SOFTWOOD LUMBER, NAFTA, AND THE NEED FOR REFORM

BY JEAN-G. CASTEL & C.M. GASTLE

The recent Canada-United States agreement settling the Softwood Lumber dispute highlights the weaknesses of the NAFTA Chapter 19 dispute settlement mechanism in anti-dumping and subsidization cases. The need to reform the mechanism is confirmed when the agreement is reviewed in the context of Canada's "win" in *Softwood Lumber III* [*In re Certain Softwood Lumber Products from Canada*, No ECC-94-1904-01USA, 1994, FTAPD Lexis II (August 3rd, 1994)]. The agreement imposes a $50.00 charge on exports per thousand beyond 14.7 billion board feet and $100.00 per thousand beyond 15.35 billion board feet. Shipments in 1995 were 16.2 billion board feet, representing approximately $8 billion in export value, and the agreement would result in duties of more than $170 million being paid should future shipments match this annual export volume. The agreement is designed to provide five years of trade peace during which no trade action will be initiated by the United States government against Canadian lumber, and any actions commenced by the United States industry will be dismissed.

THE LUMBER AGREEMENT

The agreement is a relatively good deal for Canada, which was faced with a new complaint to be filed immediately in the United States by a strong interest group, the Coalition for Fair Lumber Imports. United States Trade Representative Mickey Kantor, in a spirit of frontier justice, had already announced that he intended to impose a ten-percent duty on all shipments, which would have resulted in as much as $800 million in duties being collected per year, based on the 1995 export volume. If the duration of the new dispute matched that of *Softwood Lumber III* (October 4, 1991 to August 3rd, 1994), the interim duty of ten percent would remain until January 1999 and amount to as much as $2.4 billion, even if Canada ultimately won the dispute at which time the interim duties would be returned. The Canadian government expected that final duties would be imposed, as International Trade Minister Art Eggleton surprisingly conceded in early April, 1996 that Canada could not win a new dispute because of changes to American trade laws made subsequent to the termination of *Softwood Lumber III*. Canada also could not be certain to have the benefit of a Canadian majority on both the binational panel and the Extraordinary Challenge Committee, which appears to have been a factor in Canada's success in *Softwood Lumber III*. One of the central issues in that dispute was the proper measure of deference to be accorded by the binational panels to the American administrative agencies, and this issue clearly divided panelists and committee members along national lines, with American members requiring that almost absolute deference be shown.

Even though the agreement is the best solution in the circumstances, it is perverse in the light of free trade objectives. *The Financial Post* reported that the settlement will encourage a quota system for exports to the United States ["Softwood Deal Affords Trade in US Export Quotas", *The Financial Post*, April 3rd, 1996], which is one of the most inimical trade practices that the GATT has attempted to eliminate since its inception in 1947. If such a quota system is necessary, it may place the federal government in the delicate position of allocating the quota among the provinces. It also reflects the tendency of the United States to manage trade in certain sectors, made evident in the pattern of use of the American trade laws.

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The greatest casualty is the NAFTA Chapter 19 mechanism, which has been largely discredited by the agreement so close upon the heels of Canada's "win" in *Softwood Lumber III*, as well as by Eggleton's concession that Canada could not win a new dispute. Chapter 19 is designed to replace the domestic channels of administrative review. One of its major limitations is that only final anti-dumping and countervailing duty determinations are subject to review. Mickey Kantor's threat of a ten-percent preliminary duty represents pre-judgment relief which prompted the signature of the agreement, as it did in 1986 when a Memorandum of Understanding was signed after a preliminary duty of 14.5 percent had been announced. Not much has changed in ten years regarding the United States' ability to reach a "voluntary" understanding with Canada in one of our most sensitive trade sectors.

A more important problem in the Chapter 19 mechanism is that it blindly accepts American domestic trade laws and any changes thereto. This gives rise to a classic "Catch-22": if Canada wins an important trade dispute, Congress simply changes the trade laws, the industry interest group launches a new complaint, and the result likely will be reversed.

