



# NAFTA Renegotiations – A Different Route to Settle Trade Disputes

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## Introduction

In the impending renegotiations of NAFTA (the Agreement), the Trump team will be demanding removal of NAFTA's binational panel system in Chapter 19 of the Agreement. That is the system that allows Canadian exporters the right to use these panels in dumping and subsidy cases instead of having to appeal through US courts.

Given the importance of Chapter 19 to Canada and the fact that serious concessions were made to get that system in the original 1988 Canada-US Free Trade Agreement (FTA), the US position could lead to a breakdown in the negotiations, possibly triggering the US threat to withdraw from the trade deal in its entirety.

Faced with such a scenario, what are options? This note suggests that one worth considering is to reinvigorate the State-to-State dispute resolution system under NAFTA Chapter 20 as a replacement for the Chapter 19 panel review process, with some re-jigging to add special provisions to deal with trade remedy disputes such as the ongoing softwood lumber battle.

The result would be that, instead of Canadian exporters having to challenge US trade agency determinations under Chapter 19, any dispute with the Americans in dumping and subsidy cases would be taken over by the Canadian government. The legal case and the cost burden would be shifted from the private to the public sector.

## The Waiting Game

On May 18, US Trade Representative (USTR) Robert Lighthizer sent the US Administration's advance notification to the Congress under the so-called "Fast Track" process, setting out the Trump team's negotiating objectives. This version has less detail and, on its face, is less aggressive than the earlier draft notices that had been leaked to the press over the last two months.

It is misleading to conclude from this that the Administration will be backing off many of its core demands under Trump's "America First" policies. One reading is that the more general wording simply gives the Administration maximum flexibility in the changes it demands when Lighthizer & company actually sit down at the negotiating table with Canada and Mexico.

We are not at that point yet. Congress has to review the notification over the next 90 days and then give Fast-Track approval to the Trump team. That approved negotiating authority could come with or without new conditions tacked on. Formal negotiations with Canada and Mexico will then start after the 90-day period, sometime in the fall of 2017.

It is fair to expect that many of the critical parts of the NAFTA will be on the US radar screen, as part of a "massive" re-negotiation as Mr. Trump said in a recent interview. Canada needs to be ready for a difficult and long, drawn-out fight, with the threat of US withdrawal from the Agreement if the talks bog down in frustration.

Commerce Secretary Wilbur Ross already indicated that possibility, a shot across the bow to tell Canada and Mexico that they better be prepared to deal on US terms, or else. Hardly a propitious beginning.

### **Binational Panels Targeted**

Even if the latest draft notice makes no specific reference to NAFTA Chapter 19, judging from statements made by the Trump team, elimination of the binational panel system will most likely be a central part of the US negotiating position.

Chapter 19 originated in the Canada-US trade negotiations in the Mulroney-Reagan era and came about in intense dealings during the last phase of negotiations leading to the conclusion of the original Free Trade Agreement (FTA) in 1988.

That was a period when large-volume Canadian exports had been targeted in US trade investigations in the 1980s, including softwood lumber, groundfish and pork products. It seemed at the time that American industry would continue on its un-restrained path of alleging that Canadian imports were dumped or subsidized, putting broad swaths of the Canadian economy at constant risk. The only recourse for Canadian

companies was to seek judicial reviews through the long and expensive US court system.

From the opening round of the FTA exercise, then, Canada sought to eliminate the use of anti-dumping and countervailing duty proceedings in bilateral trade. The US would have none of it.

In the end, as part of a complex set of compromises, instead of eliminating anti-dumping and countervailing duties, the US agreed to a binational panel system whereby, instead of going to domestic courts, parties could have trade agency decisions reviewed in the binational forum. This system was incorporated into Chapter 19 of the NAFTA in 1994.

There's been a drumbeat of opposition in the US over Chapter 19 for many years. American stakeholders – like the US softwood lumber industry – have been lobbying incessantly to have the whole chapter removed from the Agreement. Among other things, opponents argue that it is unconstitutional because it removes the rights of Americans to have cases heard in their own domestic courts.

While that specific reference to removing Chapter 19 is not in the May 18 USTR notice, it is a fair assumption that this will be close to the top of US demands when the negotiations actually begin. The question is: how is Canada to deal with this?

