a handful of niche products, soft drinks are simply not marketed on the basis of whether they contain sugar or HFCS as a sweetener. In fact, U.S. soft drink companies repeatedly refer to soft drinks in advertising materials and other promotional materials (on their web sites, for example) as containing sugar, when for nearly twenty years soft drinks in the United States have been sweetened with HFCS, not sugar.¹³⁵ The recent advertising campaigns in the United States for Pepsi Edge and Coke C2 – new soft drink products sweetened with a blend of high-intensity sweeteners and HFCS – are exemplary of this:

- New Pepsi EDGE. With 50% less sugar, carbs & calories than regular colas, you can reward yourself for just about anything.

¹²⁹ *Id.*, para. 391.

¹³⁰ Resolución final de la investigación antidumping sobre las importaciones de jarabe de maíz de alta fructosa, mercancía clasificada en las fracciones arancelarias 1702.40.99 y 1702.60.01 de la Tarifa de la Ley del Impuesto General de Importación, originarias de los Estados Unidos de América, independientemente del país de procedencia, Diario Oficial, Primera Sección, Jan. 23, 1998, at 13-32 (hereinafter “Mexican AD Determination”), para. 399, Exh. US-40.

¹³¹ See *Stephen Haley, et al., Sugar and Sweeteners Outlook 19* (USDA) (May 27, 2004), Exh. US-21.

¹³² See *supra* paras. 33.

¹³³ See *supra* para. 34.

¹³⁴ See *Korea – Alcoholic Beverages*, Panel Report, paras. 10.45, 10.78 (explaining that consumer tastes in other markets can be relevant).

¹³⁵ See, e.g., The Coca-Cola Company, *Frequently Asked Questions*, available at <http://www2.coca-cola.com/contacts/faq/labeling_include.html>, Exh. US-38.

- Amazing Coca-Cola taste with 55% less calories, carbohydrates and sugar than regular cola.¹³⁶

81. Similarly with respect to Mexico, review of the annual reports of Femsa – Mexico’s largest bottler of soft drinks – from 1996 through 2003 reveals no change in marketing strategies or campaigns based on the their products’ sweetener content despite the fact that by 2001 Femsa was using a 60/40 blend of sugar and HFCS.¹³⁷

(d) Tariff Classification

82. The tariff classification system in Mexico does not separately break out soft drinks and syrups based on whether they are sweetened with sugar (whether cane or beet) or HFCS. The Mexican tariff schedule classifies soft drinks and syrups as follows:

- soft drinks, hydrating and rehydrating beverages: 2202.10 and 2202.90
- syrups (including concentrates, powders, essences and extracts): 2101.11, 2101.12, 2101.20, 2101.30, 2106.90.05, 2106.90.06 and 2106.90.07.¹³⁸

None of these subheadings or tariff items break down with regard to what type of sweetener they contain.

83. In sum, based on virtually identical physical characteristics, end-uses, channels of distribution, consumer preferences and tariff classification, HFCS-sweetened and cane sugar-sweetened soft drinks are like products within the meaning of GATT Article III:2, first sentence.

2. Soft Drinks and Syrups Sweetened with HFCS Are Taxed in Excess of Soft Drinks and Syrups Sweetened with Cane Sugar

84. The prohibition in GATT Article III:2, first sentence applies to subjecting imported products to taxes “in excess of” of those applied to like domestic products. The Appellate Body has explained that any taxation of imported products in excess of like domestic products is sufficient to render a tax inconsistent with GATT Article III:2, first sentence.¹³⁹

¹³⁶ See Pepsi Edge and Coke C2 advertising materials, Exh. US-41.

¹³⁷ See *supra* paras. 34 (discussing Mexican soft drink bottlers’ use of HFCS/sugar blends). Femsa’s annual reports from 1996 through 2003 are available on the Internet at <http://www.cocacola-femsa.com.mx/ireye/ir_site.zhtml?ticker=kof&script=700&layout=8>. These reports generally discuss marketing strategies for soft drinks bottled by Femsa. None mention the soft drinks’ sweetener as a basis for its products’ marketing strategies.

¹³⁸ See Mexican Tariff Schedule, Exh. US-43.

¹³⁹ See *Japan – Alcoholic Beverages II* AB Report, Section H.1(b).

(a) HFCS Soft Drink Tax

85. The HFCS soft drink tax applies a 20 percent tax on “final transfers in national territory, or as applicable, the final importation” of soft drinks and syrups.¹⁴⁰ Moreover, because the HFCS soft drink tax is applicable on each transfer of a soft drink or syrup (with the exception of the public sales exemption), subsequent internal transfers of imported soft drinks and syrups are also taxable at 20 percent. Only internal transfers of soft drinks and syrups sweetened exclusively with cane sugar are exempt from the IEPS. Thus, with respect to imports, the IEPS taxes (1) all soft drinks and syrups upon their importation – regardless of the sweetener used – and then (2) taxes their subsequent internal transfer if they use any sweetener other than cane sugar.

86. As explained in Section III.2, virtually all regular soft drinks and syrups produced in the United States are sweetened with HFCS, while all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar. Therefore, by exempting soft drinks and syrups sweetened with only cane sugar, the IEPS successfully exempts all regular soft drinks and syrups produced in Mexico from payment of the 20 percent tax. Imported soft drinks and syrups sweetened with HFCS, or any other sweetener for that matter, do not enjoy this same exemption, and are, therefore, taxed upon importation at 20 percent.¹⁴¹ A 20 percent tax that applies to imported soft drinks and syrups but not to soft drinks and syrups produced domestically is a tax “in excess” of that applied to like domestic products.

87. Moreover, as applied to internal transfers, the IEPS also taxes imported soft drinks and syrups “in excess of” like domestic products. As stated, the IEPS successfully exempts all regular soft drinks and syrups produced in Mexico from payment of the 20 percent tax by virtue of the fact that all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar. As reviewed above, however, soft drinks and syrups sweetened with cane sugar and soft drinks and syrups sweetened with HFCS are like products. Therefore, by applying a 20 percent tax to internal transfers of soft drinks and syrups sweetened with HFCS but not those sweetened with cane sugar, the IEPS taxes internal transfers of imported soft drinks and syrups and exempts internal transfers of soft drinks and syrups produced in Mexico. Again, a 20 percent tax that applies to imported soft drinks and syrups but not to soft drinks and syrups produced domestically is a tax “in excess” of that applied to like domestic products.¹⁴²

¹⁴⁰ IEPS as amended, Art. 1.I.

¹⁴¹ IEPS as amended, Art. 8(f) (exempting only internal transfers of soft drinks and syrups if such products are sweetened only with cane sugar).

¹⁴² The panel in *Japan – Alcoholic Beverages II* addressed a similar situation. In that case, Japan taxed vodka at a higher rate than shochu. The panel – as affirmed by the Appellate Body – found vodka and shochu to be like products and, consequently, that by taxing vodka at a higher rate than shochu, Japan had taxed an imported product in excess of the like domestic product in violation of GATT Article III:2, first sentence. See *Japan – Alcoholic Beverages II* Panel Report, para. 6.24; *Japan – Alcoholic Beverages II* AB Report, Section H.1(b) (affirming the panel).

88. Therefore, as applied at the time of importation and upon internal transfers, the HFCS soft drink tax is inconsistent with GATT Article III:2, first sentence.

(b) Distribution Tax

89. The IEPS also applies a 20 percent tax on the representation, brokerage, agency, consignment and distribution of soft drinks and syrups sweetened with HFCS.¹⁴³ Like the HFCS soft drink tax, the distribution tax applies each time a soft drink or syrup is transferred through the use of representation, brokerage, agency, consignment and distribution. Soft drinks and syrups sweetened with cane sugar are exempt from the distribution tax.

90. A tax applied on the representation, brokerage, agency, consignment and distribution of a good is, in effect, a tax on the good itself. Therefore, by taxing the representation, brokerage, agency, consignment and distribution of soft drinks and syrups sweetened with HFCS at 20 percent while completely exempting soft drinks and syrups sweetened only with cane sugar, the IEPS subjects HFCS-sweetened soft drinks and syrups to taxes “in excess of” of those applied on like domestic products – soft drinks and syrups made with cane sugar.¹⁴⁴ Accordingly, the distribution tax is also inconsistent with GATT Article III:2, first sentence.

C. The IEPS Is Inconsistent with Article III:2, Second Sentence of GATT 1994

91. GATT Article III:2, second sentence provides:

Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.*

Paragraph 1 of GATT Article III:1 provides:

The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

¹⁴³ IEPS as amended, Arts. 1.II, 2.II(A).

¹⁴⁴ As mentioned with respect to the tax on transfers, since all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar, the tax targets the distribution *et al.* of soft drinks and syrups sweetened with HFCS and imported from the United States.

The Ad Note to GATT Article III:2 states:

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

92. Thus, a measure is inconsistent with GATT Article III:2, second sentence if (1) the imported product and domestic product are "directly competitive or substitutable products;" (2) the directly competitive or substitutable imported and domestic products are "not similarly taxed;" and (3) the dissimilar taxation is applied "so as to afford protection to domestic production."¹⁴⁵ The IEPS as a tax on soft drinks and syrups made with HFCS, as well as a tax on the use of HFCS itself, meets each of these elements such that the IEPS is inconsistent with Mexico's obligations under GATT Article III:2, second sentence.

1. The HFCS Soft Drink Tax as Applied to HFCS Is Inconsistent with GATT Article III:2, Second Sentence

93. While the HFCS soft drink tax applies to imported soft drinks and syrups and plainly discriminates against them, as stated at the outset of this submission, Mexico's tax fundamentally aims to protect its domestic cane sugar industry against competition from imports of HFCS from the United States. Mexico's tax accomplishes this by taxing Mexico's largest consumer of HFCS – the soft drink and syrup industry¹⁴⁶ – if it uses HFCS instead of cane sugar. Thus, by imposing a 20 percent tax on soft drinks and syrups sweetened with HFCS, Mexico has, in effect, imposed a prohibitive tax on the use of HFCS. Taxes that discriminate against the use of an input are inconsistent with GATT Article III:2. For instance, in the *US–Malt Beverages* case under the GATT 1947, that panel found that excise tax exemptions or tax credits provided to wines produced using local ingredients were inconsistent with GATT Article III:2.¹⁴⁷

(a) HFCS and Cane Sugar Are Directly Competitive or Substitutable Products

94. HFCS and cane sugar are directly competitive or substitutable products. Indeed, the Mexican Government itself has reached this conclusion on multiple occasions in formal legal determinations, judicial decisions authoritatively interpreting the IEPS and the HFCS soft drink

¹⁴⁵ See *Japan – Alcoholic Beverages II* AB Report, Section H.2; see also *Canada – Periodicals* AB Report, p. 25.

