HOUSE OF COMMONS
CANADA

DISPUTE SETTLEMENT IN THE NAFTA: FIXING AN AGREEMENT UNDER SIEGE

Report of the Standing Committee on Foreign Affairs and International Trade

Bernard Patry, M.P.
Chair

Subcommittee on International Trade, Trade Disputes and Investment

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Also available on the Parliamentary Internet Parlementaire: http://www.parl.gc.ca

Available from Communication Canada — Publishing, Ottawa, Canada K1A 0S9

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THE STANDING COMMITTEE ON FOREIGN AFFAIRS AND INTERNATIONAL TRADE

has the honour to present its

NINTH REPORT

In accordance with its mandate under Standing Order 108(1), your committee established a subcommittee and assigned it the responsibility of examining Canada-U.S. Trade Issues.

The subcommittee submitted its First Report to the Committee.

Your committee adopted the report, which reads as follows:

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DISPUTE SETTLEMENT IN THE NAFTA: FIXING AN AGREEMENT UNDER SIEGE

Canada is fast approaching a moment of truth in its economic relationship with the United States. The current phase of the two-decades-old softwood lumber dispute, known as Softwood IV, has exposed severe institutional flaws in the North American Free Trade Agreement's (NAFTA) Chapter 19 dispute settlement mechanism. It has also revealed the high level of American antipathy towards Chapter 19, which threatens the ability of the NAFTA to guarantee Canadian access to the U.S. market.

A properly functioning Chapter 19 is supposed to ensure that each country is applying properly its own trade remedy laws, respecting due legal process and complying with NAFTA panel decisions. Intractable trade disputes, such as the one over softwood lumber, put enormous pressure on dispute settlement mechanisms in trade agreements because the parties involved are sovereign countries. Under the NAFTA, if the U.S. chooses not to comply with a panel decision, then all that Canada can do is withdraw NAFTA benefits. Canada cannot force U.S. compliance.

The problems with Chapter 19 that the softwood lumber case has brought to the fore, and that form the basis of this report, are not unique to that dispute. Dr. Elliott Feldman (Baker & Hostetler LLP) told the Subcommittee that he has seen similar U.S. delaying and pressure tactics in other cases, such as a magnesium case he has been litigating since 1991. While the Subcommittee believes that the federal government should continue to prosecute the softwood lumber case through Chapter 19, we note that even a successful conclusion to this case does not negate the need to fix Chapter 19.

Given the political reality that the United States will not abandon its trade remedy laws in the foreseeable future, a Chapter 19 that works is absolutely crucial for the protection of Canadian businesses, prosperity and, ultimately, sovereignty. A binational dispute-settlement process on antidumping (AD) and countervailing duties (CVD) was the bare minimum Canada would accept in the negotiations for the original Canada-United States Free Trade Agreement (FTA); without this process — without Chapter 19 — Canada would not have signed the FTA. It is the dispute-settlement processes of the NAFTA, of which Chapter 19 is the most important, that are supposed to guarantee secure Canadian access to the U.S. market.

At the beginning of our hearings, International Trade Minister Jim Peterson told the Subcommittee that the federal government was aware of the problems being caused by Chapter 19:

> The Prime Minister has already stated that NAFTA's Chapter 19 is causing many problems. There is no end to the challenge proceedings brought against our producers. The Prime Minister would like to obtain some kind of certainty in this respect. We are going to try to settle these things, and your (sub)committee's suggestions would be appreciated.

Apart from the Minister, this Subcommittee has heard strong testimony from trade negotiators, other senior trade officials, business groups and trade lawyers regarding the problems with Chapter 19 and, importantly, how Canada can work to fix them. They told us that doing so will be difficult: any effort to make Chapter 19 work more effectively must take into account American resistance to change and Mexican opinions. Should the United States continue to violate the NAFTA, particularly in its refusal to return over $4 billion in softwood lumber duties if the Chapter 19 process eventually rules against the U.S., Canada will also have to consider retaliation, which risks negatively affecting Canadian groups.

This Subcommittee, however, is convinced that the perils of action are outweighed by those of inaction. We believe to avoid addressing the problems with Chapter 19 for the sake of avoiding a confrontation with the United States would be to invite continued U.S. harassment and a meaningful reduction in our sovereignty and economic prosperity.

Witnesses told the Subcommittee that, to date, the federal government has neglected to fully use the tools available to it in the NAFTA. Carl Grenier (Executive Vice-President, Free Trade Lumber Council) characterized the government's response to the "assault on Chapter 19" as "less than aggressive, frequently acquiescing." Rick Paskal (Chairman, Canadian Cattlemen for Fair Trade) remarked: "The problem with this country is that we don't want to act on the trade rules we have when we're in a position to act on them. We must take a more aggressive stance for our trade rights in this country."