From a Canadian standpoint, the *Softwood Lumber III* determination also challenges the fundamental justification for the Chapter 19 mechanism. Its effectiveness is dependent upon the degree to which it can yield results different from the determinations that would have been made by the United States Court of International Trade (CIT) and United States Federal Court of Appeals (USFCA). Canadian trade officials justified the mechanism by arguing that the CIT and USFCA had been too deferential and that the American standard of judicial review ("supported by substantial evidence on the record") would allow the binational panels to be less deferential. The record of performance of the binational panels would tend to support the view that they have been less deferential, but the question arises whether this trend

will continue. Judge Wilkey, the American representative on the *Softwood Lumber III* Extraordinary Challenge Committee, argued strongly in dissent that the binational panel mechanism must show the same deference as the CIT/USFCA. We have argued elsewhere that Judge Wilkey descended into the forum and became an advocate with respect to the central requirement that the binational panel result "threatened the integrity of the binational panel review process" and, therefore, his dissent must be taken with a healthy degree of scepticism. It does appear clear from the Congressional reports that, in his dissent, Judge Wilkey relied upon the United States' intention to monitor more closely the exercise of discretion through such mechanisms as the selection of panelists, or by "correcting aberrant results" through regulatory or statutory changes, if the convenient evolution of administrative practices does not suffice. The agreement in the softwood lumber dispute certainly will give encouragement to members of Congress opposed to NAFTA Chapter 19 in this regard. *Softwood Lumber III* may well become a "high water mark" for the Chapter 19 mechanism from a Canadian standpoint, as it will be a brave American panelist who does not pay heed to the directions given by Congress and Judge Wilkey.

PROSPECTS FOR REFORM

It is questionable whether any effective reform is now possible in the light of Congressional hostility and the prominence which may be given to NAFTA during the presidential election. Nevertheless, effective reform would place greater restrictions upon the ability of a Party to impose preliminary duties, and would allow a review of preliminary determinations. Pre-judgment remedies are allowed sparingly in domestic civil litigation proceedings because of their potentially determinative effect, and they are only provided after onerous thresholds have been met by those seeking the relief and after appropriate undertakings as to damages have been given. Placing substantive restrictions upon the granting of preliminary duties is probably impossible due to the entrenchment of current preliminary duty practices in the World Trade Organization (WTO) Agreements. Effective reform would also free the panels from the tradition in the United States of deference to the administrative agencies.

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We believe that one potential route of reform is the elimination of the Chapter 19 mechanism in favour of binding and enforceable WTO Dispute Settlement Body (DSB) decisions in anti-dumping and countervailing duty disputes involving NAFTA Parties. [The WTO DSB determinations are not directly enforceable in the courts of the WTO Parties which, as a result, are not required to implement the recommendations of the DSB panels. While removal of the offending measure or provision is the primary objective of the WTO DSB, the only remedy provided if met with a refusal by the defaulting Party to comply, is that the complaining Party may suspend the application of benefits of equivalent effect until a resolution has occurred.] Since the WTO DSB can review preliminary determinations, the underlying trade legislation and any amendments thereto, it is better placed to impede unprincipled amendments to domestic trade laws designed specifically to overturn earlier determinations. The United States would have to comply immediately with WTO DSB directions that the preliminary determinations or trade law amendments were not WTO-consistent. It would also be more difficult for the United States to mount a campaign to overturn a favourable WTO DSB result, because the world trade community is now looking to the United States to support the GATT/WTO and abandon its policy of aggressive unilateralism. The WTO DSB panel determinations would also likely be more credible than Chapter 19 panel determinations, due to the advantages in due process provided by the WTO's innovative appellate procedures.

The potential reform has been criticized on the basis that it would be impossible to negotiate it with the United States or to achieve the necessary amendments to the WTO Agreements. If receptiveness by the United States is to be the litmus test of any potential reform, there is no point in suggesting any reform at all. We do note, however, that Judge Wilkey is in favour of eliminating Chapter 19 in favour of the WTO DSB, and has made a submission to that effect in Congressional hearings (although he has not commented on our proposal that the mechanism be made enforceable as a *quid pro quo*). As a result, there is a basis upon which to advance this potential reform. An amendment to NAFTA could provide that NAFTA Parties will make enforceable WTO DSB determinations in anti-dumping or countervailing duty disputes, and thus no amendment to the WTO Agreements should be necessary. If an amendment to the WTO Agreements is required, the WTO Parties would likely be receptive because the channelling of Chapter 19 disputes through the WTO DSB would be an important boost to the development of the multilateral mechanism and a body of international trade law. More importantly, making the WTO DSB determinations not only binding but *directly enforceable* upon the United States and other NAFTA members would represent an important precedent for the future development of the multilateral mechanism.

This method of reform has also been criticized on the basis that the WTO DSB requires governments to commence the proceedings, because private parties do not have direct access to them as in the case of Chapter 19 panel proceedings. An amendment to the Canadian *Special Import Measures Act* and similar American and Mexican legislation could require Canada, the United States, or Mexico to commence WTO complaints when petitioned to do so.