¹⁴⁶ See ERS Model, Exh. US-8 (showing that the soft drink industry consumes 75 to 80 percent of HFCS consumed in Mexico).

¹⁴⁷ *US – Malt Beverages*, GATT Panel Report, para. 5.22.

tax in particular, and policy statements.¹⁴⁸ The direct competition between HFCS and sugar in the bottling market, and their mutual substitutability, are supported by analysis of their physical characteristics, their end-uses, consumer tastes, their tariff classifications, their identical channels of distribution, and the market relationships between them as demonstrated over time.

95. In *Japan – Alcoholic Beverages II*, the Appellate Body stated that whether two products are “directly competitive or substitutable” must be determined on a case-by-case basis and in light of all the relevant facts in the case.¹⁴⁹ The panel in *Korea – Alcoholic Beverages*, developing this test, argued that an assessment of whether there is a direct competitive relationship between two products or groups of products requires evidence that consumers consider or could consider the two products or groups of products as alternative ways of satisfying a particular need or taste.¹⁵⁰ This requires evidence of the direct competitive relationship between the domestic and imported products, including comparisons of their physical characteristics, end-uses, channels of distribution and prices.¹⁵¹ Moreover, the category of directly competitive or substitutable products is broader than the category of “like products”: even *imperfectly* substitutable products can fall under the second sentence of Article III:2.¹⁵² Products do not have to be substitutable for all purposes at all times to be considered competitive. It is sufficient that there is a pattern that they may be substituted for some purposes at some times by some consumers.¹⁵³

(i) Physical Characteristics

96. HFCS and cane sugar for use in soft drinks and syrups have substantially the same physical characteristics. Since analysis of a product’s physical characteristics is made for the purpose of assessing their competitive relationship, this analysis should focus on the defining physical characteristics of HFCS and cane sugar for the purpose of competition in the marketplace. Because the HFCS soft drink tax applies on the use of HFCS in soft drinks and syrups, the relevant “marketplace” is the soft drink and syrup industry. Such an approach was followed by the panel in *Chile – Alcoholic Beverages*, when it examined the essential physical features of whisky and pisco.¹⁵⁴

97. As discussed in Section III, HFCS is a liquid sweetener that has substantially the same chemical characteristics as cane sugar. As noted, both HFCS and cane sugar are composed of a combination of glucose and fructose molecules and, when in a soft drink or syrup, both exist as

¹⁴⁸ See *supra* note 48-55.

¹⁴⁹ *Japan – Alcoholic Beverages II* AB Report, p. 20.

¹⁵⁰ *Korea – Alcoholic Beverages* Panel Report, para. 10.40; confirmed by the Appellate Body in *Korea – Alcoholic Beverages* AB Report, para. 115.

¹⁵¹ *Korea – Alcoholic Beverages* Panel Report, para. 10.43.

¹⁵² *Korea – Alcoholic Beverages*, AB Report, para. 118.

¹⁵³ *Chile – Alcoholic Beverages*, Panel Report, para. 7.43.

¹⁵⁴ *Chile – Alcoholic Beverages* Panel Report, paras. 7.48-7.54.

monosaccharides within three to four weeks of bottling. HFCS-55 contains just five percent more fructose than cane sugar; HFCS-42 contains just eight percent less.

98. The similar chemical composition of HFCS and cane sugar is not accidental. In fact, when HFCS was developed, it was calibrated to be just as sweet as sugar as a sweetener for soft drinks. This was done by developing a fructose-glucose ratio that closely mimicked that of cane sugar.

99. Because the chemical constituents of sugar and HFCS are so similar, the taste perceptions in soft drink and syrup formulations are extremely similar. This is especially true after the sugar in a soft drink has inverted, or broken down to a monosaccharide solution of fructose and glucose molecules just as the molecules exist in HFCS.¹⁵⁵ As recounted above, testing conducted by the soft drink and HFCS industries found that HFCS-sweetened soft drinks and sugar-sweetened soft drinks were comparable and of equal acceptability to the consumer.¹⁵⁶

100. HFCS and cane sugar are also physically similar when it comes to smell and color. Both HFCS and cane sugar are odorless and, as liquids, both are colorless.

101. HFCS's form as a liquid sweetener does not distinguish it from cane sugar as a sweetener for soft drinks and syrups. First, some producers of soft drinks and syrups actually use cane sugar in its liquid form. In fact, in 2001, the Mexican Government itself considered producing liquid sugar at recently expropriated sugar mills to directly challenge U.S. HFCS sales to Mexico.¹⁵⁷ And since the HFCS soft drink tax was imposed in 2002, some Mexican refiners have been providing liquid sugar at a premium price to bottlers who no longer had the warehouse facilities¹⁵⁸ required to store sugar.¹⁵⁹ In the United States, prior to its conversion to HFCS, liquid sugar was used as the dominant sweetener for soft drinks and syrups and is used today to produce limited amounts of sugar sweetened soft drinks that meet kosher standards.¹⁶⁰

102. Second, part of the bottling process when using cane sugar as a sweetener is mixing the cane sugar with water to produce a sugar syrup, which is then mixed with other ingredients to produce a soft drink.

¹⁵⁵ See *supra* para. 22.

¹⁵⁶ See *supra* paras. 77-79.

¹⁵⁷ *Mexican Government to Keep HFCS Duties and Begins Producing Liquid Sugar to Compete in Soft Drink Production*, Food & Drink Weekly, December 10, 2001, Exhibit US-45.

¹⁵⁸ The Mexican soft drink industry has traditionally received sugar from sugar refineries in granular form, in 50-kg bags. Soft drink production with sugar has required bottlers to receive, offload and warehouse a reasonable inventory of sugar.

¹⁵⁹ See, e.g. offering of invert sugar syrup by Metco, S.A. de C.V., at <http://www.metco.com.mx/azucarinvertido.html>, Exh. US-46.

¹⁶⁰ Liquid sugar used by the U.S. bottling industry prior to the switch to HFCS was predominately invert sugar – i.e., liquid sugar in which all or part of the sucrose had been hydrolyzed.

103. The Mexican Government has also determined that cane sugar and HFCS share the same essential physical characteristics, in the context of the SECOFI antidumping investigation of HFCS in 1997-98. In its final antidumping determination published on January 23, 1998, SECOFI examined HFCS and cane sugar in detail with respect to their physical composition, chemistry, presentation, flavor, sweetening power, nutritional properties, and product shelf-life. SECOFI concluded that the two products both have very similar composition and characteristics, and share the essential characteristics of being sugars.

The sweetening power of HFCS is equivalent to that of sugar; their nutritional characteristics and caloric content are practically identical; they have highly similar ability to impart sweetness, volume, body and texture to beverages and foods; they both can dissolve in water and be used in liquid form; and they both do not contain flavors or odors that mask other flavors or odors.

Since HFCS and sugar have very similar characteristics and composition, even if they are not perfect substitutes they fulfill the same functions and are commercially interchangeable in the marketplace. . . .¹⁶¹

104. SECOFI concluded on this basis that HFCS-55, HFCS-42 and sugar are “like products” for the purposes of Mexico’s antidumping law and Article 2.6 of the Anti-Dumping Agreement.¹⁶² Article 2.6 defines “like product” as “a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product in question.”

105. When this antidumping determination was challenged in binational panel proceedings under NAFTA Chapter 19, the respondents argued that the petitioner in this investigation, the Sugar Chamber, had lacked standing to submit the petition because in their view, sugar and HFCS were not “like products.” Mexico argued in response that:

...even though sugar and HFCS differ physically in regards to the products they originate from, i.e., corn and sugar cane, and sugar beet, as well as in their processing and in their production technology, both products are finally sweeteners, with similar nutritional properties and similar sweetening power.¹⁶³

¹⁶¹ Final HFCS AD Determination, *supra*, paras. 423-425, Exh. US-40.

¹⁶² *Id.*, para. 426.

¹⁶³ NAFTA Chapter 19 Decision, *supra*, Exhibit US-14, para 503.

The binational panel agreed with Mexico that sugar and HFCS are “like products”, explaining that:

. . . it is clear that while sugar and HFCS are not equal products, they are sweeteners of similar physical composition. They are ternary organic compounds of carbon, hydrogen and oxygen with general composition $C_m(H_2O)_n$ and both have elemental compounds such as glucose and fructose.

It is also clear that sugar and HFCS as sweeteners are like products because they possess a high sweetening power, similar nutritional properties and caloric contribution, an equivalent capacity to sweeten, and give volume, texture and appropriate body for food and beverages. They also have a high and immediate water solubility and a taste that does not cover other flavors. At the same time HFCS and sugar have no toxic effects and are easy to digest.¹⁶⁴

(ii) End Uses and Consumer Preferences

106. The end-uses of HFCS and cane sugar, and consumer tastes for these products, further demonstrate their competitiveness or substitutability. As the *Chile – Alcoholic Beverages* panel observed, overlap in end-use is important in determining direct competitiveness or substitutability. The existence of mixtures, and the use of two products in varying mixtures, also testifies to their overlap in uses and to their commercial interchangeability.¹⁶⁵ Commonality of end-uses in foreign markets is also relevant; as the panel in *Korea – Alcoholic Beverages* found, if two products also compete in another market where choices are less affected by government tax policies, that competition is at least relevant in determining whether the two products might potentially be competitive in the market at issue.¹⁶⁶ Consumer tastes are also relevant. For HFCS itself or sugar, the relevant consumers are sweetener users of HFCS in the bottling industry and elsewhere.¹⁶⁷

107. The evidence submitted by the United States shows that HFCS was developed with the end-use of soft drink bottling as its major objective. HFCS was developed as a pure sweetener,

¹⁶⁴ *Id.*, paras 505-506 (internal citations omitted).