Given the importance of the binational panel system and the fact that Canada made major concessions to get it in the original Free Trade Agreement – including agreeing to continental free trade in energy – one possibility would be for Canada to simply say removing Chapter 19 is non-negotiable and simply refuse to deal on the point. That would be a risky position and could have unpredictable consequences, as indicated, including a potential breakdown in the negotiations.

### **Options are Available**

Other options exist, however. One is to consider the often-overlooked State-to-State dispute settlement provisions in NAFTA Chapter 20 as a counter to US insistence on eliminating the Chapter 19 panel system.

These State-to-State provisions replicate the multilateral dispute settlement process in the *World Trade Organization Agreement* that the US is a party to and frequently uses to challenge trade measures applied by other governments. The Trump team could hardly deny the legitimacy of the State-to-State procedure that it uses itself on the multilateral front.

### **Chapter 20 Architecture**

What is Chapter 20 all about?

Chapter 20 covers disputes between NAFTA governments based on allegations of breaches of state obligations under the Agreement. This is in contrast to the Chapter 19 system which is much narrower and entails private-sector applications for binational panel reviews of trade agency decisions.

Chapter 20 provisions are modelled on the WTO Agreement and its *Understanding on Rules and Procedures Governing the Settlement of Disputes*. It allows any NAFTA government the option of initiating binding arbitration in cases where the other side has enacted laws or taken measures in contravention of either the NAFTA itself or the WTO Agreement.

Article 2005, paragraph 1, of Chapter 20 says that any dispute between Parties under either the NAFTA or the GATT (now part of the WTO Agreement) may be settled in either forum at the option of the complaining Party.

While not advocating that Canada retrench from its insistence on Chapter 19 remaining in the NAFTA, it is possible to re-tool Chapter 20 to handle trade remedy disputes as a substitute for the Chapter 19 panel system. The following explains how.

### **Advantages of State-to-State Dispute Settlement**

A revised Chapter 20 could include special provisions to deal with final determinations of trade agencies that are alleged to be in breach of NAFTA obligations or obligations under the WTO Agreement. This would go some distance in ensuring that anti-dumping and/or countervailing duty decisions in any one of the NAFTA countries do not contravene the NAFTA or the GATT/WTO Agreement.

Instead of the costs being born by a private sector complainant as under Chapter 19, the financial burdens would fall on the complaining government.

To illustrate in the context of softwood lumber, instead of Chapter 19 panel reviews, where the domestic industry would be seeking reviews of decisions of the Commerce Department or the US International Trade Commission, the Canadian government could initiate a NAFTA dispute on a State-to-State basis.

Canada used State-to-State remedies under the WTO Agreement in *Softwood Lumber IV*, claiming that in its subsidy calculations, Commerce acted contrary to US WTO obligations. The WTO panel agreed and a major part of its decision was upheld on appeal to the Appellate Body. In arriving at these conclusions, both the panel and the Appellate Body examined the minutiae of the Commerce Department calculations. In other words, these WTO bodies acted in a manner similar to a domestic court.

More recently, as another example, Taiwan brought Canada to the WTO and succeeded, on the basis that, in using generally-applied dumping margins rather than precise data from individual exporters, the Canada Border Services Agency contravened certain parts of Canada's WTO obligations. The WTO panel examined every aspect of the CBSA's decision to assess whether it complied with Canada's treaty obligations.

These and other cases illustrate the fact that State-to-State dispute settlement has evolved into a highly exacting process that examines all aspects of national agency decisions in relation to that government's treaty obligations, something that would never have occurred in such detail under the former GATT regime. In a sense, the WTO-like State-to-State process has become close to being a supra-national appeal court.

Using this State-to-State process in Canada-US trade remedy disputes and making it more efficient and timely offers advantages that were not apparent when the NAFTA was concluded over 20 years ago.

### **Remedies**

A new section in Chapter 20 on trade remedy disputes also would be advantageous in terms of strengthening available remedies. Because the Chapter 19 panel system process is limited to judicial reviews as they would be conducted in the domestic courts in the country whose decision is under challenge, the remedy is limited to a remand order.

A remand order is a direction by a reviewing court (or, in this case, a NAFTA panel) to the lower agency concerned to review its original decision and report back on the results of that review. It differs significantly from an appeal, where a court can actually overturn an agency decision and replace it with the appeal court's own decision. Under Chapter 19, the brass ring is restricted to a remand order.

