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Making NAFTA Better

Comments on the Evolution of Chapter 19

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March 2005

No. 57

Occasional Papers
in International Trade
Law and Policy

Articles varies sur la
politique et le droit
commercial international

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Introduction

Chapter 19 of the North American Free Trade Agreement (NAFTA) provides for reviews of domestic agency decisions in dumping and subsidy investigations by specially appointed panels. These panels are a substitute for judicial proceedings in domestic courts.

Binational panel review was a critical feature of the original Canada-United States Free Trade Agreement (Canada-US FTA) of 1987 and these same procedures were subsequently incorporated into Chapter 19 of the NAFTA when it was concluded in 1993.

The NAFTA Chapter 19 process has been operating now for over ten years. Some experts argue that it is working quite well, while the opposite view, largely as a result of the impasse in settling the *Softwood Lumber* case, is that Chapter 19 is wholly deficient as a means of resolving trade disputes.

The House of Commons Standing Committee on Foreign Affairs and International Trade (SCFAIT) issued a detailed report on NAFTA Chapter 19, in December 2002, following extensive hearings and expert testimony.¹ A subsequent review of Chapter 19 was undertaken in 2003 by the Senate Standing Committee on Foreign Affairs.² Both reports noted the inadequacies in Chapter 19 and made recommendations for improving it, arguing for a more comprehensive dispute settlement procedure to be built into the NAFTA.

A report on Chapter 19 done for the CD Howe Institute at about the same time, as part of its series entitled "The Border Papers," took a different tack.³ That report concluded that the Chapter 19 panel system was functioning effectively, dampening US trade protectionism and providing a unique system of agency oversight of benefit to Canada. It concluded that Chapter 19 helped

¹ *Partners in North America: Advancing Canada's Relations with the United States and Mexico*, House of Commons, SCFAIT, December 2002, Chapter 4, entitled, "Key Issues in Managing and Advancing the North American Economic Relationship."

² *Uncertain Access: The Consequences of US Security and Trade Actions for Canadian Trade Policy*, Report of the Standing Senate Committee on Foreign Affairs, June 2003.

³ "Dispute Settlement in the NAFTA: A Surprising Record of Success," Macrory, P., *Commentary*, CD. Howe Institute, No. 168, September 2002.

ensure that US trade agencies governed themselves carefully and did not overreach their mandate with protectionist decisions adverse to Canadian interests.

Since these assessments were done, there have been developments in the un-ending *Softwood Lumber* case. A succession of Chapter 19 panel reports have found fault with both US Commerce Department and International Trade Commission (ITC) determinations against Canadian imports. A key panel decision went so far as to order a rescinding of the finding by the ITC that softwood lumber from Canada threatened injury to American producers.⁴ The US government is challenging that last panel decision under the Extraordinary Challenge provisions of the NAFTA.

The result is that today, in spite of these rulings, a resolution of the *Softwood Lumber* dispute seems to be as remote as ever. This has prompted one Washington, DC-based business organization to conclude that the legitimacy of Chapter 19 is under concerted assault in the United States, both by private interests and by the US government itself, which is attempting to either bend the Chapter 19 system to US advantage or to totally destroy it.⁵

Whether this startling assertion is right, the further unfolding of the *Softwood Lumber* case has underscored the frailties and weaknesses of Chapter 19. It is thus timely to review some of these issues, taking a stab at offering suggestions to improve the operation of the Chapter while at the same time recognizing the political difficulties of attempting to open up Chapter 19 to even modest amendment.

Some Basic Propositions

A fundamental point underscored in the 2002 SCFAIT Report is that, in spite of the *Softwood Lumber* case (as well as subsequent trade problems such as BSE and the Canadian Wheat Board litigation), most of Canada's trade with the United States has been, and continues to be, trouble free. The NAFTA has reduced tariffs and harmonized border procedures and, as a result, ensured preferential access to the US market for Canadian products. Trade statistics prove the case in support of the NAFTA having achieved its goal insofar as increased trade flows are concerned.⁶

While this may be so, trade data by themselves mask the fact that where trade problems arise with the Americans, they often affect large sectors of the Canadian economy and put Canadian jobs at risk. There is no corresponding impact when Canadian trade remedy actions target US imports.

⁴ *In the Matter of Certain Softwood Lumber Products from Canada*, Second Remand Decision of the Panel, 3 August 2004, USA-CDA-2002-1904-07.

⁵ *Duties and Dumping: What's Going Wrong with Chapter 19?*, Baker & Hostetler LLP, Washington, DC, June 2004, prepared for the Canadian American Business Council and the Centre for Strategic and International Studies, Washington, DC, pp. 14-15.

⁶ *Fifth Annual Report on Canada's State of Trade*, Department of Foreign Affairs and International Trade, March 2004, p. 28.

This is a structural issue related to the asymmetry in the two economies and the fact that Canada is vitally dependent on access to the US market, whereas the reverse is simply not true.⁷

The other key proposition is that, while NAFTA Chapter 19 works reasonably well under its narrow and restricted mandate, it is not a “dispute settlement” process at all. It is in reality a bilateral (or trilateral) treaty regime allowing for limited, extra-national review of national agency decisions affecting private parties. It is not intended to be, and does not function as, a kind of supra-national regime aimed at resolving trade differences between NAFTA governments.