¹⁶⁵ *Korea – Alcoholic Beverages* Panel Report para. 10.77.

¹⁶⁶ *Id.*, para. 10.78.

¹⁶⁷ Although HFCS may not be usable for some applications of sugar in the baking industry, the HFCS soft drink tax does not affect those uses of HFCS, but only beverage uses. After the January 2002 inception of the HFCS tax, sugar was quickly substituted for virtually all of the HFCS sold for soft drinks subject to the tax. In any event, the soft drink industry is the primary industrial consumer of sweeteners in Mexico. See ERS Model, Exh. US-8. And, before imposition of the HFCS soft drink tax, 75 percent of HFCS consumed in Mexico was consumed by the soft drink industry. See *id.*

devoid of coloring or other flavoring that would mask the underlying flavor of beverages or food. The key customers for the producers of HFCS were the multinational soft drink producers, including Coca-Cola and Pepsi-Cola, because these companies set product standards for their bottlers. HFCS took off when these companies determined that HFCS would meet those standards just as well as sugar or invert sugar, the sweeteners used before that time.

108. Mexican soft drink producers have used varying mixtures of HFCS and cane sugar, and have converted from cane sugar to mixtures of HFCS and then back again.¹⁶⁸ This free variation between sweeteners testifies to the commercial interchangeability of HFCS and cane sugar in Mexican soft drink production. When a soft drink bottler uses a blend of HFCS and sugar, the bottler is using both sweeteners for the same purpose, in the same plant, for the same brand of the same soft drink.

109. As recounted in Section III, before January 2002, many Mexican bottlers used mixtures of HFCS and cane sugar in their soft drinks. In addition, because the HFCS soft drink tax does not apply to fruit or vegetable juices,¹⁶⁹ major juice bottlers can, and do, use as much HFCS in their sweetened juices as they wish – up to 100 percent of sweetener in some cases. Mexican bottlers' reaction to the HFCS soft drink tax was to switch back to 100 percent sugar.¹⁷⁰ The former use of HFCS and sugar in mixtures, and the use of up to 100 percent HFCS by bottlers who are not subject to a prohibitive tax, testify to the distortion of market choices created by the HFCS tax. As Coca-Cola, the world's largest soft drink producer, states: "Because there is no noticeable taste difference, bottlers have the option of using either high fructose corn syrup (HFCS), beet sugar or cane sugar, depending on availability and cost."¹⁷¹ In the United States and Canada, soft drink and syrup producers have shifted almost entirely from sugar to HFCS over time.¹⁷²

110. As the speed at which Mexican bottlers converted from sugar to HFCS/sugar blends and back again suggests,¹⁷³ switching between HFCS and sugar is not expensive or difficult. If a customer has the equipment to use HFCS, it can switch in one day. Customers that want a reliable supply will acquire their own storage tanks and pumps at a cost of US\$50,000 to US\$250,000 depending on the bottler's standards. This cost is not significant for a bottler operating on the scale of Mexican soft drink bottlers. Switching from HFCS to sugar is more difficult and costly, and Mexican bottlers would not have done so if they had not been forced to by the 20 percent tax. In the early 1980s in the United States when U.S. bottlers were using

¹⁶⁸ See *supra* para. 34 (recounting Mexican bottlers' use of HFCS/sugar blends and reversion to cane sugar with imposition of Mexico's discriminatory taxes).

¹⁶⁹ IEPS as amended, Art. 3, Exh US-4.

¹⁷⁰ See *supra* para. 34.

¹⁷¹ The Coca-Cola Company, *Frequently Asked Questions*, at <http://www2.cocacola.com/contactus/faq/labeling.html>, Exhibit US-38.

¹⁷² See *Stephen Haley, et al., Sugar and Sweeteners Outlook 19* (USDA) (May 27, 2004), Exh. US-21.

¹⁷³ See *supra* para. 34 (recounting Mexican bottlers' use of HFCS/sugar blends and reversion to cane sugar with imposition of Mexico's discriminatory taxes).

blends of HFCS and sugar, varying the HFCS-sugar ratio in a given batch of soft drinks could be done with relative ease.¹⁷⁴

111. Also, as mentioned in Section V.B.1.a, Mexican labeling regulations do not distinguish between “sugars” as a food or beverage ingredient. Thus, a bottler can move between different mixtures of HFCS and sugar without changing its labeling. Mexican consumers drink soft drinks, refreshing beverages and fruit juices sweetened with sugar, and soft drinks, refreshing beverages and fruit juices sweetened with HFCS, without any differentiation.

112. The Mexican Government has recognized the overlap in end-uses and consumer tastes between HFCS and cane sugar. As noted above, in the final antidumping determination of January 1998, SECOFI found that HFCS and sugar “fulfill the same functions and are commercially interchangeable in the marketplace.”¹⁷⁵ SECOFI noted the ample proofs presented that consumers “perceive no difference at all” between sugar, invert sugar and HFCS.¹⁷⁶ The determination also notes a taste test, performed by a panel of 30 tasters, indicating that the panel did not detect any significant difference in sweetness or any pattern of preference for HFCS-55, refined sugar or invert sugar.¹⁷⁷ Moreover, it notes that an examination of a range of food and beverage industries showed a practice that substitution of HFCS for sugar was not promoted as a change in brand or a “new flavor.”¹⁷⁸

113. During the review of this determination by the binational panel under Chapter 19, in defending SECOFI’s determination that sugar and HFCS are like products (and therefore the Sugar Chamber had standing to submit an antidumping petition regarding HFCS), Mexico argued that “technical studies and testimonies of representatives of the [soft drink] industry show that HFCS and sugar are both used interchangeably in the industry without affecting the quality of soft drink products,” and that “HFCS and sugar while not perfect substitutes possess characteristics and composition sufficiently similar that they serve a great number of similar functions. This allows them to be commercially interchangeable in such a great variety of sub-sectors of the beverages and food sectors.”¹⁷⁹ The Chapter 19 binational panel concluded:

¹⁷⁴ See James R. Clayton, *Extra Care in Blending*, Beverage World 44, 56 (Aug. 1981), Exh. US-49 (“A blending unit essentially consists of two positive displacement pumps, one for sucrose, the other for HFCS. Both are driven by a single motor. This system delivers a predetermined blend for each and every batch. However, the blend may be changed (if different proportions are desired), by changing drive sprockets to deliver a new proportion of each product. Since this can be a time-consuming task if blended proportions frequently change, this same system may be equipped with a four-speed transmission. A shift of the gear lever then delivers any of the four different blend ratios.”)

¹⁷⁵ Final HFCS AD Determination, Exh. US-40, para. 425.

¹⁷⁶ *Id.*, para. 355.

¹⁷⁷ *Id.*, para. 391.

¹⁷⁸ *Id.*, para. 396.

¹⁷⁹ NAFTA Chapter 19 Decision, paras. 512, 514, Exh. US-14.

. . . even though it is true that HFCS and sugar can present certain advantages and disadvantages in some of the products of the industries in which they are competitive due to their physical presentation or certain technical and economical advantages that each one possess in its applications, the above does not prevent sugar and HFCS from serving similar functions or being commercially interchangeable, when applying them in a liquid state to a variety of uses in the beverages and food sector, including soft drinks. . . The proof of the above is that, in general terms, the ability to use both sweeteners coexist in the national market in same plants, even for the same brands.

. . . experts reports and technical studies that were filed during the investigation demonstrate that the existence of similar physical properties in HFCS and sugar regarding sweetening, body, acid balance, viscosity, density and caloric contribution, allow producers and consumers to use the two products interchangeably without sacrifice of the final product quality.¹⁸⁰

The Chapter 19 panel’s finding that sugar and HFCS are commercially interchangeable, as well as the other evidence above, confirm that sugar and HFCS are directly competitive or substitutable, and that beverages sweetened with each or with admixtures of both are substitutable, and in direct competition in the marketplace.

(iii) Channels of Distribution

114. The channels of distribution for HFCS and cane sugar, and for soft drinks sweetened with them, provide additional evidence that these products are directly competitive or substitutable. As the panel in *Chile – Alcoholic Beverages* noted, the fact that one good shares distribution channels with another serves as evidence of substitutability in end-uses.¹⁸¹ HFCS and sugar are sold through similar channels from producers to industrial bottlers, and in some cases the same company sells both HFCS and sugar to similar customers.

115. HFCS of U.S. origin has been sold to Mexican customers through two channels. Before the IEPS eliminated almost all U.S. exports of HFCS to Mexico, some Mexican bottlers affiliated with U.S.-based soft drink companies purchased HFCS on an FOB basis directly from the U.S. exporter under North American supply agreements, and acted as the importer of record. However, the bulk of the trade in HFCS took place through terminals built by HFCS exporters in

¹⁸⁰ *Id.*, paras. 517-518.

¹⁸¹ Panel Report, *Chile – Alcoholic Beverages*, para. 7.81.

Mexico.¹⁸² These terminals received HFCS exports from plants in the United States and then sold the HFCS to customers in Mexico. Mexican bottlers buy Mexican cane sugar directly from the sugar mill or from a distributor.¹⁸³ Any difference in distribution channels is, thus, attributable to the fact that HFCS is the imported sweetener and cane sugar is the domestic sweetener. Both sweeteners are sold directly from the sweetener producer to the end-user, which with respect to this dispute are soft drink and syrup bottlers.

116. In the antidumping investigation on HFCS from the United States, SECOFI examined distribution channels for HFCS and sugar and found that they were the same, and were targeted at the same customers.¹⁸⁴

(iv) Tariff Classification

117. The classification of these products in the Mexican tariff schedule also supports the conclusion that these are directly competitive or substitutable products. Both HFCS and sugar are classified in Chapter 17, “Sugars and sugar confectionery.” Cane sugar in solid form is classified under heading 1701. Liquid sugar, invert sugar and HFCS are classified under “Other sugars” in heading 1702. Liquid sugar and invert sugar are classified under 1702.90.01; HFCS 42 is classified under items 1702.40.01 and 1702.40.99; HFCS 55 is classified under 1702.60.00, 1702.60.01 and 1702.60.99.¹⁸⁵ Thus, although cane sugar is generally classified under heading 1701 and HFCS under heading 1702, some cane sugar products (i.e., liquid cane sugar and invert cane sugar) are classified under heading 1702.