Critics should also remember that a practice has developed of taking aspects of disputes before the binational panels to GATT panels, now WTO DSB panels. *Softwood Lumber III* was taken before GATT with respect to self-initiation of the investigation, along with certain other aspects of the dispute. Had there been a binding GATT mechanism, the duties would have been repaid in October 1993

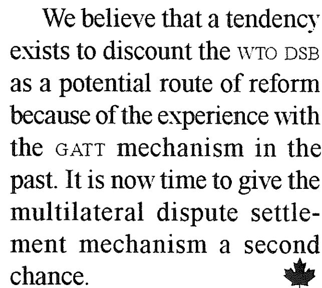
continued on page 78

THE NEED FOR REFORM

from page 77

instead of a year later. If the Chapter 19 panel determination had been made by a binding WTO DSB panel, the world trading community would have had a stake in ensuring that the United States could not simply change the rules as they did.

We believe that a tendency exists to discount the WTO DSB as a potential route of reform because of the experience with the GATT mechanism in the past. It is now time to give the multilateral dispute settlement mechanism a second chance.



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ENDNOTE

1. The authors have provided a detailed analysis of the Softwood Lumber III Extraordinary Challenge decision, as well as potential reforms of the Chapter 19 mechanism in Gastle & Castel, *Should the North American Free Trade Agreement Dispute Settlement Mechanism in Antidumping and Countervailing Duty Cases be Reformed in the Light of Softwood Lumber III?*, Law and Policy in International Business, Vol. 26, Spring 1995, pp. 823-896.

NAFTA AND INVESTMENT: AN ECONOMIC CONSTITUTION?

BY BARRY APPLETON

While generally considered to be strictly a trade agreement, it comes as a surprise to many to find that a large part of the NAFTA's three-thousand-plus pages is devoted to the protection of investment, services, and intellectual property. Indeed, so strong are these protections that the NAFTA can properly be called the most far-reaching international investment agreement in the world.

What makes the NAFTA so remarkable is not just its very broad definition of investment, but also its unique process to protect the "rights" of NAFTA investors. The NAFTA imposes obligations upon its signatories in a number of investment areas. The difference is that if these obligations are not met, individual investors have direct legal rights that can be brought to a tribunal without the agreement of their home government.

The NAFTA's "investor state" dispute settlement process, a central component of the agreement, provides for a fast and effective means of settling disputes between investors and governments by bypassing domestic courts. Designed to provide protection for foreign investors in developing countries, the investor-state dispute process focuses strictly on settling investment disputes between individuals and governments.

The use of arbitration is not new in international law. Countries have relied upon it to settle their disputes for hundreds of years. What is new is that the NAFTA makes this formerly country-only process available to all North American private citizens and their businesses. What is surprising is that these governments have agreed to accept the decisions of these international tribunals to discipline their conduct.

The NAFTA requires that there be some international element involved in an investment dispute. Under the agreement, any individual or business resident in a NAFTA country can launch a claim against the government of another NAFTA country. Thus, Canadian investors are not eligible to bring disputes against the government of Canada, but American or Mexican investors are. A major exception to this rule is that Canadian corporations "owned or controlled directly or indirectly" by a citizen of another NAFTA country can bring a claim against a Canadian government.

The bizarre result is that foreign companies or investors are able to access the NAFTA investor-state process to protect their rights while Canadians are not. This is not just an academic quandary. In

WHAT RIGHTS DOES THE NAFTA PROTECT?

The thousands of pages that make up the NAFTA are divided into twenty-two chapters and supplemented by thousands of pages of annexes. The Agreement contains one chapter dealing with trade in goods but five chapters dealing with investment and services (one chapter each on investment, cross-border services, telecommunications, financial services, and intellectual property).

The NAFTA investment chapter imposes stringent obligations on member governments regarding investments from other NAFTA countries. The NAFTA defines an investor as a NAFTA citizen (private or corporate) that "seeks to make, is investing or has made an investment."

The types of investment rights covered include:

NATIONAL TREATMENT: Foreign investors must be treated at least as well as domestic ones. This means that neither formal nor substantive rules can be structured in such a way as to give an advantage to domestic companies.

MOST-FAVOURED NATION TREATMENT: Any special treatment given to non-NAFTA country investors must also be extended toNAFTA investors.

MINIMUM STANDARDS OF INTERNATIONAL TREATMENT: Investors and their investments must be given due process, fairness, and other protections.

LIMITS ON PERFORMANCE REQUIREMENTS: Rules that require ll loca local hiring, local sourcing, or a percentage of local content are severely limited or prohibited against all foreign investments (not just NAFTA-based investments).

FULL COMPENSATION ON EXPROPRIATION: Full, swift, and fair compensation must be paid after any expropriation or any act that is similar to expropriation. In some circumstances, excessive government regulation could constitute an act "tantamount to expropriation."

These obligations apply to national and subnational governments as well as to Crown corporations that exercise any authority given to them by governments.