It seems obvious that in such a large and deep economic and political relationship as that involving Canada, the United States, and Mexico, a more effective mechanism is needed. The fact that the *Softwood Lumber* case has been continuing without closure since 2001 is testimony to the serious limitations of Chapter 19 as it now operates. It is unreasonable that major trade problems involving large economic sectors affecting the world’s largest trading partners cannot be more expeditiously and fairly resolved without allowing privately driven trade remedies to run their course.

This last proposition runs up against political realities in the form of unbending resistance in the US Congress to any weakening of US trade laws through the enhancement of the NAFTA system. Added to this are the significant risks of opening a Pandora’s Box by seeking NAFTA amendments, since a quest for change in one area can lead to requests for changes in other areas, making the endgame in the process largely unpredictable.

That being said, it is important for NAFTA governments to be continually examining areas for improving the system, both in big picture terms and in a less comprehensive manner. Only through constant attention can these treaty mechanisms be adjusted so as to make them work more effectively, keeping in mind the object and purposes of the NAFTA itself. Indeed, if some imagination and creativity were applied, as suggested below, there are areas where Chapter 19 could be made more effective—without embarking on a textual revision of the NAFTA itself—to the long-term advantage of all three NAFTA parties.

Imbalance in the North American Trading System

The *Softwood Lumber* case brings home the constant exposure of large sectors of the Canadian economy to privately driven US trade remedy actions. The case reveals how private actions can be used to reduce market participation of an exporting industry and frustrate commercial activities by tying up the resources of that industry in the unending rigours of a dumping and subsidy investigation.⁸

⁷ This factor was referred to by many witnesses testifying before the Standing Committee in 2002 and is noted throughout Chapter 4 of the 2002 SCFAIT Report.

⁸ By “private actions,” I refer to the fact that dumping and subsidy relief through antidumping and countervailing duties is initiated in both Canada and the United States by private parties filing a complaint (a “petition” in US parlance) with investigating agencies. Only in the rarest of cases are investigations

One illustration of the trade-limiting effects of threatened US trade actions is the case of the Canadian steel industry. While there has been relative peace on the steel front since the major US steel trade actions in 1993 that included Canada, Canadian steel exporters continue to face the spectre of potential market access restrictions resulting from US trade actions.⁹

The result has been a retrenchment of Canadian steel exports to the United States over the last decade, while the US share of the Canadian steel market has grown substantially during the same period. Current Canadian participation is about 4 percent of the US steel market, while US imports have grown to almost 26 percent of the Canadian market by 2004.¹⁰

Some market participants suggest that this is the result of fears by Canadian producers of being targeted by the U.S. steel industry in an aggressively applied US trade remedy action, whereas US exporters have much less to fear in the relatively benign application of Canadian trade laws.

In short, while by far the larger volume of Canadian trade is not affected by US trade remedy actions, threats of antidumping and countervailing duty investigations and other types of remedies in the United States have the potential to dampen Canadian exports and interfere with the operation of market forces. Even if this threat is not as dramatic as that which occurred in the early 1980s, where a series of actions affected Canadian exports of pork, groundfish, steel and lumber, it remains a significant negative factor limiting the benefits of the NAFTA and the more open bilateral trading regime that it is supposed to foster.

Limits of the NAFTA Chapter 19 Process

While refusing Canada's proposal for a single, harmonized system of trade remedies, the one concession made by the US side in the original FTA negotiations in 1985-1986 was to accept a system of binational panel reviews in lieu of normal judicial review in domestic courts. This was less than Canada had been seeking but still an important gain for Canada in "bi-nationalizing" the

initiated unilaterally by governments themselves, although this was done in the case of the US investigation in an earlier manifestation of the *Softwood Lumber* case ("*Lumber III*"). Out-of-court settlement of trade complaints under the respective laws requires the consent of virtually all of the affected parties, limiting the possibilities of resolution through traditional antidumping or anti-subsidy regimes.

⁹ In the steel safeguard action under section 201 of the US *Trade Act of 1974*, for example, Canadian exports were found not to be contributing to the injury of the US producers. Canada was excluded from these US relief measures but subject to import "surge" monitoring, which meant that, if US authorities had found that steel from Canada had surged while the safeguard measures were in effect, the Canadian exemption would be revoked.

¹⁰ Canadian Steel Producers Association, Steel Statistics 2004, www.canadiansteel.ca.

process and giving Canadians an avenue of recourse other than going before US domestic courts.¹¹

Judicial review, as the name implies, however, is a limited “review” proceeding and not a full appeal process, which would allow more wide-ranging involvement by the courts. In judicial reviews, whether in Canada or the United States, courts apply the doctrine of judicial deference to specialized tribunals and agencies. They allow these bodies wide scope in their decision making in the discharge of their statutory functions.

While the exact legal terminology differs, in each country these review standards are quite similar. Lower agencies are entitled to be wrong as long as there is some reasonable basis for their conclusions. In Canada, the courts must find that the impugned decision was made capriciously and without regard to the evidence before the tribunal.¹² In the United States, the standard is whether the decision being contested is “unsupported by substantial evidence on the record or is otherwise not in accordance with law.”¹³ In each case, the bar is very high for those seeking to overturn these agency decisions.