The Subcommittee notes that Canada and the United States have designated two senior officials to explore ideas on how to resolve problems in Chapter 19. While such actions are to be commended, we believe that more must be done. Specifically, we believe that it is time for Canada to assert its rights under the NAFTA, an agreement signed in good faith by the governments of Canada, Mexico and the United States. We caution, however, against lashing out at the United States simply from a sense of being wronged. This is not about retribution, but about protecting the NAFTA and Canada's interests. As Simon V. Potter (Partner, McCarthy Tétrault LLP) put it, "Let's get tough, but we must get tough in a principled and chosen and surgical way."

In this report, we offer recommendations regarding both what needs to be fixed, and how the federal government should make its voice heard. Most importantly, the Subcommittee recommends:

Recommendation 1:

That the federal government move beyond informal consultations with the United States on NAFTA trade dispute settlement matters, and actively and formally engage the United States to the extent necessary, but particularly through the use of the NAFTA's Chapter 20 (see Recommendation 12), to ensure that the original intent of Chapter 19, and thus the NAFTA, is respected.

Despite the very serious problems with Chapter 19 that must be addressed quickly, we note that Canadians and Americans enjoy mostly harmonious economic relationships and that trade has been a source of mutual strength for both countries. As Mr. Potter, noted, the Canada-U.S. border:

> … is a mutual enterprise. We are each other's largest trading partner, and both countries benefit from that two-way flow, that two-way easy flow. A very high percentage of our trade flows across the border with nearly no impediment whatsoever, and we should be happy about that.

We therefore hope that this report will be taken as a constructive contribution to the strengthening of our bilateral relationship.

BACKGROUND

A. History

Canadian prosperity is tied largely to the United States: fully one-third of everything Canada produces is bought by Americans. Secure access to this market is thus a longstanding Canadian policy objective. It was this desire for guaranteed access to the U.S. market — specifically, the desire to avoid harassment under U.S. trade remedy law — that led to the negotiations toward the FTA in the 1980s.

Originally, as Prof. Donald McRae (Hyman Soloway Professor of Business and Trade Law, University of Ottawa) reminded the Subcommittee, Canada's objective in the free trade negotiations was a complete exemption from U.S. trade remedy law; talks, in fact, broke down over this point, and it was only high-level political involvement from Ottawa that saved the negotiations. In the end, Prof. McRae remarked, "One might argue it (Canada) got very little, and the very little was Chapter 19." According to Mr. Potter, "The Chapter 19 solution was a compromise to patch things together so that a free trade agreement could happen." As Mr. Paul Perkins (Vice-President, Policy & Planning, Weyerhaeuser Company) told the Subcommittee, "It is questionable whether Canada would have entered into the FTA without U.S. agreement to a binding binational dispute resolution process."

While Chapter 19, by any measure, fell significantly short of the original goal of a full exemption from U.S. trade remedy law, it nonetheless is, in the words of Dr. Feldman, "the heart of the negotiated free trade agreement, and its most creative novelty. … With the extension of Chapter 19 to Mexico, there is nothing like this feature in any relationship, treaty, agreement or arrangement the United States has with any other country."

B. What Is Chapter 19?

Chapter 19's innovative nature stems from the fact that, instead of applying international standards, it requires only that each country properly implement its existing trade remedy laws, while at the same time allowing binational panels staffed by trade law experts to judge whether this was being done.

Chapter 19 is designed to handle disputes over anti-dumping (AD)[1] and countervailing duty (CVD)[2] among the NAFTA partners in a timely manner. By volume, it is the most active dispute-settlement process in the NAFTA, accounting for over 80% of total NAFTA trade disputes,[3] including the ongoing softwood lumber dispute.

Before the FTA/NAFTA, Canadian companies had the option of appealing AD/CVD cases through the American legal system or using the General Agreement on Tariffs and Trade's (GATT) dispute settlement mechanism. Pursuing disputes through the American legal system was time-consuming and fraught with the perception that U.S. domestic courts and agencies were not treating Canadian businesses fairly. For its part, the GATT mechanism was much weaker than its successor in the World Trade Organization, and its decisions could be blocked.

Chapter 19 cases are heard by binational panels comprised of trade specialists from the two countries involved in the dispute. The panels are limited to

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1 Anti-dumping actions are taken against individual firms who are determined to be selling goods in foreign markets at prices below "normal value." In the United States, the Department of Commerce (DOC) is responsible for investigating potential cases of anti-dumping. The DOC determines dumping margins by comparing the price at which the subject goods are sold in the United States ("export price") with the "normal value" of the goods in Canada (the price at which comparable sales of the subject goods are made in the home market).

2 A countervailing duty (CVD) is imposed to protect an industry from injury caused by government-subsidized imports from other countries. The importing country must prove both that the imported goods have been subsidized and that such subsidized imports are causing material injury or are threatening to cause injury to the domestic industry. If these two conditions are met, a CVD equal to the amount of the subsidy is imposed upon the imports of the subsidized merchandise. In the United States, the DOC is responsible for conducting CVD investigations, while the U.S. International Trade Commission (ITC) is responsible for determining whether the U.S. industry producing the like goods has been materially injured, or threatened with material injury.