In contrast, Chapter 20 allows an arbitration panel to issue a binding decision that a given law, regulation, measure or policy contravenes a NAFTA government's treaty obligations. Unlike the WTO system, where panels can only decide that a given measure must be brought into line with WTO obligations, Chapter 20 does not restrict panels in the scope of the awards that can be made.

Article 2004 of Chapter 20 applies to the settlement of "all disputes" between the Parties "regarding the interpretation or application" of the NAFTA whenever one of the Parties considers that a given measure "nullify or impairs" that country's NAFTA benefits.

There is nothing in Chapter 20 that restricts a panel from ordering monetary compensation or, in the trade remedy context, ordering a cancellation and return of antidumping or countervailing duties that may have been collected. Even if the jurisdiction of these panels is not 100 percent clear in regard to monetary award, the re-jigging process can clarify the issue.

Another benefit under Chapter 20 is that when panel decisions are not implemented, Article 2019 allows the successful Party to unilaterally suspend NAFTA benefits to the other side – retaliation - within 30 days of a panel decision. Unlike the cumbersome WTO process that requires time-consuming steps before retaliation measures are approved, Article 2019 allows retaliation by the winning side after this 30-day implementation period if the respondent government fails to abide by the panel's decision.

### ***Time-Frame***

A further advantage is that the Chapter 20 time-frame is significantly shorter than that under Chapter 19. The Chapter 19 envisages a total of 315 days from the beginning of a panel review request to end of the procedure. In contrast, Chapter 20 provides for a total time of 210 days from start to finish, a saving of approximately 100 days.

Certain parts of the Chapter 20 process could be weeded out to tighten the time-frame even more. As it exists, there are some preliminary steps in Chapter 20 that must be undergone before a government can file its case. It must first request a 30-day consultation (Article 2006) with the other side in the hope of resolving the matter.

In practical terms, this is no more than a *pro forma* exercise. It replicates the multilateral system in the WTO Agreement but is superfluous in bilateral disputes and is particularly unsuited in trade remedy disputes. As well, nothing prevents governments from settling trade issues at and stage in a dispute where there is political will, making the mandatory up-front 30-day consultation step arguably unnecessary.

If the 30-day period of consultations fail to settle the matter, it must next be referred to the NAFTA Free Trade Commission for a further 30-day period (Article 2007), during which the Commission is to use its good offices to try to mediate a settlement.

The Free Trade Commission comprises cabinet-level representatives from each of the three NAFTA parties and, at least on paper, is charged with supervising the implementation of the Agreement (Article 2001). In reality, the Commission meets only in highly orchestrated annual sessions and except in one or two instances where it issued NAFTA interpretation bulletins, undertakes no real hands-on role of treaty supervision. It is in many ways a fictional body only.

There are other deficiencies as well. First, the Commission has the discretion of deciding when to meet to deal with a bilateral dispute. Article 2007 says it shall meet within 10 days of a request "unless it decides otherwise", meaning the Commission could delay meeting as circumstances dictate. This could delay the overall Chapter 20 process.

More importantly, even if the Commission meets within the 10-day period, it is questionable whether its mediation role serves any effective purpose. The Commission is unlikely to be neutral or non-partisan and, in any case, its mediation offices have never been used. Its role of good offices under the NAFTA is a hortatory declaration, a hope that is not born out by reality. This step could be eliminated, saving another 30 days.

Allowing a trade remedy dispute to go directly to arbitration under a revised Chapter 20 would thus shave at least 60 days

off the process. Given the time sensitivity of these kinds of cases, where duties are being collected from the point of a preliminary determination of dumping or subsidizing, a saving of 60 days can be an important advantage.

## **Conclusions**

Chapter 20 adjudication offers a viable replacement for the Chapter 19 panel system in trade remedy disputes with the United States. If the US insists on removing Chapter 19, Canada could counter with its own proposals to revise Chapter 20 and make it an effective substitute for handling trade remedy (dumping and subsidy) disputes.

Changes the Chapter would maintain its overall structure but set out a more rapid mechanism and clarify the authority of panels to order compensation and where necessary the return of duties found to be improperly collected.

While not a perfect substitute for Chapter 19 panel reviews, there are untapped advantages in NAFTA Chapter 20 that should be factored into Canada's negotiating position.