While the early days of the Canada-US FTA seemed to indicate that Chapter 19 panels would exercise their review jurisdiction liberally, experience since then is that Chapter 19 NAFTA panels apply the same conservative and deferential standard to agency decisions as do the courts and rarely find that such decisions merit remand. Experience also shows that successful recourse to Chapter 19 panels by Canadian or US parties has been fairly modest over the years, although the *Softwood Lumber* case has brought use of Chapter 19 to an exceptional level of intensity.¹⁴

¹¹ Some commentators say that this unique concession by the United States is of exceptional value to Canada and that the Chapter 19 process, even confined to the judicial review exercise, should be maintained at all costs.

¹² Section 18.1(4) of the *Federal Court Act*. Canadian courts will interfere in final tribunal or departmental decisions in trade matters only if it is found to be unreasonable and not supported by some evidence on the record. Even if the courts disagree with the tribunal or Canadian Border Services Agency, they will refrain from interfering in such decisions in the absence of some gross error of law or “patently unreasonable” finding of law or of fact. See: *Stelco v. British Steel Canada, et al.*, [2000] 3 F.C. 282 (Federal Court of Appeal, 25 January 2000); *National Corn Growers v. Canadian Import Tribunal*, [1990] 2 S.C.R. 1324 (Supreme Court of Canada).

¹³ See: *In the Matter of Certain Softwood Lumber Products from Canada: Final Affirmative Threat of Injury Determination*, Remand Decision of the Panel, NAFTA Article 1904 Binational Panel Review, File No. USA-CDA-2002-1904-07, 19 April 2004.

¹⁴ Following the overall strategy of the Canadian side referred to above, there are currently four NAFTA panel reviews involving four separate US agency determinations in the *Softwood Lumber* case, none of which have been terminated.

Notwithstanding the limitations on the review jurisdiction of these panels, the Chapter 19 process, as a process, operates reasonably well.¹⁵ Once underway, the system follows a defined time line and works efficiently. The quality of panel decisions has been consistently high, given that the panels tend to be composed of persons with an expertise in trade law. And for Canada the *Softwood Lumber* case shows as well that the process can achieve positive legal results, even if no final resolution has yet been achieved.

That being said, there are equally many shortcomings and negative aspects of the system that are underscored in the *Softwood Lumber* case which, to date, has been running since 2001 and not achieved closure in spite of a series of Chapter 19 panel decisions in Canada's favour.

The question, then, is whether the lessons of the softwood lumber experience can be profitably applied by the NAFTA governments in reviewing the operations of this part of the agreement and, then, to what extent changes to the NAFTA Chapter 19 process can be made realistically to make it more effective, without proposing wholesale re-negotiation of the treaty.

Let us turn to an examination of some of the major operational defects in the Chapter.

No Institutional “Core”

Unlike the European Union and the Treaty of Rome and related instruments, the NAFTA contains no true institutions at its core.¹⁶ While the NAFTA establishes a Free Trade Commission under Article 2001, the Commission is nothing more than the periodic gathering of NAFTA trade ministers that meet to bless a series of pre-cooked declarations and general statements. In practical terms, it is not a true functional treaty institution exercising a continuing, substantive role in ensuring its smooth operation.

This state of affairs is arguably inconsistent with the actual terms of NAFTA Article 2001, by virtue of which the Commission “shall” do a number of things: (1) supervise the implementation of the treaty; (2) oversee its further elaboration; (3) resolve disputes over its “interpretation and application”; (4) supervise the work of subsidiary bodies; and (5) consider “any other matter” affecting the operation of the treaty.

¹⁵ This is the thesis in the CD Howe *Commentary* by Macrory, referred to above. There are many other analyses of the workings and benefits of Chapter 19, far too numerous to cite here. However, some earlier comments on Chapter 19 can be found in “Why We Were Right and They Were Wrong: An Evaluation of Chapter 19 of the FTA and the NAFTA,” Penner, A. and Fellow, R., in a paper prepared by the Department of Foreign Affairs and International Trade, September 1996 (SP78A). See also: “NAFTA Binational Panel Review: Should it be Continued, Eliminated or Substantially Changed?”, Burke, R. and Walsh, B., [1995] Vol. XX:3 *Brooklyn Journal of International Law* 429.

¹⁶ This factor was discussed by several witnesses in the 2002 hearings and led to the Committee recommending a number of options to strengthen NAFTA institutions. See Recommendation 24 of the Report. These recommendations focused on creation of a permanent NAFTA court (see below) but stopped short of addressing issues concerning the Commission and the NAFTA Secretariat.

In reality, all of this is a fiction. The Commission meets approximately once a year, delivers general statements, and has exercised only a few of its substantive powers since the NAFTA entered into force in 1994.

At its most recent annual meeting in July 2004, for example, the Commission merely took note of work underway in the various NAFTA working groups but made no decisions of substance.¹⁷ At its previous meeting in October 2003, it likewise reviewed actions in the working groups but took no decision of substance, other than issuing procedural directions regarding the contents of the filing of a notice of intent to submit an arbitration claim under Article 11 (investment disputes) of the NAFTA.¹⁸

The one significant decision of the Commission to date has been its issuance of an interpretation bulletin covering a number of the key provisions under NAFTA Chapter 11 dealing with expropriation and standards of treatment required by host states. Among other things, the bulletin clarified the interpretation that Chapter 11 arbitration panels are to give to the term “minimum standard of treatment” in Article 1105 of the treaty.¹⁹

While it has been argued that this particular bulletin was a watershed development and represented an important development under NAFTA,²⁰ in reality this was an exceptional exercise of authority and was out of step with the normal, carefully orchestrated and rather *pro forma* communications emanating from the Commission.

