

## **Draft Explanatory Note for set-top boxes with a communication function**

### **Legal assessment**

2 June 2006

#### **Introduction**

1. The European Commission has proposed a draft Explanatory Note for Combined Nomenclature ("CN") code 8528 12 91 "set-top boxes with a communication function" for approval by the CN Committee. This draft note contains criteria which, in the Commission's view, determine the correct scope of CN Code 8528 12 91. However, several of these criteria violate the wording of the CN and are, therefore, unlawful.
2. According to settled case-law of the European Court of Justice ("ECJ"), Explanatory Notes must be compatible with the provisions of the CN and may not alter the meaning of those provisions. The wording of CN code 8528 12 91 is as follows:

"Apparatus with a microprocessor-based device incorporating a modem for gaining access to the Internet, and having a function of interactive information exchange, capable of receiving television signals ('Set-top boxes with communication function')."

3. The relevant wording has been in force since 1 October 2000 and was introduced via Council Regulation 2559/2000 of 16 November 2000. The preamble of that Regulation indicates that these changes to the CN were made pursuant to obligations accepted by the EC in the WTO, pursuant to the so-called Agreement on trade in information technology products ("ITA"). The relevant obligation is to allow duty free import for all covered products, including the following:

"Set top boxes which have a communication function: a microprocessor-based device incorporating a modem for gaining access to the Internet, and having a function of interactive information exchange."

4. The proposed Explanatory Note is incompatible with the CN and the ITA on at least two counts:
  - The proposed requirement that the set-top box must provide unlimited access to the Internet; and
  - the proposed criterion providing that set-top boxes "which incorporate a device performing a recording function (e.g. a hard disk or DVD drive) are excluded from this subheading, even where they have a communication function".

#### **Providing unlimited access to the Internet**

5. The proposed Explanatory Note appears to disqualify boxes that do give access to the Internet but not to all possible applications on the Internet. This is problematic in a number of respects.
6. *First*, it is not clear, how "limited" the access to the Internet must be before the device is disqualified for CN code 8528 12 91. Clearly, the criterion cannot be that a set-top box must be capable of running all possible Internet applications. There are several devices that do not offer access to all applications on the Internet: Internet enabled mobile phones, Blackberries and computers that are not sufficiently powerful to run the most recent Internet technologies or cannot make use of the speed of broadband connections. Yet no one will seek to deny that these devices can access the Internet.

7. *Second*, the only criterion that CN code 8528 12 91 and the ITA impose with regard to Internet connectivity is that the set-top box "incorporat[es] a modem for gaining access to the Internet". A set-top box that meets this criterion comes within that code and there is no requirement of access to *all applications* on the Internet. Therefore, disqualifying a set-top box that is capable of providing access to the Internet (albeit not to all applications thereon) amounts to an addition to the wording of the CN, which alters its meaning.
8. *Third*, it is settled case law from the ECJ that the decisive criterion for the classification of goods for customs purposes is in general to be found in their objective characteristics and properties, as defined in the wording of the relevant heading of the CN. However, the "unlimited access" criterion is primarily related to the usage that will be made of a set-top box. Just like a computer, the set-top box could be linked to a service provider's own network only (as opposed to the "network of networks" that is the Internet). That same set-top box, however, could also be linked to the Internet. What matters for customs classification under CN Code 8528 12 91, however, is not which services a specific service provider offers, but the objective characteristics and properties of the product, *i.e.* whether the set-top box contains a modem, and the necessary hardware and firmware to access the Internet.
9. *Fourth*, an interpretation that a set-top box must be able to access all applications on the Internet would conflict with the principle of technological neutrality. A set-top box capable of providing "sufficient" access to the Internet to qualify for ITA duty treatment in 1997, would not be able to access all Internet applications available today. However, it is settled case law of the ECJ that the interpretation of the tariff cannot vary as and when technology changes. If a set-top box provided sufficient access to the Internet to qualify for ITA duty treatment in 1997 it should, therefore, still qualify in 2006. Further, it is the stated objective of the ITA to ensure that "each party's trade regime should evolve in a manner that enhances market access opportunities for information technology products". This pleads against a "reductive" interpretation of the scope of the ITA, whereby a product that was originally covered becomes excluded due to certain technical developments.