118. With respect to soft drinks and syrups sweetened with either HFCS or cane sugar, as recounted above, the tariff classification system in Mexico does not separately break out soft drinks and syrups based on whether they are sweetened with cane sugar or HFCS.¹⁸⁶

(v) Price Relationships and Competition in the Marketplace

119. The price relationships between HFCS and cane sugar in soft drink use also demonstrate that they are directly competitive or substitutable products. In Mexico, the HFCS soft drink tax and its economic effects have thrown the sugar-HFCS relationship into high relief. The connection between the price, or availability, of HFCS and the price of sugar has been amply demonstrated by the real-world economic experiment of the HFCS soft drink tax. In the three days following the enactment of the tax, for example, 30 Mexican bottlers cancelled all orders for

¹⁸² See Peter Buzzanell, *Sugar and Sweeteners Outlook* 32 (June 30, 1995), Exh. US-17.

¹⁸³ See National Chamber of Alcohol and Sugar Industries, Procazucar, S.A. de D.V., *Comparative Study Between Sugar and High Fructose Corn Syrup* 14, Exh. US-47.

¹⁸⁴ Final HFCS AD Determination, paras. 446-447, Exh. US-40.

¹⁸⁵ See Mexican Tariff Schedule, Exh. US-43.

¹⁸⁶ See *supra* para. 82.

HFCS.¹⁸⁷ By mid-January 2002, the HFCS soft drink tax had resulted in a 8 percent increase in Mexican sugar prices.¹⁸⁸

120. Because of the HFCS tax, and the collapse of demand for HFCS from bottlers, importers shuttered their terminals or otherwise virtually ceased imports of HFCS for soft drink and syrup production, and domestic HFCS producers partially or totally idled their production. Yet demand for sweeteners has remained constant or growing with annual growth in population and GDP.¹⁸⁹ As sugar replaced HFCS in soft drink and syrup production, the additional demand for sugar forced up the price of sugar and artificially created a sugar shortage, resulting by summer 2003 in acute difficulties for the bottling and confectionery industries and other Mexican users of sweeteners. One of the best causal explanations appeared in an August 21, 2003 press release of the Secretariat of Economy, explaining the government's decision to provide an extraordinary *cupo* (market access quota) for sugar imports during the latter part of 2003:

This plan results from various complaints about shortage problems in sugar, presented to the Secretariat of Economy by producers who use sugar in their production processes. *These concerns are fundamentally a consequence of the entry into force of the Impuesto Especial sobre Producción y Servicios (IEPS) for soft drinks made with fructose*, which has generated a substitution of sugar for fructose equal to approximately 500,000 MT, through which exportable surpluses of sugar have been significantly reduced and domestic production has reached a point very close to domestic consumption. Given the foregoing, and in accordance with estimates of annual consumption, in the last months of this year there may be a shortage of sugar, particularly refined sugar.¹⁹⁰

121. In 2004, there has been an increasing shortage of sugar, price increases, and complaints by Mexican sweetener users, who now face sugar prices 42 percent higher than in 2001.¹⁹¹

122. The Mexican Government Comisión Federal de Competencia (CFC, or Federal Competition Commission) has also recognized that sugar and HFCS are directly competitive with each other in the marketplace, in two separate decisions regarding competition in the sugar industry. These decisions were based on an examination of the detailed facts of competition in

¹⁸⁷ *Venta-Fructosa*, Servicio Universal de Noticias, January 6, 2002, Exh. US-50.

¹⁸⁸ *Industriales México rechazan gravamen a refrescos*, Reuters, January 10, 2002, Exh. US-52.

¹⁸⁹ See USDA ERS Model, Exh. US-8.

¹⁹⁰ *Boletín #55, Cupo de Importación de Azúcar, Medida de Prevención*, Boletín de Prensa No. 199, Aug. 21, 2003, available via Secretariat of Economy press room at <http://www.apps1.economia.gob.mx/webportal/boletines/html/boletines.asp>, Exh. US-53 (emphasis added).

¹⁹¹ *Government accused of manipulating sugar prices*, Corporate Mexico, Aug. 27, 2004, Exh. US-54.

the Mexican sweeteners market by the CFC, a governmental agency with substantial expertise on the facts of this particular market and on competition in Mexico.

123. The CFC's report of its activities in 1993-94 discusses its examination of the acquisition of Xafra S.A. de C.V. (Xafra) by Consorcio Integral de Empresas S.A. de C.V. (CIE). The combined enterprise would control 48 percent of the market of refined sugar, and 7.9 percent of the market of *estandar* (semi-refined) sugar. The CFC determined that refined sugar was the relevant market for its examination. The CFC then examined internal transportation costs for sugar, the high tariffs on sugar, and the fact that Mexico's trade agreements did not require Mexico to reduce these tariffs in the near future. For these reasons, the CFC determined that the relevant geographic market was limited to Mexico. The CFC determined that this high a concentration might nevertheless not lead to substantial market power in the refined sugar market: as one reason, the CFC stated that because HFCS is a "close substitute for refined sugar in carbonated drinks," a market mechanism existed that would limit the ability of the merged enterprise to exercise monopoly power in the refined sugar market. Nevertheless, as a preventive measure, the CFC required CIE to notify all future acquisitions in the sugar sector.¹⁹²

124. The CFC examined another refinery merger in 1999, when the integrated sugar grower and refiner Grupo Industrial Azucarero de Occidente, S.A. de C.V. sought to acquire a sugar distributor and a sugar refinery owned by the distributor. The CFC identified the relevant market as the production and commercialization of sugar in the Mexican national market, with two segments, refined and *estandar* sugar. The CFC observed that the principal use for refined sugar was in bottling, and stated that "High fructose corn syrup (HFCS) is a substitute primarily for refined sugar. The demand for HFCS has grown significantly in recent years and has been met by domestic production and by imports. Within the relevant market, numerous competitors compete, some of which are tied to bottlers, moreover there are no significant barriers to imports of HFCS. Because of the above, the Commission determines that the transaction will not generate effects contrary to the process of free competition."¹⁹³

125. As the panel in *Chile – Alcoholic Beverages* noted, "the question of competition from an anti-trust perspective . . . generally utilizes narrower market definitions than used when analyzing markets pursuant to Article III:2, second sentence. Consequently, it seems logical that competitive conditions sufficient for defining an appropriate market with respect to anti-trust

¹⁹² Comisión Federal de Competencia, *Informe Anual 1993-94*, Cap. II, Concentraciones, at <http://sp.cfc.gob.mx:8080/cfc01/Documentos/cfc99e/Informes/Informe%20Anual%201993-1994/capII9394.htm>, Exh. US-55.

¹⁹³ Comisión Federal de Competencia, Grupo Azucarero del Occidente, SA de CV/Grupo More, SA de CV/Ingenio Jose Maria Morelos, SA de CV, Resolution CNT-61-99, Jun. 17, 1999, at <http://www.cfc.gob.mx/Contenido.asp?P=DirResults.asp?txtDir=http://xeon2/cfc01/Documentos/cfc99e/Difusión/Documentos%20Publicados>, Exh. US-56.

analysis would *a fortiori* suffice for an Article III analysis.”¹⁹⁴ Just as that panel read the findings of Chilean competition authorities to confirm the finding that pisco and other distilled spirits were directly competitive or substitutable products in the Chilean market, the Panel should read the findings of the CFC to confirm that cane sugar and HFCS are directly competitive or substitutable products in the Mexican market.

(vi) Summary on Direct Competition and Substitutability

126. As the panel noted in *Chile – Alcoholic Beverages*, it is the shared characteristics of goods that create possibilities for substitution and, thus, for competition in the marketplace.¹⁹⁵ HFCS as a product was developed to mimic the characteristic of sugar that is most important to soft drink and syrup bottlers, that it imparts sweetness. This shared characteristic makes the two products competitive in the sweeteners markets in Mexico, the United States, Canada and elsewhere.

127. To set the HFCS-sugar comparison in perspective, the Panel might consider the WTO disputes regarding discrimination in taxation of distilled spirits. Each of these disputes concerned a situation of long-standing tax discrimination, in which tax barriers largely foreclosed the market to the imported product. The panel and the parties in each of these cases had to place a particular focus on *potential* competition and latent demand, since actual discrimination was so severe and so long-standing.

128. Nevertheless, the panel in *Japan – Alcoholic Beverages II* found direct competition and substitutability between shochu and whisky, brandy, rum, gin, genever and liqueurs.¹⁹⁶ The panel in *Korea – Alcoholic Beverages* found direct competition and substitutability between soju and vodka, whiskies, rum, gin, brandies, cognac, liqueurs, tequila and admixtures.¹⁹⁷ The panel in *Chile – Alcoholic Beverages* then found direct competition and substitutability between all kinds of pisco and all kinds of whisky, brandy, rum, gin, vodka, liqueurs, aquavit, fruit brandies, ouzo and tequila.¹⁹⁸ In each of these past WTO disputes, product pairs recognized as directly competitive or substitutable included products with far sharper physical differences than those seen in the case of HFCS and cane sugar used in beverage production.

129. In the present case, there is not just *potential* competition between imported HFCS and domestic cane sugar: the Panel has available to it data on *actual* competition between these

¹⁹⁴ Panel Report, *Chile - Alcoholic Beverages*, WT/DS87/R, para. 7.87, endorsing the finding in para. 10.81 of the Panel Report on *Korea - Alcoholic Beverages*, WT/DS75/R, that since Article III is primarily concerned with competitive opportunities it defines markets more broadly than anti-trust which is designed to protect the actual mechanisms of competition.

¹⁹⁵ *Chile - Alcoholic Beverages* Panel Report, para. 7.82.