The NAFTA Secretariat, which provides the backstopping to the Commission and the infrastructure for the dispute settlement process, is composed of three separate national sections and located severally in the three NAFTA capitals. Its officials are employees of the separate NAFTA governments and many of their tasks are duplicative. The Secretariat has no independent source of funding, few resources, and no independent juridical status as an organization. In operational terms, the Secretariat is confined to the mundane tasks of organizing NAFTA panel proceedings, distributing documents, and arranging hearing rooms. In terms of being an effective NAFTA institution, it too is largely a fiction.

¹⁷ NAFTA Free Trade Commission, *Joint Statement on the “Decade of Achievement,”* San Antonio, Texas, 16 July 2004, www.international.gc.ca.

¹⁸ The Commission also agreed to the establishment of the North American Steel Trade Committee at its October 2003 meeting, another NAFTA body charged with little more than consultative functions. Joint Statement of NAFTA Governments, 7 October 2003: www.international.gc.ca.

¹⁹ NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions*, 31 July 2001. Reports of the meetings of the Commission and the political joint statements are found on the International Trade Canada website at www.international.gc.ca.

²⁰ *Protecting Investors: Can Governments Stop the Music?* NAFTA Chapter Eleven Background Paper prepared by Baker & Hostetler LLP for the Canadian American Business Council, June 2004.

Lack of Continuity in the *Ad Hoc* Panel System

Chapter 19, like the NAFTA dispute settlement systems in other parts of the agreement, operates as an *ad hoc* system with panelists appointed by governments to hear a particular dispute. These panels have no permanency. Panelists decide individual cases and then disband, returning to their own endeavours in their own countries, as private practitioners, academics, etc. This has other implications, reviewed below. As in the case of the Commission, there is no true, continuing NAFTA institution or “core” at the centre of the Chapter 19 regime.

Practical Delays in Finding Persons Willing to Serve

Upon filing of a request for Chapter 19 panel review by an aggrieved private party, governments canvass persons on their respective rosters to determine availability and then consult to agree on a slate of five panelists. This takes time and, because the typical Chapter 19 case is a low priority for the respective governments, little urgency is attached to finding an acceptable list of candidates.

As well, for reasons related to low remuneration, the increasing time commitments required of panelists and real or perceived conflicts of interest, it has often proven difficult and time consuming for governments to find acceptably qualified panelists willing or able to serve.²¹

Where such delays are encountered in finding possible panel members, governments suspend the normal time periods in NAFTA Article 1904(14) until a panel is formally constituted. The result has been to substantially lengthen the 315-day time period within which decisions of panels are to be rendered,²² thereby reducing one of the main benefits of the Chapter 19 process.

The report prepared for the Canadian-American Business Council, referred to earlier, goes even further. It argues that there has actually been a concerted effort on the part of the US government to use dilatory tactics in appointing panelists, and to appoint panelists with limited trade law expertise, in an attempt to undermine and discredit the Chapter 19 process.²³ Whether this is the

²¹ Panelists are paid US\$600 a day, with very limited financial assistance for research assistance and other backstopping. Moreover, many cases are now very complex, with voluminous case materials requiring study. I can speak from personal experience that the low remuneration, long absence from practice, and limited financial support for legal assistance was a significant factor preventing my agreement to serve on NAFTA panels.

²² While Article 1904(14) states that the panel rules “shall be designed to result in decisions within 315 days of the date on which a request for a panel is made,” where panels cannot be constituted because of the difficulty in finding candidates, this provision is suspended by agreement. The NAFTA Secretariat does not send out the notice of panel review and the deadlines for filing material, etc., until the panels have been constituted.

²³ *Duties and Dumping: What’s Wrong with Chapter 19?*, *supra*, pp. 4-6.

case or not, the fact remains that it is taking increasingly longer to appoint panels, and that delay detracts from one of the significant benefits written into the NAFTA.

As well, given the time and other sacrifices that have to be made to serve on NAFTA panels, recent experience is that private trade law practitioners have shied away from serving on panels.²⁴ While the quality of Chapter 19 panel reports has still been remarkably high, the limited availability of trade law practitioners has removed one of the more important benefits that the process was supposed to bring.

Another worrying aspect of the present system is that, given the absence of permanency and security of tenure of panel appointments, individual panelists can be subject to various forms of political pressures. Notwithstanding the fact that panelists take an oath affirming their independence and impartiality upon being appointed, the fact that panelists return to their normal functions in their own countries at the end of a case can place them in a difficult and delicate position, particularly in high profile cases where matters of national interest of their own countries are involved.²⁵

Divergence and Inconsistency in NAFTA Jurisprudence

Because NAFTA panels are appointed only for a given dispute, there is an absence of institutional continuity in panel decisions as, for example, in a superior or appellate court in domestic law. While panels have tended to follow prior decisions, the impermanence of the Chapter 19 system leads to variations and inconsistency in jurisprudence, as would not be the case with a permanent court.²⁶

Some of these same shortcomings are evident in the NAFTA dispute resolution systems under both Chapter 20 (state-to-state disputes) and Chapter 11 (investment disputes). Chapter 11 differs from Chapters 19 and 20 in that the investment provisions adopt formal arbitration mechanisms under either the rules of the International Centre for the Settlement of Investment Disputes (ICSID) or the U.N. Commission on International Trade Law (UNCITRAL).²⁷ However, there are commonalities in the sense that each process involves, to a greater or lesser extent, *ad hoc*

²⁴ Under Annex 1901.2, a majority of panelists on any particular case must be “lawyers in good standing” but this does not require that these lawyers necessarily be trade law experts.