### **Set-top boxes with a hard disk**

10. It is proposed that a set-top box incorporating a hard disk for recording purposes should always be excluded from CN code 8528 12 91 even if it meets all the criteria contained in the wording of the code. More specifically, the Commission seems to suggest that such a set-top box should be classified under subheading 8528 12 20. This suggestion for classification is discussed in detail below. It is surprising, however, that the Commission has made this proposal without any consultation of industry. This is particularly surprising because EICTA has been in discussions with the Commission on the classification of set-top boxes over the last eleven months.

11. The two relevant subheadings provide as follows:

8528 12 20	Apparatus incorporating a video recorder or reproducer
8528 12 91	Apparatus with a microprocessor-based device incorporating a modem for gaining access to the Internet, and having a function of interactive information exchange, capable of receiving television signals ("Set-top boxes with communication function")

12. Pursuant to the sixth general rule for interpretation of the CN:

"For legal purposes, the classification of goods in the subheadings of a heading shall be determined according to the terms of those subheadings and any related subheading notes and, *mutatis mutandis*, to the above rules, on the understanding that only subheadings at the same level are comparable. For the purposes of this rule, the relative section and chapter notes also apply, unless the context requires otherwise."

13. Both subheadings are part of Chapter 85 of the CN (which is in turn part of Section XVI of the CN). Note 3 to Section XVI provides the following (emphasis supplied):

"Unless the context otherwise requires, composite machines consisting of two or more machines fitted together to form a whole and other machines designed for the purpose of performing two or more complementary or alternative functions are to be classified as if consisting only of that component or as being that machine which performs the principal function."

14. When this criterion is used to decide the classification of a set-top box with a hard disk under CN Subheadings 8528 12 20 or 8528 12 91, it should be clear that many set-top boxes are primarily devices used to receive digital TV signals, in combination with interactive services, including Internet access, from one particular digital TV platform.

15. In this respect it should be noted that a video recorder (digital or analogue) has a number of key capabilities that are absent in many set-top boxes with a hard disk:

- the capability to record video images and sound onto external physical media such as DVDs or magnetic tapes;
- the capability to reproduce video images and sound from external physical media such as magnetic tapes or DVDs; and
- the capability to record from any given (analogue) signal, including TV broadcasters, cameras, video reproducing equipment, and certain set-top boxes.

16. Most set-top boxes with a hard disk and recording function will only be capable of recording one specific type of digital signal, distributed over one specific digital TV platform. In essence, therefore, such a set-top box provides access to a number of services, provided by a particular service provider. The presence of a hard disk allows the service provider to offer the additional service of "time shifting" and the way in which this can be used will depend on the service offered by the service provider. The recording capacity of such a set-top box will typically be limited to 20 or 40 hours of video and the operating system of such a set-top box will normally be designed to automatically delete older content on a "first in first out basis". Permanent recording and storage on external media of video content recorded on the set-top box is only possible by connecting it to a video recorder. By consequence, it is certainly not the principal function of such a set-top box to serve as a video recorder.

17. It is possible that the Commission takes the view that technological progress will make these distinctions irrelevant. As mentioned above, however, it is settled case law of the ECJ that the interpretation of the CN cannot vary as and when technology changes. In that respect it should also be noted that a set-top box with a recording function is primarily a more advanced version of the traditional set-top box, without a recording function.

18. By consequence, the proposed Explanatory Note is unlawful to the extent that it requires all set-top boxes with a recording function and a hard disk to be classified outside CN code 8528

12 91, irrespective of the principal function of the set-top box. In doing so, the Explanatory Note alters the meaning of the CN. It further violates the EC's WTO obligations flowing from the ITA.

19. The application of the CN to set-top boxes with a recording function and a hard disk set out in paragraphs 13 to 18 above is further confirmed by the third and fourth general rule for the interpretation of the CN (emphasis supplied):

General rule 3:

"When by application of Rule 2 (b) or for any other reason, goods are, prima facie, classifiable under two or more headings, classification shall be effected as follows.

- a) The heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to part only of the materials or substances contained in mixed or composite goods or to part only of the items in a set put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.
- b) Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to 3 (a), shall be classified as if they consisted of the material or component which gives them their essential character, insofar as this criterion is applicable.
- c) When goods cannot be classified by reference to 3 (a) or 3 (b), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration."

General rule 4:

"Goods which cannot be classified in accordance with the above rules shall be classified under the heading appropriate to the goods to which they are most akin."