¹⁹⁶ *Japan - Alcoholic Beverages II* Panel Report, para. 7.1(b).

¹⁹⁷ *Korea - Alcoholic Beverages* Panel Report paras. 10.98, 10.57.

¹⁹⁸ *Chile - Alcoholic Beverages*, Panel Report, para. 7.88.

products including product switching before and just after the HFCS soft drink tax was imposed. HFCS itself was developed to mimic and improve on cane sugar in soft drink bottling operations, and its success in the marketplace of the bottling industry testifies to how close a substitute it is for sugar. Indeed, if HFCS were not quite so successful at competing with cane sugar, the Mexican Government might not have acted to protect the Mexican sugar industry, by enacting the HFCS soft drink tax to expel imported HFCS from the soft drink and syrup market in Mexico.

130. For all these reasons, the Panel should find that for purposes of sweetening soft drinks, imported HFCS and Mexican cane sugar are directly competitive or substitutable products, and compete directly in the soft drink and syrups sweeteners marketplace in Mexico.

(b) HFCS and Cane Sugar Are Not Similarly Taxed

131. There can be no question that the HFCS soft drink tax taxes HFCS and cane sugar dissimilarly.¹⁹⁹ When contained in a soft drink or syrup, HFCS results in a 20 percent tax on the value of the finished soft drink or syrup. Use of exclusively cane sugar in that same soft drink or syrup results in no tax at all. As applied to HFCS, however, the impact of the tax differential actually far exceeds a 20 percentage point difference. As recounted above, this is because the HFCS soft drink tax is calculated on the value of the finished soft drink or syrup such that the tax results in a tax that is four times the value of the HFCS – or in other words, a 400 percent tax on HFCS. With a tax liability of 400 percent, the HFCS producer cannot even provide HFCS to its customer for free: the producer would have to pay the customer to take it. As U.S. exporters have experienced, the HFCS soft drink tax is essentially a prohibitive tax on the use of HFCS in soft drinks and syrups. Needless to say, a prohibitive tax applied to the imported product that is not applied to the directly competitive or substitutable domestic product is a dissimilar tax within the meaning of GATT Article III:2, second sentence.²⁰⁰

(c) HFCS Soft Drink Tax Is Applied So As to Afford Protection to Domestic Production

132. The protective application of a measure is to be discerned from the structure of the measure itself, including the very magnitude of the dissimilar taxation involved. As the Appellate Body in *Japan – Alcoholic Beverages II* explained:

[W]e believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to

¹⁹⁹ See *Japan – Alcoholic Beverages II* AB Report, p. 27 (regarding “not similarly taxed”).

²⁰⁰ Cf. *Canada - Periodicals* AB Report, pp. 31-32 (finding an essentially prohibitive tax on imports to violate GATT Article III:2, second sentence).

imported products. We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the Panel rightly concluded in this case.²⁰¹

133. A measure's purpose, to the extent it is "objectively manifested in the design, architecture and structure of the measure" may also be "intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production."²⁰²

134. Mexico's tax on the use of HFCS is applied "so as to afford protection" to Mexican cane sugar production.²⁰³ As elaborated below, this conclusion is supported by the structure of the tax itself, including the sheer size of the dissimilar taxation involved, and confirmed by an extraordinary series of judicial pronouncements and legislative statements that the purpose of the IEPS is to "protect the sugar industry."

135. The HFCS soft drink tax is structured such that all soft drinks and syrups are taxed 20 percent, except those sweetened exclusively with cane sugar. As elaborated above, cane sugar is a domestically-produced sweetener in Mexico. Since Mexico does not import sugar – or does so in only very small amounts – this is a benefit bestowed nearly exclusively on domestic producers.²⁰⁴ Domestic producers have, thus, benefitted from being placed in an un-taxed category, while their greatest commercial rival, the imports of HFCS, remain subjected to taxation.

136. Moreover, as indicated above, HFCS remains not only subject to taxation but taxation at a prohibitive rate. As stated, a 20 percent tax on the value of the finished soft drink or syrup results in a 400 percent tax on the use of HFCS itself. The enormity of this dissimilar taxation

²⁰¹ See *Japan – Alcoholic Beverages II* AB Report, Section H.2(c); *Chile – Alcoholic Beverages* AB Report, para. 61.

²⁰² See *Chile – Alcoholic Beverages* AB Report, para. 71; see also *id.* para. 72 (stating that to "try to relate the observable structural features of the measures with its declared purposes" is "a task that is unavoidable in appraising the application of the measure as protective or not of domestic production").

²⁰³ As noted in Section III, Mexico does not produce beet sugar – a product that in its refined form is chemically indistinguishable from cane sugar. Thus, an exemption from the HFCS soft drink tax that benefits only cane sugar is clearly aimed at protecting domestic production, and is inconsistent with Article III:2, first sentence, since even the chemically identical product, that happens not to be produced in Mexico, is still taxed.

²⁰⁴ See *supra* para. 20.

has effectively excluded imported HFCS from the Mexican sweeteners market. Moreover, the tax on the use of HFCS applies to any taxable product as long as it is not *exclusively* sweetened with cane sugar. Therefore, if a bottler were to use a 20-80 blend of HFCS and sugar, the tax would actually amount to many times the cost of the HFCS in the soft drink or syrup. The IEPS thus particularly prevents customers from using the HFCS-sugar blends that were starting to become popular in 2001. Dissimilar taxation of this magnitude and nature objectively manifests the intention of the tax to protect Mexican cane sugar production.

137. Further, the structure of the HFCS soft drink tax is such that the low-taxed product is almost exclusively domestically-produced, while the high-taxed product, prior to imposition of the discriminatory tax, comprised virtually all directly competitive or substitutable imports. Indeed, in 2001 HFCS accounted for 99.7 percent of Mexican nutritive sweetener imports.²⁰⁵ By contrast, in 2001 cane sugar comprised somewhere between 90 and 95 percent of domestically produced sweeteners in Mexico.²⁰⁶ Thus, at the time of its imposition, the HFCS soft drink tax applied to nearly 100 percent of sweetener imports but less than ten percent of Mexican production.

138. The Appellate Body addressed a similar situation in *Chile – Alcoholic Beverages*. In that dispute, the Appellate Body observed that with respect to alcoholic beverages, Chile largely applied one of two fixed tax rates: 27 percent for beverages with an alcohol content of less than 35 degrees and 47 percent for beverages with an alcohol content of more than 39 degrees. Although Chile’s tax applied based on alcohol content, the Appellate Body pointed out that the consequence of that tax was that approximately 75 percent of all domestic production was taxed at the lowest rate, whereas approximately 95 percent of the directly competitive or substitutable imported products were taxed at the highest rate.²⁰⁷ After also noting the magnitude of the dissimilar taxation, the Appellate Body then concluded that the “design, architecture and structure” of Chile’s tax “tend[ed] to reveal that the application of dissimilar taxation of directly competitive or substitutable products will ‘afford protection to domestic production.’”²⁰⁸ Like Chile’s tax, the “design, architecture and structure” of the IEPS reveals an intent to afford protection to domestic production.

139. The protectionist structure of the IEPS is confirmed by a remarkable series of judicial and political pronouncements, as discussed in Section III, that the purpose of the tax is to protect Mexico’s domestic cane sugar industry. For example, Mexico’s legislative leaders have stated:

²⁰⁵ See Sweetener Imports and Market Share, Exh. US-42.

²⁰⁶ See *supra* note 38.

²⁰⁷ *Chile – Alcoholic Beverages* AB Report, paras. 64-67; see also *Korea – Alcoholic Beverages*, AB Report, para. 150 (“[T]he tax operates in such a way that the lower tax brackets cover almost exclusively domestic production, whereas the higher tax brackets embrace almost exclusively imported products.”)

²⁰⁸ *Id.*, paras. 66, 76. Notably, the Appellate Body dismissed Chile’s point that domestic products are not only subject to the highest tax rate but also comprise the major part of the volume of sales in that bracket. “This fact does not, however, by itself outweigh the other relevant factors, which tend to reveal the protective application of the [Chile’s tax].” *Id.*, para. 67.

[i]n order to not cause a major injury to the sugar industry, it is proposed that the tax on soft drinks apply exclusively to those which for their production utilize fructose in substitution for cane sugar.”²⁰⁹

[w]e legislators, however, have the commitment to protect the domestic sugar industry because a great number of Mexicans’ subsistence depends on it. To that effect, a tax on soft drinks that applies only to those which for their production utilize fructose in substitution for cane sugar is proposed.”²¹⁰

Mexico’s highest Mexican judicial authority, the Supreme Court, has also authoritatively ruled that the purpose of the HFCS tax is to protect domestic production. That ruling of principle is now binding on all lower courts.²¹¹

140. In sum, the HFCS soft drink tax, as a tax on HFCS but not the directly competitive or substitutable domestic product cane sugar, is applied in a manner so as to afford protection to domestic production, and, therefore, is inconsistent with Mexico’s obligations under GATT Article III:2, second sentence.

²⁰⁹ *Gaceta Parlamentaria, Cámara de Diputados*, No. 911-IV, Dec.30, 2001, at <http://gaceta.cddhcu.gob.mx/Gaceta/58/2001/dic/Anexo-IV-30Dic.html> (unofficial English translation), Exh. US-28 (“Con el objeto de no ocasionar una afectación mayor a la industria azucarera, se propone que el impuesto a los refrescos se aplique exclusivamente a aquellos que para su producción utilizan la fructosa en sustitución del azúcar de caña.”).

²¹⁰ Stenographic record of debate by Deputies, at <http://cronica.diputados.gob.mx/PDF/58/2001/dic/011229-4.pdf>, at pp. 711-712 (unofficial English translation), Exh. US-29 (“Tenemos nos legisladores, sin embargo, el compromiso de proteger a la industria azucarera nacional, ya que de ella depende la subsistencia de gran numero de mexicanos. Para tal efecto se propone que el impuesto a los refrescos se aplique solamente a aquellos que para su producción utilicen la fructuosa en sustitución del azúcar de caña.”).

²¹¹ *See supra* para. 55.