²⁵ The Canadian-American Business Council Report, *supra*, at p. 5, says that sustained attacks on the integrity of panelists in the United States have had a “chilling effect” on the willingness of trade experts to serve on NAFTA panels.

²⁶ In a typical Chapter 19 proceeding, the panelists actually meet one another for the first time in physical terms the evening before the panel begins hearing a case.

²⁷ Under NAFTA Article 1120, a disputing investor may invoke, at its option, arbitration under either ICSID or the UNCITRAL Rules. The main difference is that ICSID Arbitrations are conducted within a pre-existing institutional framework whereas arbitrations under UNCITRAL rules are entirely *ad hoc*.

proceedings. Even ICSID arbitrations, which are within a permanent institutional framework, involve an external process that is not integrated into the NAFTA itself.

There are additional dispute settlement provisions specifically tailored to the financial services sector under NAFTA Article 1414. These provisions follow the same framework for resolving state-to-state disputes under NAFTA Chapter 20, through special panels composed of financial services experts. These panels share the impermanent characteristics of the Chapter 19 and 20 NAFTA panels.

While this article is focused on Chapter 19, we raise these additional aspects in arguing that there is merit in having a single, permanent NAFTA panel system to rationalize and systematize the series of *ad hoc* dispute settlement bodies throughout the treaty. From an efficiency standpoint alone, it would seem reasonable that a single, permanent panel roster be used to rationalize and centralize the system and to handle all of the various NAFTA disputes that could arise under the different chapters.

It is not clear whether such a unified roster would require amendment to the NAFTA. Since governments appoint these panelists from a roster of individuals that they have nominated, there is an argument that the NAFTA Commission, in exercising its supervisory functions under Article 2001 of the agreement, could establish such a unified roster as an administrative matter and give the members security of tenure during their terms of office. Acting through the Commission's administrative powers, it could also ensure that various individual panels in different parts of the agreement are selected from amongst these permanent members.

Continued Application of Trade Remedy Laws

A glaring defect in the NAFTA is that it does nothing to curb the application of regular antidumping and countervailing duty laws in each of the parties. Although Canada attempted to have these done away with in the FTA negotiations in the mid-1980s, its efforts were not successful. The United States insisted on the undiminished application of these laws and the right of private parties to invoke such remedies, irrespective of the free trade provisions in the treaty. This right was continued under Article 1902 of the NAFTA²⁸.

The result is that, notwithstanding the free trade principles of the NAFTA, the treaty does nothing to diminish the right of private parties to invoke the full panoply of trade remedies under their respective domestic laws. While there are some provisions that ameliorate the application of these

²⁸ Canada continued its quest to eliminate recourse to antidumping and countervailing duty remedies in its free trade agreement with Chile, concluded in 1996. The agreement suspends such remedies in two-way trade and provides that issues related to unfair pricing will be dealt with by recourse to competition laws of each country. So far, no cases of claims to unfair pricing have arisen under the operation of the agreement.

remedies at the enforcement stage,²⁹ the primary aspects of an antidumping or countervail action continues to be driven by private parties.

NAFTA Chapter 19 in the *Softwood Lumber* Case

Looked at through this prism, it becomes clear why the current phase of the *Softwood Lumber* case was bound to happen when the bilateral agreement expired in 2001 and why it has been impossible to effectively resolve the case under the current treaty mechanisms. Notwithstanding the overall objectives of the treaty, the invocation of trade remedies continues to be driven by private interests. In the *Softwood Lumber* case, the dollar values also tell the story.

Canadian lumber exports had an approximate CA\$10 billion annual market share when the most recent petition was filed by US producers. If a Commerce Department dumping and subsidy investigation (really akin to a series of audits) can put Canadian competitors off balance and allow US producers to regain even a minimal 1 percent of that CA\$10 billion market share, the result equates to a gain for the US industry of CA\$100 million in annual sales. With those kinds of stakes, the US petitioners may come out ahead even if they ultimately lose the dispute through Canada's challenges in the panel system.

From the outset of the present action, the Canadian strategy was to use both the WTO and the NAFTA Chapter 19 and 20 processes to challenge US trade agency decisions at every step of the way. These challenges were part of a broader strategy to leverage a negotiated settlement with the US side, recognizing that only through a bilateral deal can there be long-term stability and hassle-free access to the American market. Thus, determinations of both the US Commerce Department and the International Trade Commission were challenged by Canada in tandem in both the WTO and under NAFTA Chapter 19.

On whether the US industry was threatened with injury by Canadian imports, a WTO panel eventually found in 2004 that the injury determination by the ITC was not one "that could have been reached by an objective and unbiased investigating authority." The panel said that the United States had breached its WTO obligations and therefore was required to rescind the ITC decision to bring it into line.³⁰

Since the US government has refused to change that decision (the ITC rejected the WTO panel ruling on 24 November 2004) and refund the duties collected on Canadian imports, Canada is now seeking rights from the WTO to withdraw trade benefits equivalent to the amount of CA\$4.1

²⁹ For example, in the case of safeguard or emergency border measures under NAFTA Chapter 8, no NAFTA party can apply safeguard relief to the goods of another NAFTA party unless it has been shown that such imports are "contributing importantly" to serious injury in the country concerned.

