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TRADE LAW MEMORANDUM

To: Clients and Friends

Re: SOFTWOOD LUMBER – THE NEXT PHASE

Date: November 6, 2001

Canfor's Dramatic Announcement

There is a new twist in the softwood lumber dispute with Canfor Corp.'s announcement on November 5th that it is filing an arbitration claim under the NAFTA investment provisions, seeking \$250 million in compensation from the U.S. government. There are several heads under Chapter 11 but the main one Canfor will likely use is the requirement in Article 1105 that obliges the U.S. government to accord "fair and equitable treatment" and "full protection and security" in accordance with international law to all Canadian investors and their investments in the United States.

This claim -- which has a long way to go before any decision is rendered by an independent arbitration panel -- is an important strategic development. It is the first use of Chapter 11 in this kind of trade dispute and therefore breaks new ground by seeking to have trade remedies adjudicated under Chapter 11 investment standards. Second, it gains negotiating leverage for Canfor and for entire Canadian softwood industry in the main dispute, taking back some of the initiative from the U.S. side.

On substantive grounds, the challenge is for Canfor to prove unfair or inequitable treatment or discrimination against Canadian exports to such a degree that it amounts to a breach of the NAFTA by the U.S. government. This task is not an easy one. The U.S. will argue that it is simply applying ordinary trade remedy laws as sanctioned by the WTO agreements.

On the other hand, if there is evidence that Commerce responded to political pressure and unfairly targeted Canadian softwood, it might just be possible to convince an arbitration panel that the U.S. has not given Canadian investments the kind of “fair and equitable treatment” that NAFTA and international law demands. If successful, Canfor could obtain compensation for all the anti-dumping and countervailing duties paid as well as lost profits resulting from the investigation.

Frailties of the Trade Remedy System

The Commerce Department’s decision on October 31st to apply a 13% anti-dumping duty on Canadian softwood (on top of an earlier countervailing duty for alleged subsidies) clearly was a serious blow to the Canadian industry. The effects on Canadian exports were immediate. It revealed both the extent of Canada’s exposure to the trade remedy system south of the border and the value to U.S. producers in using trade laws for strategic purposes. It also illustrates the practical limitations of the NAFTA provisions in reducing that exposure.

No one doubts that the right long-term option is for the Canadian industry and the Federal and Provincial governments to fight the case out to the end. This is a good and proper strategy and one that most of the industry seems to agree with. But it will not alleviate the immediate harm being caused to forestry and lumber-mill workers and to the

Canadian economy at large and this is putting pressure on the solidarity of the Canadian team. Short of a negotiated solution, there are few avenues for immediate relief.

Sensible efforts therefore are now underway to explore the modalities of a negotiated solution through high-level talks. Such a solution could result in what is called a suspension agreement, allowing the case to be effectively halted. That is what happened in 1986 and again in 1995 when Canada agreed to a managed system of export taxes and quota limitations.

The problem with a suspension agreement is that the clock is ticking and there is a deadline looming for its conclusion. That means that all the complex details would have to be sorted out within a window of about 90 days, making it a difficult practical problem. It is too bad trade law is not like civil litigation where settlements are possible at the foot of the courthouse steps. Resolution of trade disputes is trickier and has to be shoehorned into the precise requirements of the WTO Agreement and the time limits set out in national legislation.

Judging from comments by the U.S. softwood industry's representatives, any settlement would have to radically alter Canadian forest management practices and laws, to bring them in line with what the American ideas of a market-based auction system. That means a wholesale alteration of Canada's Crown-owned timber regime and the manner in which economic rents (stumpage fees) are set and collected.

Pending the results of talks between Pierre Pettigrew and Marc Racicot of the U.S. side, there are other fronts where the battle can be joined. While none can offer immediate relief and none are guaranteed to be ultimately successful, these can help to give Canada some additional negotiating leverage in terms of securing a successful a political settlement.

Judicial Review under U.S. Law

The Canadian industry could also initiate a point-by-point challenge of both the methodology and the calculation of the preliminary margins and amounts of subsidy by the Commerce Department through additional submissions to U.S. authorities, setting the stage for application by way of judicial review to the U.S. Court of International Trade.