2. The HFCS Soft Drink Tax and Distribution Tax as Applied to Soft Drinks and Syrups Is Inconsistent with GATT Article III:2, Second Sentence

(a) Soft Drinks and Syrups Sweetened with Cane Sugar Are Directly Competitive or Substitutable with Soft Drinks and Syrups Sweetened with HFCS

141. The category of “like” products is a subset of those products which are directly competitive or substitutable.²¹² Therefore, as soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are like products they are necessarily directly competitive or substitutable products.

142. Moreover, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are directly competitive or substitutable products for many of the same reasons they are “like”.

143. First, with respect to physical appearance, end-uses and channels of distribution, consumer preferences and tariff classification, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are virtually the same. Physically, a soft drink or syrup sweetened with HFCS cannot be distinguished from a soft drink or syrup sweetened with cane sugar by looking at it or even by reading its ingredient label. With respect to the products’ chemical composition and structure, each product’s sweetener component consists of a similarly proportioned ratio of glucose and fructose molecules and is absorbed by the human body in the same way. Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar also share the same end-uses and distribution channels and are marketed to consumers in the same way. Moreover, numerous consumer surveys have demonstrated a lack of consumer preference for one product over the other and shown that the two products are equally acceptable to consumers. In addition, the Mexican tariff classification system does not differentiate between soft drinks and syrups sweetened with HFCS and those sweetened with cane sugar.

144. Second, HFCS-sweetened and sugar-sweetened soft drinks and syrups compete in the same market and for the same customers. The periods of transition from sugar to HFCS in both the Mexican and U.S. make this clear. For example, in the early 1980s in the United States, Coca-Cola switched to an HFCS/sugar blend several years prior to Pepsi-Cola. There is no evidence that Coca-Cola-Pepsi rivalry ended, or abated even, during the time when Pepsi-Cola continued to sweeten their products with sugar while Coca-Cola had converted to an HFCS/sugar blend.²¹³ The same is true for the Mexican market, where Coca-Cola bottlers like Coca-Cola

²¹² See *Japan – Alcoholic Beverages II* Panel Report, para. 6.22 (unmodified by the AB); *Korea – Alcoholic Beverages* Panel Report, para. 10.40 (unmodified by the AB).

²¹³ See, e.g., ‘83: *More Trench Warfare*, *Beverage World* 26-28 (Feb. 1983), Exh. US-51.

Femsa had converted to HFCS blends while Pepsi-Cola bottlers continued to use exclusively cane sugar. Moreover, the fundamental reason bottlers switch to producing HFCS-sweetened soft drinks was the price advantage and efficiencies gained by using HFCS as opposed to cane sugar. This price advantage and these efficiencies were sought, of course, not to produce a product that could no longer compete with sugar-sweetened soft drinks, but to produce a product that would compete better.

145. For these reasons, as well as others examined in more detail in Section V.B.1, soft drinks and syrups sweetened with HFCS and soft drinks sweetened with cane sugar are directly competitive or substitutable products within the meaning of GATT Article III:2, second sentence.

**(b) Soft Drinks and Syrups Sweetened with HFCS and Soft Drinks
and Syrups Sweetened with Cane Sugar Are Not Similarly
Taxed**

146. As stated in Section III.B.1, the HFCS soft drink tax imposes a tax at a rate of 20 percent on (1) all importations of soft drinks and syrups from the United States and (2) subsequent internal transfers of such soft drinks and syrups if they are sweetened with HFCS. The IEPS exempts from the latter soft drinks and syrups sweetened with cane sugar. As also stated in Section III.2, all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar, such that the exemption successfully excludes all regular soft drinks and syrups produced in Mexico from payment of the tax. Consequently, the HFCS soft drink tax results in a 20 percent tax on imported soft drinks and syrups, and their subsequent internal transfer if sweetened with HFCS, that is not similarly applied to directly competitive or substitutable products.²¹⁴ Imposing a 20-percentage-point differential between the tax on the imported product and the tax on the directly competitive or substitutable product clearly means that the products are not “similarly taxed”.²¹⁵ Accordingly, the HFCS soft drink tax as applied to soft drinks and syrups – both at the time of importation and on subsequent transfers – results in the type of dissimilar taxation captured under GATT Article III:2, second sentence.

147. In addition, the distribution tax also results in dissimilar taxation of imported soft drinks and syrups. Like the tax on internal transfers, the IEPS exemption for soft drinks and syrups sweetened with cane sugar, also successfully excludes all regular soft drinks and syrups produced in Mexico from payment of the distribution tax. Because virtually all regular soft drinks and syrups produced in the United States are sweetened with HFCS, imported soft drinks and syrups do not enjoy the same exemption. As a consequence, the distribution tax taxes the

²¹⁴ The Appellate Body in *Japan – Alcohol* stated that “to be ‘not similarly taxed’, the tax burden on imported products must be heavier than on ‘directly competitive or substitutable’ domestic products and that burden must be more than *de minimis* in any given case.” See *Japan – Alcohol*, AB Report, p. 29.

²¹⁵ See *Japan – Alcohol* AB Report, Section H.2(b) (“We agree with the Panel that this amount of differential taxation must be more than *de minimis* to be deemed “not similarly taxed in any given case.”); *Chile – Alcohol* AB Report, para. 66.

representation, brokerage, agency, consignment and distribution of imported soft drinks and syrups but not the representation, brokerage, agency, consignment and distribution of soft drinks and syrups produced in Mexico.

148. As stated in Section III.B.1, a tax on the representation, brokerage, agency, consignment and distribution of a good, is in effect, a tax on the good itself. Therefore, the distribution tax constitutes a tax applied on imported soft drinks and syrups that is not similarly applied to directly competitive or substitutable products produced in Mexico.

(c) The HFCS Soft Drink and Distribution Tax Is Applied So As to Afford Protection to Domestic Production

149. As stated above, whether a measure is “applied so as to afford protection to domestic production” is “an issue of how the measure in question is applied.” The IEPS – both its HFCS soft drink tax and its distribution tax – is applied such that it affords protection to domestic production. Under the IEPS, soft drinks and syrups sweetened with HFCS are taxed at 20 percent (whether on their importation, internal transfer or in connection with their representation, brokerage, agency, consignment or distribution), whereas soft drinks and syrups sweetened with cane sugar are not. As discussed above, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are directly competitive or substitutable products. Moreover, as also explained above, all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar,²¹⁶ whereas virtually all soft drinks and syrups produced in the United States are sweetened with HFCS.²¹⁷ Therefore, the structure of the IEPS, by which it taxes soft drinks and syrups made with HFCS, but not those made with cane sugar, is to apply a 20 percent tax on soft drinks and syrups imported from the United States and no tax on directly competitive or substitutable soft drinks and syrups produced in Mexico.

150. The structure of the IEPS is precisely the type of structure that has been found on prior occasions to constitute persuasive evidence that a measure is applied “so as to afford protection.” For example, in *Chile – Alcoholic Beverages* as detailed above, the Appellate Body viewed as persuasive evidence of the measure’s protectionist intent the fact that the Chilean tax placed 75 percent of domestic products in the category with the lowest tax rate, and approximately 95 percent of the directly competitive or substitutable imported products in the category subject to the highest tax rate.

151. In that same dispute, the Appellate Body also took note of the 20 percentage point difference between the two tax rates – a difference the Appellate Body characterized as

²¹⁶ Even prior to imposition of the HFCS soft drink tax and distribution tax, sugar comprised over 70 percent of the sweeteners consumed by the Mexican soft drink industry. See USDA ERS Model, Exh. US-8. Thus, even factoring out the discriminatory effect of the tax on bottlers’ choice of sweeteners, cane sugar was still the dominant sweetener used in Mexican soft drink and syrup production.

²¹⁷ See *supra* paras. 30-32.

“considerable.”²¹⁸ The same percentage point difference exists with respect to Mexico’s taxation of soft drinks and syrups sweetened with HFCS. If viewed on an order of magnitude basis, however, the 20-percentage point difference in this dispute far exceeds the tax differential examined in *Chile – Alcoholic Beverages* as well as the tax differentials observed in the other WTO alcoholic beverages disputes. Moreover, the IEPS applies not only on the importation and internal transfer(s) of soft drinks and syrups themselves but also on their representation, brokerage, agency, consignment and distribution. Thus, the tax differential is not just 20 percent on the value of the soft drink or syrup but an additional 20 percent on the value of any representation, brokerage, agency, consignment or distribution used to effectuate that soft drink or syrup’s transfer.

152. As a tax on imported soft drinks and syrups that is not similarly applied to directly competitive or substitutable soft drinks and syrups produced in Mexico, the IEPS (HFCS soft drink tax and distribution tax) is inconsistent with Mexico’s obligations under GATT Article III:2, second sentence.

D. The HFCS Soft Drink Tax, Distribution Tax and Reporting Requirements Applied on the Use of HFCS Are Inconsistent with GATT Article III:4

153. GATT Article III:4 provides in relevant part:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

154. In examining a claim under GATT Article III:4, the Appellate Body has identified three distinct elements required to establish a violation: (1) the imported and domestic products are "like products;" (2) the measure is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products; and (3) the imported product is accorded less favorable treatment than the domestic like product.²¹⁹

155. The IEPS meets each of these criteria as a tax on the use of HFCS by (1) taxing the transfer of soft drinks and syrups made with HFCS at 20 percent (HFCS soft drink tax); (2) taxing the representation, brokerage, agency, consignment and distribution of soft drinks and syrups made with HFCS (distribution tax); and (3) subjecting soft drinks and syrups made with

²¹⁸ *Id.*, para. 66.

²¹⁹ *Korea – Various Measures on Beef* AB Report, para. 133.

HFCS to numerous bookkeeping and reporting requirements (reporting requirements). These measures are not imposed on cane sugar or soft drinks and syrups made only with cane sugar.