³⁰ *United States Investigation of the International Trade Commission in Softwood Lumber from Canada*, Report of the Panel, WT/DS277/R, 22 March 2004, para. 7.122.

billion, representing the value of the un-refunded duties.³¹ Withdrawal of equivalent trade benefits (by raising duties or applying quota to US imports) is the ultimate sanction to enforce WTO panel rulings.

Working in tandem with the WTO litigation, a NAFTA Chapter 19 panel likewise found in 2003-2004 that the ITC lacked the necessary evidence, this time under US domestic law, to justify its finding that Canadian imports posed a threat of injury to American producers.³² As required under Chapter 19, the matter was remanded to the ITC for correction. In two successive remand reports, the ITC simply re-affirmed its original findings.

In its third and last remand order, in frustration, the panel instructed the ITC to issue a revised finding that there was, in fact, no threat of injury from Canadian imports.³³ Faced with this, the ITC made the required “no injury” order in September 2004, stating that it did so in protest and that the NAFTA panel had failed to apply the correct standard of review, improperly substituted its own judgment for that of the Commission and grossly exceeded its authority.³⁴

A statement such as this by a lower agency, questioning the legitimacy of a reviewing court’s decision, would be unacceptable under the domestic law of both Canada and the United States. It seems intolerable that such derision of panel decisions should be permitted in the context of the NAFTA Chapter 19, which is, after all, equally part of the law of the United States.

Extraordinary Challenge Proceedings

This latest NAFTA panel decision and remand order is now being challenged by the US government under the Extraordinary Challenge proceedings in Article 1904(13) of the NAFTA, on the basis that, among other things, the panel exceeded its authority or otherwise failed to apply the appropriate standard of review.

³¹ Statement by Minister Peterson on Softwood Lumber, DFAIT News Release No. 29, 9 February 2005.

³² *In the Matter of Certain Softwood Lumber Products from Canada: Final Affirmative Threat of Injury Determination*, Remand Decision of the Panel, 19 April 2004, USA-CDA-2002-1904-07, referred to above. This panel dealt with the ITC’s injury finding. Separate NAFTA panels have been invoked by the Canadian side to challenge both the final determinations of dumping margins and the amount of subsidy by the US Commerce Department. Separate NAFTA panel remands required the Commerce Department to adjust those amounts. These proceedings are still continuing.

³³ *In the Matter of Certain Softwood Lumber Products from Canada: Final Affirmative Threat of Injury Determination*, Second Remand Decision of the Panel, 31 August 2004, NAFTA Article 1904 Binational Panel Review, USA-CDA-2002-1904-07.

³⁴ “ITC Files Response to Softwood Lumber Binational Panel Decision with NAFTA Secretariat,” USITC News Release, 10 September 2004; *Views of the Commission in Response to the Panel Decision and Order of August 31, 2004*, 10 September 2004.

It is difficult to estimate, at this stage, whether the United States will succeed in its extraordinary challenge. No previous ECC proceeding has been successful, including the invocation of the ECC procedures by the United States in *Softwood Lumber III*.³⁵ It is not suggested here that there is anything untoward or unacceptable in the invocation of this challenge process by the US government. Should the US challenge be turned back in this instance, this phase of the NAFTA proceedings will be brought to an end and, at least on the legal front, the Canadian side will have achieved some success in the NAFTA Chapter 19 process.

Lack of Finality in the Process

However, the conclusion of the ECC process will not resolve the matter of the antidumping and countervailing duties that have been collected on Canadian imports to date. Notwithstanding the determination by the NAFTA panel that the ITC had no basis for finding that a threat of injury exists, the US Under-Secretary of Commerce stated in January that the panel cannot require the US government to return the CA\$4 billion in duties collected on Canadian imports.³⁶

In other words, the position of the US government is that, even with a final NAFTA ruling declaring that US agency findings have not been legally made (or, using the NAFTA parlance, are not “in accordance with” US law), and even with a vindicated remand order that directs a no-injury finding, there is no specific wording in the NAFTA that requires the US government to return duties that have been improperly (that is, illegally) collected on Canadian imports.

This is an astonishing position for a NAFTA government to take. It complicates the matter and illustrates the further shortcomings of Chapter 19 as a vehicle for effective dispute settlement and closure.

The US position on duty refunds also runs counter to the obligation on governments in Article 1905 of NAFTA to implement panel decisions and give them “binding force and effect.” If a panel has found that the duties are not warranted because of the absence of sufficient evidence, it follows that the duties have been improperly collected. Giving “force and effect” to panel decisions requires their return by the US government.

There are remedies available under NAFTA Article 1905 to deal with this. If US domestic law prevents the United States from implementing the panel decision or has denied it binding force and effect, Canada can request consultations and, ultimately, the creation of a special committee to adjudicate on the failure or refusal of the United States to implement the panel decision. If the special committee were to decide in Canada’s favour, Canada would have the right to retaliate against the United States by withdrawing NAFTA benefits to the tune of CA\$4 billion.

³⁵ *In the Matter of Certain Softwood Products from Canada*, Extraordinary Challenge Proceeding, NAFTA Secretariat File: ECC-94-1904-10 USA, 3 August 1994.

³⁶ “Aldonas Says US Will Not Return Lumber Duty Deposits without Settlement,” *Inside US Trade*, 25 January 2005. See the Canadian Trade Minister’s response, 26 January 2005, DFAIT News Release No. 17.

