



Trade Law Memo

Vol. 4, No. 2, February 2005

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Softwood Lumber – Canada Plays Hardball

Canada Seeks Retaliation

Canada's move to seek retaliation against the United States is a dramatic development in the current phase of the softwood lumber dispute.

It ratchets up the stakes by asking the WTO for the green light to apply duties or quotas against U.S. imports to the tune of \$4 billion.

Canada wants these duties on the grounds that the U.S. government has failed to comply with a WTO panel ruling that found there was no evidence that Canadian imports threatened to injure U.S. lumber producers.

The following is a very encapsulated summary, explaining how we got to this point and some comments on where the two sides go from here.

Canada's Two-Track Strategy

From the outset, the Canadian strategy was to challenge U.S. trade agency decisions at every step, using both the WTO Agreement and NAFTA dispute settlement procedures. These challenges were part of a broader strategy to leverage a negotiated settlement with the U.S. side, recognizing that only through a bilateral deal can there be long-term stability and hassle-free access to the American market.

Threat of Injury Not Proven

The Canadian move to retaliate flows from a decision by a WTO panel in March 2004 that said the threat of injury determination by the U.S. International Trade Commission (ITC) was not one

that "could have been reached by an objective and unbiased investigating authority." The panel said that the U.S. had breached its WTO obligations and required it to revise the ITC's order accordingly.

Since the U.S. government refuses to change that decision and refund the countervailing duties collected on Canadian imports, Canada is seeking rights from the WTO to withdraw trade benefits equivalent to the amount of the non-refunded duties. This is the ultimate sanction to enforce WTO rulings.

At the same time, a separate NAFTA Chapter 19 panel also found that the ITC lacked the necessary evidence under U.S. domestic law to justify its finding that Canadian imports posed a threat of injury to American producers. 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. 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 grossly exceeded its authority.

Thus, under both the WTO Agreement and the NAFTA, Canada has succeeded in obtaining legal decisions that the ITC did not have evidence before it to substantiate its conclusion that there was a threat of material injury to U.S. producers from Canadian imports. Without such threat of injury, there is no legal basis for applying countervailing duties.

U.S. Invokes Extraordinary Challenge Process

As a result of the NAFTA panel remand, the U.S. has invoked extraordinary challenge proceedings under Article 1904.13 of the NAFTA, on the grounds that the panel “manifestly exceeded its powers, authority or jurisdiction” or failed to apply the appropriate standard of review and, as a result, both the panel’s decision was materially affected and the “integrity” of the NAFTA panel process has been threatened.

The only previous extraordinary challenge under NAFTA involving Canada and the U.S. (in the third Softwood Lumber case in 1994) said that the Challenge Committees cannot revoke a panel finding save in the most serious and exceptional circumstances and where there has been gross jurisdictional abuse. This will be a serious hurdle for the U.S. to overcome.

U.S. Refusal to Refund Duties

While all of this was going on, a senior U.S. governmental official stated in January 2005 that whatever the decision of these panels the U.S. will not refund countervailing duties on Canadian imports since, in his view, NAFTA panels have no jurisdiction to order duties be returned.

These comments run counter to the obligation of governments in Article 1905 of NAFTA to implement panel decisions and give them “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 U.S. government.

Dumping and Subsidy Panels

In conjunction with the foregoing, the Canadian side has been litigating the U.S. Commerce Department’s calculation of the dumping margins and subsidy amounts and has been reasonably successful in obtaining positive rulings in both the WTO and NAFTA panels. These proceedings are still in process.

Negotiation While Litigation Continues

There have been sporadic attempts to get negotiations back on the rails while the litigation is proceeding. Little progress has been achieved so far. One of the stumbling blocks is the return of the duties paid by Canadian exporters.

Canada is now taking the matter one step further. By seeking authorization to withdraw trade benefits on a range of U.S. goods, the Canadian government is signalling that there is now a widening dimension to the softwood trade war. Whether this will ultimately work in favour of a negotiated compromise is hard to say.

The problem in achieving a negotiated settlement is that much of trade remedy law is driven by private parties and it is difficult for governments to impose settlements without their consent. On the American side, whatever the disposition of the government, the lumber industry has considerable weight in Washington and opposes any deal that allows continued access to the U.S. market without some kind of pricing or volume limitation. And on it goes.

International Trade Law Group

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