1. HFCS and Cane Sugar Are Like Products

156. As the details provided in Section V.C.1 reveal, HFCS and cane sugar compete head-to-head as sweeteners for soft drinks and syrups. Indeed, as a sweetener in soft drinks and syrups, HFCS and cane sugar are near perfect substitutes. This is demonstrated by the facts reviewed above and, in particular, by the fact that prior to imposition of the IEPS, soft drink and syrup producers were, in rapidly increasing amounts, actually substituting HFCS for cane sugar. These facts overwhelmingly support a finding that HFCS and cane sugar are “directly competitive or substitutable” products for purposes of sweetening soft drinks and syrups within the meaning of GATT Article III:2. They are also more than adequate to support a finding that HFCS and cane sugar are “like” products within the meaning of GATT Article III:4.

157. First, to the extent a determination of “likeness” under GATT Article III:4 is “fundamentally, a determination about the nature and extent of a competitive relationship” between products,²²⁰ the analysis provided with respect to the GATT Article III:2, second sentence claim thoroughly establishes that, prior to the discriminatory tax, HFCS competed directly with cane sugar as a sweetener for soft drinks and syrups in Mexico. In fact, it was the very success of this competition, whereby Mexican bottlers were rapidly and increasingly substituting HFCS for sugar, that led the Mexican Congress to impose the HFCS soft drink and distribution taxes.

158. Second, HFCS and cane sugar overlap in the ways deemed relevant to the like product inquiry: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.²²¹ Each of these elements was addressed in relation to the claim under GATT Article III:2, second sentence, and support a determination that, for purposes of GATT Article III:4, HFCS and cane sugar are “like” products as sweeteners for soft drinks and syrups.

2. IEPS Is a Law Affecting the Use of HFCS

159. As confirmed by the Appellate Body in *US – FSC (Article 21.5)*, the term “affecting” in GATT Article III:4 is broad in scope.²²² This broad scope, as articulated by several panels and affirmed by the Appellate Body, “cover[s] not only laws and regulations which directly govern

²²⁰ *EC – Asbestos* AB Report, paras. 98-99.

²²¹ *See EC – Asbestos* AB Report, para. 101.

²²² *US – FSC Article 21.5* Panel Report, para. 210.

the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products.”²²³ As found by prior panels and affirmed by the Appellate Body:

[A] measure pursuant to which the use of domestic – but not imported – products contributes to obtaining an advantage has an impact on the conditions of competition between domestic and imported products and thus "affects" the internal "use" of imported products.²²⁴

160. The IEPS “affects” the use of HFCS by conditioning access to an advantage on use of the domestic sweetener, cane sugar.²²⁵ Specifically, under the IEPS, soft drink and syrup producers who use exclusively cane sugar to sweeten their products are wholly exempt from the HFCS soft drink tax, the distribution tax and the reporting requirements. Soft drink and syrup producers who use HFCS to sweeten their products do not enjoy the same advantage. Instead, soft drink and syrup producers who use HFCS to sweeten their products must (1) pay a 20 percent tax on the transfer of their products (HFCS soft drink tax); (2) pay a 20 percent tax on representation, brokerage, agency, consignment or distribution of their products; and (3) track and report commercially sensitive information, including their products’ top 50 customers and suppliers, to the Mexican authorities (reporting requirements). The added burdens imposed on the use of HFCS not only “influence”²²⁶ producers’ choice of sweeteners but, because of the prohibitive nature of the tax (four times the value of the sweetener itself), economically compel producers to use domestically-produced cane sugar over HFCS. It is difficult to imagine evidence more telling of this, than the fact after imposition of the IEPS every Mexican bottler using HFCS reverted to a 100 percent use of cane sugar. The IEPS is, thus, a law “affecting” the “internal ... use” of HFCS.

²²³ *US – FSC Article 21.5* Panel Report, para. 8.147; *US – FSC Article 21.5* AB Report, paras. 208-13 (upholding the panel with respect to its findings on “affecting” internal sale, etc.); see *EC – Bananas III* AB Report, para. 213. Other panels have similarly interpreted the word “affecting” to encompass measures that “might adversely modify the conditions of competition between domestic and imported products. See, e.g., *Italian Discrimination Against Imported Agricultural Machinery*, BISD 7S/60, 63, GATT Panel Report, adopted on October 23, 1958; see also *EC – Bananas III*, AB Report, para. 220 (citing the panel’s discussion in *Agricultural Machinery* in interpreting “affecting” as it appears in GATT Article I:1).

²²⁴ *US – FSC Article 21.5* Panel Report, paras. 8.147-48; *US – FSC Article 21.5* AB Report, paras. 208-13 (upholding the panel with respect to its findings on “affecting” internal sale, etc.); see also *Indonesia – Autos* Panel Report, para. 14.38; *Canada – Auto Measures*, Panel Report, para. 10.80; *India – Autos* Panel Report, para. 7.202; *Parts and Components* GATT Panel, p. 5.21

²²⁵ See *supra* 20 (noting that cane sugar is almost exclusively a domestically-produced product in Mexico).

²²⁶ See *US – FSC Article 21.5* AB Report, para. 212 (finding that a rule that “influences the manufacturer’s choice between like imported and domestic input products if it wishes to obtain the tax exemption under the [tax] measure” to affect the internal use of imported products).

3. IEPS Accords Less Favorable Treatment to HFCS

161. The IEPS undoubtedly affords “less favourable treatment” to imports than “accorded like products of national origin.” As noted numerous times throughout this submission, in Mexico cane sugar is almost exclusively a domestically-produced sweetener. Second, the IEPS bestows a real and substantive advantage on the use of cane sugar that is not accorded to HFCS – a product which prior to application of the IEPS to soft drinks and syrups accounted for nearly 100 percent of U.S. sweetener imports. While soft drinks and syrups using exclusively cane sugar as a sweetener are wholly exempt from the IEPS, those sweetened, even partially, with HFCS are subject by virtue of the IEPS to (1) a 20 percent tax on their transfer (HFCS soft drink tax); (2) a 20 percent tax on their representation, brokerage, agency, consignment and distribution (distribution tax); and (3) bookkeeping and reporting requirements concerning commercially sensitive information (reporting requirements). The first of these alone – as a tax four times the value of the input – is sufficient to work as a prohibition on the use of HFCS. The Appellate Body has had little trouble concluding that differential treatment of a far less egregious nature constitutes less favorable treatment.²²⁷ Accordingly, the IEPS through its HFCS soft drink tax, distribution tax and reporting requirements accords less favorable treatment to imported HFCS than to the like domestic product of national origin, cane sugar.

162. In sum, the IEPS is inconsistent with GATT Article III:4 as a law affecting the internal use of HFCS and affording imported HFCS less favorable treatment than the like product of national origin by:

- (1) applying a 20 percent tax on the transfer of soft drinks and syrups sweetened with HFCS (HFCS soft drink tax);
- (2) applying a 20 percent tax on the distribution *et al.* of soft drinks and syrups sweetened with HFCS (distribution tax) and
- (3) subjecting soft drinks and syrups sweetened with HFCS to certain bookkeeping and reporting requirements (reporting requirements).

²²⁷ See, e.g., *US – FSC Article 21.5 AB Report*, para. 220 (“In sum, if the manufacturer wishes to obtain the beneficial tax exemption under the ETI measure, the fair market value rule provides a considerable impetus, and, in some circumstances, in effect, a requirement, for manufacturers to use domestic input products, rather than like imported ones. As such, the fair market value rule treats imported products less favourably than like domestic products.”).

IV. CONCLUSION

163. For the reasons set out above, the United States respectfully requests the Panel to find that the IEPS is:

(1) inconsistent with GATT Article III:2, first sentence as a tax applied on imported soft drinks and syrups “in excess of those applied to like domestic products” (HFCS soft drink tax);

(2) inconsistent with GATT Article III:2, first sentence as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS “in excess of those applied to like domestic products” (distribution tax);

(3) inconsistent with GATT Article III:2, second sentence as a tax applied on imported HFCS which is “directly competitive or substitutable” with Mexican cane sugar which is “not similarly taxed” (HFCS soft drink tax);²²⁸

(4) inconsistent with GATT Article III:2, second sentence as a tax applied on imported soft drinks and syrups which are directly competitive or substitutable with domestic soft drinks and syrups which are “not similarly taxed” (HFCS soft drink tax);

(5) inconsistent with GATT Article III:2, second sentence as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS which are directly competitive or substitutable with domestic soft drinks and syrups which are “not similarly taxed” (HFCS soft drink tax); and

(6) inconsistent with GATT Article III:4 as a law that affects the internal use of imported HFCS and accords HFCS “treatment ... less favorable than that accorded to like products of national origin” by

(a) taxing soft drinks and syrups that use HFCS as a sweetener (HFCS soft drink tax),

²²⁸ The IEPS is also inconsistent as a tax on HFCS with GATT Article III:2, first sentence. However, because the IEPS so clearly taxes a directly competitive or substitutable imported product in a manner so as to afford protection to domestic production, the United States, in the interest of brevity, has chosen to focus its submission on the second sentence.

(b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS (distribution tax), and

(c) subjecting soft drinks and syrups sweetened with HFCS to various bookkeeping and reporting requirements (reporting requirements).²²⁹

²²⁹ The IEPS is also inconsistent with GATT Article III:4 as a law that affects "the internal sale, offering for sale, purchase, transportation, [and] distribution" of imported soft drinks and syrups and accords them "treatment ... less favorable than that accorded to like products of national origin" by taxing their agency, representation, brokerage, consignment and distribution (distribution tax). However, because the IEPS also so plainly violates GATT Article III:2, the United States, in the interest of brevity, has focus this submission on analysis under GATT Article III:2 with respect to the distribution tax as applied to soft drinks and syrups.