Developing Some True NAFTA Institutions

Following the propositions outlined earlier and adapting lessons learned in the current phase of the *Softwood Lumber* case, curing the absence of permanent treaty institutions charged with some tasks in upholding the proper functioning of the treaty regime would seem to be an important objective for the three NAFTA governments.³⁷

This lack of such central treaty institutions, given the asymmetry in the Canada-US relationship, tends to weaken Canada's position as a treaty partner. The same is true of Mexico. Strengthening the core of the NAFTA through institutional reform would be in Mexico's and Canada's interest. But improving the administration of the system and making it more efficient could also be portrayed as in the US interest as well.

While it is unrealistic to expect the United States to agree to the creation of new treaty entities or bodies with separate authority, there are certain aspects of the NAFTA that lend themselves to modest institution building, at least as a first step. The result would be to start to build a more complete NAFTA edifice, with additional parts of the structure added in future. A recommendation along these lines is contained in the House of Commons Committee report.³⁸

A Permanent and Effective NAFTA Commission

A first step would be to enlarge on the role of the Free Trade Commission and the NAFTA Secretariat under the provisions of Articles 2001 and 2002 of the agreement. This could be done under current NAFTA authority, arguably without need for any change in the treaty wording. As noted earlier, the NAFTA Commission has inchoate powers now under Article 2001; these powers are simply not being used to the full.

Second, it would seem possible to change the *de facto* operational status of the NAFTA Secretariat without the need to actually amend the agreement. Even though Article 2002(1) provides that the Secretariat is made up of three national sections, under the authority of Article 2002(3) the Commission could decide to give the Secretariat a single, central location and the beginnings of a unified office and structure in day-to-day terms. The Secretariat could then be

³⁷ The absence of functioning institutions within the NAFTA system was commented upon recently in an independent task force report prepared for the US Council on Foreign Relations, the Canadian Council of Chief Executives, and the Consejo Mexicano de Asuntos Internacionales, entitled "Creating a North American Community" (New York: Council on Foreign Relations, 2005). The task force addressed institutions broader in scope than the NAFTA, proposing the creation of a North American Advisory Council to deal with strategic issues affecting North America at large. But the overall point about the lack of permanent institutions in the North American context is consistent with the thesis of this article.

³⁸ *Partners in North America*, *supra*, p. 159.

given additional funding to support defined roles in treaty supervision and implementation to assist the Commission within the terms of Article 2002(3).³⁹

It would be politically problematic to give powers to the Secretariat that currently can only be exercised by consensus among the political ministers acting as the Commission. However, without amending Article 2002, the Secretariat could be delegated roles by the Commission, such as collection of NAFTA trade and investment data, issuing regular reports to governments and to the Commission on any shortcomings in the implementation of treaty obligations.⁴⁰

Another step, perhaps reserved for subsequent consideration, would be the establishment of the NAFTA Commission itself as a permanent institution, with an executive head with specific powers, as opposed to the present *ad hoc* arrangement where the Commission meets infrequently as a gathering of trade ministers. This would not be intended to supplant the authority of the Commission but rather to support the Commission as a unified, treaty agency, with ongoing functions.

A Permanent NAFTA Panel System

Along with establishing a permanent Commission and independent Secretariat, the second suggestion is to create a permanent NAFTA panel system.⁴¹ Again, this would build on the present NAFTA structure under Chapters 14, 19, and 20, discussed earlier.

Such a permanent NAFTA entity would replace the existing *ad hoc* panels that are appointed to decide on individual cases that were previously described. Having security of tenure would make the panelists independent of their national governments. Jurisprudence would be more uniformly developed and more consistently applied. The delays and frustration of searching out persons free of conflicts and willing to serve on separate panels would be eliminated. The additional advantage is that this would give some weight, or *gravitas*, to the present NAFTA system, without radically altering the respective mandates of these bodies.

One area for development is whether this unified panel system could be harnessed to deal with investment disputes under Chapter 11 of the NAFTA. This is a bit more complicated. It may be impossible to supplant recourse to the International Centre for the Settlement of Investment Disputes (ICSID), which is specifically provided for in Article 1120.

³⁹ For example, Article 2002(3) provides that the Secretariat is to “provide assistance to the Commission” and, as the Commission may direct, “otherwise facilitate the operation of the Agreement.”

⁴⁰ This would be a kind of NAFTA performance review, much like the trade policy reviews of member states done in the WTO. Like the WTO process, the review would be done by an independent body that would be able to be critical of governments where necessary.

⁴¹ A recommendation along these lines is also contained in the House of Commons Committee report, *ibid.*, Recommendation 24, p. 162.

However, that article also allows an investor recourse to *ad hoc* arbitration in investment disputes, using the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). It may be possible to designate the proposed permanent NAFTA panel as an optional forum for this purpose, which would then apply the UNCITRAL Rules if so selected by the investor. This could avoid the need to actually amend the treaty provisions.

Improving Options for State-to-State Dispute Resolution

A further deficiency under the NAFTA is the inability of governments to resolve large-scale antidumping or countervailing duty cases, which raise broad economic interests or issues. The *Softwood Lumber* case is the best example. Having begun by way of private petition, there are significant legal roadblocks to sidelining the private interest elements, removing the case from the trade remedy docket and elevating it to the level of governments to settle.⁴²

An area for exploration is whether it is feasible to create a new procedure in the NAFTA so that in cases that engage “major” economic interests of the state, the private remedy process could either be suspended or side-tracked for a time so that the issues could be placed on the Article 2006 agenda for governments to settle or, if bilateral settlement through negotiation were not possible, to have it resolved through panel adjudication.⁴³

While it is for later discussion as to what criteria would be used to determine when a petition or complaint concerned a “major” economic interest of a NAFTA party, if the concept could be agreed to, parties could then work toward better defining the circumstances under which a private trade action would be temporarily sidetracked for settlement consultations.