A parallel option is to challenge the claim that Canadian imports have been a cause of material injury to the U.S. producers. Under WTO rules, dumping and subsidization in themselves are not illegal. It is only where these actions cause material injury that governments can apply anti-dumping or countervailing duties.

The way it works is that once the Commerce Department has finished its initial investigation, the case goes to the U.S. International Trade Commission for a hearing. The ITC is charged with deciding whether the subsidization and the dumping, as found by the Commerce Department, is one of the causes of the material injury to the American softwood producers.

In many instances, the proof of causation is a foregone conclusion. The standard is pretty low. Dumping or subsidization must merely be one of the causes of material injury and not the only cause. Nevertheless, the evidence must objectively establish this “causal link” and Canadian exporters may have a number of arguments to fight causation under U.S. law.

While causation is established on a Canada-wide basis and is not required to be shown company-by-exporting-company, if it can be proven that softwood exports from

individual Canadian sources has not contributed to that injury, it gives those exporters the possibility of seeking exclusions from the final target list.

Again, this may not help Canadian producers in the short term. It shows, however, that the game is not yet over and that there remain several battles on several fronts that should be fought with determination and vigour.

Fighting it out at the WTO

We pointed out in previous memos that there have been major changes in the multilateral system since 1994 when the WTO Agreement came into effect. Under the GATT, applying anti-dumping and countervailing duties was the pretty much the preserve of governments and rarely interfered with. Things have changed.

National trade agency decisions are now regularly appealed to WTO dispute panels. The panels have been aggressive in examining these decisions to see if they comply with the detailed requirements of the Agreement.

As well, there is now a fast-track timeline for dispute settlement at the WTO. While the U.S. can delay Canada's first request for a panel, it cannot forestall a panel's establishment beyond an initial 30-day period. Once convened, the panel must issue its decision within 6 months or, in exceptional cases, within 9 months. This is also of value to Canada.

Illustrative of these changes are a rather remarkable couple of cases, where WTO panels have scrutinized U.S. dumping decisions in great detail, concluding that the Commerce Department breached the requirements of the Anti-Dumping Agreement.

While these cases focus on anti-dumping, similar reasoning applies to countervailing duties under the Subsidies and Countervailing Measures Agreement.

In *Stainless Steel Plate and Sheet from Korea*, 22 December 2000, a WTO panel found that the Commerce Department breached the Anti-Dumping Agreement and nullified and impaired benefits accruing to Korea, giving that country the right to retaliate. Similarly, although for different reasons, a subsequent WTO panel in *Hot-Rolled Steel Sheet from Japan*, 28 February 2001, found the Commerce Department's margin determinations breached the requirements of the same Agreement, giving Japan a right of retaliation.

The U.S. appealed *Hot-Rolled Steel Sheet* to the WTO Appellate Body, but the AB upheld the original panel's decision on several key points. What is of interest is what the Appellate Body said about the role of panels under the Article 17.6 of the WTO Anti-Dumping Agreement, a view that is pertinent to the present case. Article 17.6 (with almost identical language in the Subsidies Agreement) states that,

“in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned”. (emphasis added)

The key words in Article 17.6 are “proper”, “unbiased” and “objective”. It is useful to quote what the Appellate Body had to say in the *Hot-Rolled Steel Sheet* case:

“. . . panels must assess if the establishment of the facts by the investigating authorities was *proper* and if the evaluation of those facts by those authorities was *unbiased and objective*. If these broad standards have not been met, a panel must hold the investigating authorities' establishment or evaluation of the facts to be inconsistent with the *Anti-Dumping Agreement*". (emphasis added)

These steel products cases are different in their facts from the present softwood investigation. But judging from the above legally binding views of the role of WTO panels set out by of the Appellate Body, the U.S. Commerce Department -- and subsequently the ITC -- can be put to the test before the WTO. While each case has to be fought on its merits, it is clear that Canada and the Canadian softwood industry have some important WTO options that were not previously available.

As was stated at the outset, these are not going to produce immediate results. However, in cases such as these it is important to pursue all available avenues and clearly the WTO route is a key part of any Canadian strategy.

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