TABLE OF EXHIBITS

Exhibit US-	Title of Exhibit
1A	<i>Ley del Impuesto Especial Sobre Producción y Servicios</i> , Diario Oficial de la Federación, Jan. 1, 2002, Segunda Sección (Spanish)
1B	<i>Ley del Impuesto Especial Sobre Producción y Servicios</i> , Diario Oficial de la Federación, Jan. 1, 2002, Segunda Sección, (English Translation)
2A	<i>Se Reforman Y Adicionan Diversas Disposiciones de la Ley del Impuesto Especial sobre Producción y Servicios</i> , Diario Oficial, Dec. 30, 2002, Cuarta Sección (Spanish)
2B	<i>Se Reforman Y Adicionan Diversas Disposiciones de la Ley del Impuesto Especial sobre Producción y Servicios</i> , Diario Oficial, Dec. 30, 2002, Cuarta Sección (Partial English Translation)
3A	<i>Se Reforman, Adicionan y Derogan Diversas Disposiciones de la Ley Del Impuesto Al Valor Agregado, de la Ley Del Impuesto Sobre La Renta, de la Ley Del Impuesto Especial Sobre Producción y Servicios, de la Ley Del Impuesto Sobre Tenencia o Uso De Vehículos, de la Ley Federal Del Impuesto Sobre Automóviles Nuevos y de la Ley Federal De Derechos</i> , Dec. 31, 2003 (pp.1-11) (Spanish)
3B	<i>Se Reforman, Adicionan y Derogan Diversas Disposiciones de la Ley Del Impuesto Al Valor Agregado, de la Ley Del Impuesto Sobre La Renta, de la Ley Del Impuesto Especial Sobre Producción y Servicios, de la Ley Del Impuesto Sobre Tenencia o Uso De Vehículos, de la Ley Federal Del Impuesto Sobre Automóviles Nuevos y de la Ley Federal De Derechos</i> , Dec. 31, 2003 (Partial English Translation)
4A	<i>Ley Del Impuesto Especial Sobre Producción y Servicios</i> , Dec. 31, 2003 (Spanish)
4B	<i>Ley Del Impuesto Especial Sobre Producción y Servicios</i> , Dec. 31, 2003 (Partial English Translation)
5A	<i>Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios</i> , May 15, 1990 (Spanish)
5B	<i>Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios</i> , May 15, 1990 (English Translation)
6A	<i>Resolución Miscelanea Fiscal Para 2003</i> , Title 6, March 31, 2003 (Spanish)
6B	<i>Resolución Miscelanea Fiscal Para 2003</i> , Title 6, March 31, 2003 (English Translation)

7A	<i>Resolución Miscelanea Fiscal Para 2004</i> , April 30, 2004 (Spanish)
7B	<i>Resolución Miscelanea Fiscal Para 2004</i> , Title 6, April 30, 2004 (English Translation)
8	USDA ERS Model
9	<i>Decreto por el que se crean, modifican y suprimen diversos aranceles de la Tarifa de la Ley de los Impuestos Generales de Importación y Exportación</i> (Decree creating, modifying and eliminating various duties under the Tariff Schedule of the General Law on Importation and Exportation), Diario Oficial, Sept. 26, 2003 Segunda Sección at 47-55, in force through Dec. 31, 2003
10	Mexico Secretary of Economy, HFCS Imports from US
11A	USDA FAS GAIN Reports 2000, at 1-7
11B	USDA FAS GAIN Reports 2001, at 1-7
11C	USDA FAS GAIN Reports 2002, at 1-6
11D	USDA FAS GAIN Reports 2003, at 1-7
11E	USDA FAS GAIN Reports 2004, at 1-7
12	Presentation by <i>Cámara Nacional de Las Industrias Azúcarera y Alcohólera: Sugar and NAFTA</i> (Oct. 2003) (un-numbered pages 1 and 5)
13	Mexico Secretary of Economy, Soft Drink Imports from US
14	<i>Review of the Final Determination of the Antidumping Investigation on Imports of High Fructose Corn Syrup, Originating from the United States of America, Final Decision</i> , Case: MEX-USA-98-1904-01 ("NAFTA Chapter 19 Decision"), August 3, 2001, pp. 61-82
15	Sugar Production and Imports
16	Mexico Food, beverages and tobacco background (Exec. Briefing No. 310, Economist Intelligence Unit Ltd.) (Mar. 1, 2004)
17	Peter Buzzanell, Sugar and Sweeteners Outlook (June 30, 1995) (un-numbered pages 1, 31-34)
18	Ben Cooper, <i>Mexico a growing jewel in soft drink crown</i> , Just-Drinks (May 17 2004)
19	Contal, <i>Soft Drink Industry</i> (web site material)
20	<i>The Coca-Cola Company Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934</i> , Form 10-K (for the fiscal year ended Dec. 31, 2003) at 1-12, 22-25

21	Stephen Haley et al., <i>Sugar and Sweeteners Outlook</i> (Economic Outlook Report from the Economic Research Service (ERS), USDA) (May 27, 2004) at 1, 12-13, 19, 21-23
22	<i>The History of High Fructose Corn Syrup</i> , 1996 Corn Annual
23	Mexicans are second-largest soft drink consumer in world, Corporate Mexico, September 4, 2003
24	Coca-Cola Femsa, Annual Report 2001 at 30
25	Coca-Cola Femsa, <i>Coca-Cola Femsa Announces 16.0% Operating Profit Growth for First-Quarter 2002</i> (First-Quarter 2002 Press Release) (April 25, 2002)
26	<i>Emvasa usa mezcla azúcar y fructosa por partes iguales</i> , Reuters (Sept. 22, 1997)
27	<i>Embotelladores Coca-Cola México abandonan fructosa por azúcar</i> , Reuters (Jan. 11, 2002)
28	<i>Gaceta Parlamentaria, Cámara de Diputados</i> , no. 911-IV, Dec. 30, 2001, at http://gaceta.cddhcu.gob.mx/Gaceta/58/2001/dic/Anexo-IV-30Dic.html (Spanish)
29	Stenographic record of debate by Deputies, available at http://cronica.diputados.gob.mx/PDF/58/2001/dic/011229-4.pdf , at pp. 673, 710-712 (Spanish)
30A	<i>Decreto por el que se exime el pago de los impuestos que se indican y se amplia el estímulo fiscal que se menciona</i> , Diario Oficial, March 5, 2002, Primera Sección at 1-3 (Spanish)
30B	<i>Decreto por el que se exime el pago de los impuestos que se indican y se amplia el estímulo fiscal que se menciona</i> , Diario Oficial, March 5, 2002, Primera Sección at 1-3 (English Translation)
31A	<i>Suprema Corte de Justicia de la Nación, Sentencia relativa a la controversia constitucional 32/2002, promovida para la Cámara de Diputados del Congreso de la Unión, en contra del Titular del Poder Ejecutivo Federal</i> , published in Diario Federal, July 17, 2002, Primera Sección, 44-82, (Suprema Corte Decision re Fox Suspension) (Spanish)
31B	<i>Suprema Corte de Justicia de la Nación, Sentencia relativa a la controversia constitucional 32/2002, promovida para la Cámara de Diputados del Congreso de la Unión, en contra del Titular del Poder Ejecutivo Federal</i> , published in Diario Federal, July 17, 2002, Primera Sección, selected pages (Suprema Corte Decision re Fox Suspension) (Partial English Translation)

32	<i>Gaceta Parlamentaria</i> , November 6, 2003, at http://gaceta.cddhcu.gob.mx/Gaceta/59/2003/nov/Anexo-I-06nov.html (Spanish)
33	Stephen Zamora <i>et al.</i> , <i>Mexican Law</i> 268-269, 274-82 (2004)
34A	Amparo in review 797/2002, La Perla de la Paz, S.A. de C.V., Feb. 7, 2003 (Spanish)
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35	Summary Collection of Amparos In Review (English)
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37A	Mexican Official Norm, NOM-51-SCFI-1994, <i>Especificaciones generales de etiquetado para alimentos y bebidas no alcohólicas preenvasados</i> (Spanish)
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38	The Coca-Cola Company, <i>Frequently Asked Questions</i> available at < http://www2.coca-cola.com/contactus/faq/ingredients_include.html >
39	Pepsi Bottling Group: At a Glance, available at < http://www.pbg.com/01_02.asp >
40A	<i>Resolución final de la investigación antidumping sobre las importaciones de jarabe de maíz de alta fructosa, mercancía clasificada en las fracciones arancelarias 1702.40.99 y 1702.60.01 de la Tarifa de la Ley del Impuesto General de Importación, originarias de los Estados Unidos de América, independientemente del país de procedencia</i> , Diario Oficial, Primera Sección, Jan. 23, 1998 (“Final HFCS AD Determination”) (Spanish)
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42	Sweetener Imports and Market Share
43A	Mexican Tariff Schedule, Chapters 17, 21 and 22 (Spanish)
43B	Mexican Tariff Schedule, Chapters 17, 21 and 22 (English Translation)

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48	<i>The Fruit Juice and Soft Drink Market in Mexico</i> , Market Research Centre and the Canadian Trade Commissioner Service, Agri-Food Trade Service, July 2003
49	James R. Clayton, <i>Extra Care in Blending</i> , Beverage World 44, 56, 74 (Aug. 1981)
50	<i>Venta-Fructosa</i> , Servicio Universal de Noticias, January 6, 2002
51	<i>83 Trench Warfare</i> , Beverage World (Feb. 1983)
52	<i>Industriales México rechazan gravamen a refrescos</i> , Reuters, January 10, 2002
53	<i>Boletín #55, Cupo de Importación de Azúcar, Medida de Prevención</i> , oletín de Prensa No. 199, Aug. 21, 2003, available via Secretariat of Economy press room at http://www.apps1.economia.gob.mx/webportal/boletines/html/boletines.asp , Exh. US-53
54	<i>Government accused of manipulating sugar prices</i> , Corporate Mexico, Aug. 27, 2004
55A	Comisión Federal de Competencia, Informe Anual 1993-94, Cap. II, Concentraciones, at http://sp.cfc.gob.mx:8080/cfc01/documentos/cfc99e/Informes/Informe%20Anual%201993-1994/capII9394.htm (Spanish)
55B	Comisión Federal de Competencia, Informe Anual 1993-94, Cap. II, Concentraciones (English Translation)
56A	Comisión Federal de Competencia, Grupo Azucarero del Occidente, SA de CV/Grupo More, SA de CV/Ingenio Jose Maria Morelos, SA de CV, Resolution CNT-61-99, Jun. 17, 1999, at http://www.cfc.gob.mx/Contenido.asp?P=DirResults.asp?txtDir=http://xeon2/cfc01/Documentos/cfc99e/Difusión/Documentos%20Publicados (Spanish)
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