As an illustration, this would mean that the *Softwood Lumber* case would be “off-ramped” from the private remedy process for a set time so that the state-to-state settlement mechanisms could be applied. Ultimately, if a negotiated settlement could not be achieved, a Chapter 20 NAFTA panel would determine if provincial programs were or were not contrary to treaty rules.

It is recognized that this suggestion is controversial. There are laws in place in all three NAFTA countries that would have to be changed and private rights would be impacted. However, Canadian experience indicates that only where these large-scale private actions can be resolved outside of the constraints of a standard dumping or subsidy investigation is there chance of settlement. And since the mechanism is already provided for in Article 2006, there would seem to be some merit in exploring this possibility further.

⁴² As an illustration, the recent US government proposals for resolving the *Softwood Lumber* case offer some possibilities for settlement but totally within the framework of US countervailing duty laws, by way of a “changed circumstances review” by the Commerce Department.

⁴³ It is noted that Article 2006 already permits a NAFTA party to request Chapter 20 consultations on “any other matter that it considers might affect the operation of this Agreement” and goes on to provide that the matter can then be referred to the Commission for settlement.

Securing Implementation of Panel Decisions

The issue of the United States denying Canada the “binding force and effect” of the softwood lumber panel’s decision on the matter of injury by refusing to refund the duties collected by the US government was briefly reviewed above. As an immediate step, Canada should litigate this critical issue under Article 1905 and, if Canada’s position is upheld, take immediate retaliatory measures against the United States as permitted under that provision.

The various time frames for taking special committee action under Article 1905 are unnecessarily long, requiring a prior period of consultations before a special committee can be requested. These time periods could be looked at with a view to shortening them so that a final reading on the issue of implementation is decided much more expeditiously.

Ongoing NAFTA Work

There are a series of requirements for regular consultations on the operation of NAFTA Chapter 19 under Article 1907, including consultation on the “potential for reliance on a substitute system of rules for dealing with unfair transborder pricing practices and government subsidization.”

It is uncertain the extent to which Canada has pursued these provisions, recognizing that the United States is undoubtedly hostile to any work that would in any way suggest that there could be alternatives to the present system. No updates have been issued by either the Commission or the Department of International Trade indicating that any serious work has been underway on this substitute system under Article 1907 since at least 2003.

It is recognized that this issue is complicated by the fact that these working groups are trilateral and involve Mexico as well as Canada and the United States. The trilateral nature of the exercise will inevitably hinder progress, even if there was political will to accomplish something. Nevertheless, these treaty provisions are binding on all three states and consideration should be given to seeing that their objectives are furthered by continuing to press for substantive progress.

Conclusions – The Importance of Institution Building

The NAFTA is really a first-generation free trade agreement. It made important advances in Canada-US relations, building on the Canada-US FTA, and went some way in leveling the playing field to Canada’s advantage, as the perpetually smaller party. However, it is clear from experience in the *Softwood Lumber* case that Chapter 19 and related provisions are not effective in promoting the free trade principles of the treaty.

It seems timely to think about moving on to a second generation of institution building, particularly under Chapter 19 but in other areas as well. This could be done, not by offering politically unrealistic suggestions such as creating new NAFTA bodies, but by a more creative use of existing mechanisms and institutions to strengthen the NAFTA at its core.

Some of these suggestions require both political will on the part of Canada and concerted pressure on the United States to move matters forward. It is also recognized that the issues are not merely bilateral but are complicated because of the addition of Mexico to development of NAFTA institutions.

Taking all of this into account, there would seem to be a number of options for Canada to improve the system, as addressed in the body of this article:

- Utilize the supervisory functions of the NAFTA Free Trade Commission by giving it a permanent staff to backstop the Commission on an ongoing basis.
- Make use of the jurisdiction of the Commission in treaty interpretation and implementation and in dealing with “any other matter” arising in accordance with the terms of Article 2001.
- Centralize the *de facto* operations of the NAFTA Secretariat under the existing provisions of Articles 2001 and 2002.
- Create a permanent NAFTA panel system, building on the present NAFTA structure under Chapter 19 but adding jurisdiction over disputes arising under Chapter 14 (Financial Services) and Chapter 20 (Institutional Arrangements) and, possibly under Chapter 11 (Investments) as well.
- Create a procedure allowing private trade actions that engage “major” economic interests of the state to be suspended or sidetracked for a time so that the issues could be referred to governments to settle under Article 2006.
- In the *Softwood Lumber* case, continue to follow the present NAFTA litigation strategy to the full and use all remedies available under the retaliation provisions in Article 1905.
- Continue to press the United States to agree to real and meaningful work on a substitute system of rules for dealing with unfair transborder pricing practices under NAFTA Article 1907.

Some of these suggestions are far-reaching and, admittedly “outside the box.” However, none are so radical as to involve opening up sacred provisions of agreement. They are designed with the objective of being administrative adjustments within the treaty wording as it stands now, and are offered up to stimulate some thinking and discussion.

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