3 The other three dispute-settlement mechanisms are Chapter 11 (investment), Chapter 14 (financial services) and Chapter 20 (general interpretation of the agreement).

reviewing the application of domestic laws; they do not create or amend laws, and panel decisions cannot be used as precedents in subsequent Chapter 19 cases.

Under Chapter 19, a country can examine:

- the methodology behind the calculation of AD/CVD duties;
- findings of injury (or the threat of injury), which is necessary for AD/CVD to be imposed; and/or
- whether changes to a country's domestic AD/CVD laws are NAFTA-consistent.

Panels are empowered either to uphold the AD/CVD determinations or finding of injury or to remand the decision back to the government that made the determination; in doing so, they may describe where and how the country erred in making its final determination and provide instructions on how to correct the error.

A Chapter 19 panel must be requested within 30 days of a final (not preliminary) determination of AD/CVD, even though the United States imposes interim duties based on its preliminary rulings; effectively, affected companies must pay duties for almost a year before the panel process can even begin.

Panels are composed of five people, selected from a roster of at least 25 candidates from each country, a majority of whom must be practicing or retired lawyers or judges. Each country selects two panellists; these four then select the fifth. Countries have 30 days to select their four panel members; the panellists have a further 25 days to select the fifth. Each country may also block the appointment of up to four of the other's selected panellists.

In theory, Chapter 19 panels are supposed to render a final decision within 315 days of the request for the panel. In practice, if the panel remands a final determination, the process can take much longer. A country must be given time to comply with the remand, which the panel then reviews to ensure that its instructions were followed. This process can be repeated if the panel is not satisfied.

Beyond this timeline, a panel decision can be appealed to an extraordinary challenge committee (ECC). This can only happen in cases where it is alleged that:

- the panel seriously departed from a fundamental rule of procedure;
- panel members were guilty of conflict of interest or other misconduct; and/or

- the panel clearly exceeded its powers, to the point that the integrity of the entire binational panel review process was threatened.

The United States has been the only party to invoke an ECC; it has done so seven times, four involving Canada. No extraordinary challenge of a NAFTA panel has ever succeeded.

C. The Usefulness of Chapter 19

Early on, Chapter 19 was a clear improvement on the existing system: cases were settled more quickly and Canadians fared better than they had under the American legal system. According to Mr. Potter, "It used to be that only 20% or so of cases against Canada would result in judicial review, and once Chapter 19 came in, that figure went up to 50%. Not only that, only one-third of the 20% succeeded in Canada's favour, but about two-thirds of the 50% succeeded in Canada's favour one way or the other, either reducing the duty or erasing it." From 1989 to 1994, Mr. Grenier noted, "Binational panel reviews were faster, cheaper, and fairer than appeals to the U.S. Court of International Trade."

Witnesses from the softwood lumber industry, which has probably had more experience with Canada-U.S. trade disputes than any other, called Chapter 19, in the words of Mr. Perkins, "invaluable to the Canadian lumber industry in defending against American trade attacks on our industry." Keith Mitchell (Legal Counsel, B.C. Lumber Trade Council) remarked that "Many Canadian litigants will tell you their experiences in the U.S. court systems have not been friendly to foreign exporters so we are supportive of Chapter 19 and supportive of the Free Trade Agreement and its successors. We believe it lays the groundwork for continental market development, which both countries thought was the positive outcome of NAFTA, and which we support."

Prof. McRae, who has served on Chapter 19 panels, told the Subcommittee that the process continues to be characterized by "collegial decision making" and has had a positive, "perceptible impact on the process of applying anti-dumping and countervailing duty law in all of the three countries."

D. American Reaction to Canadian Successes Under Chapter 19

Canada's earlier Chapter 19 success did not go unnoticed in the U.S., where, said Dr. Feldman, "U.S. private interests believe they would have fared better in U.S. courts." As a result, he added, "the United States has refused to negotiate anything like it with anyone else and regrets having negotiated it with Canada and having extended it to Mexico." Instead, "(t)he United States, therefore, wants to destroy Chapter 19 and has been trying to do so for the last ten years."

Furthermore, according to Mr. Perkins, "The centrality of Chapter 19 to NAFTA means that an attack on Chapter 19 is, in turn, a collateral attack on NAFTA itself."

According to witnesses, the United States has spent much of the past decade trying to undermine Chapter 19 in what Mr. Grenier called a "scorched earth" policy. Dr. Feldman remarked that Chapter 19 allows Canada to deal with the United States as a sovereign equal, though "(t)he United States, for its part, continues to seize every opportunity to diminish Canada's economic and political independence, and it understands the obstacle Chapter 19 represents" to this end.

Protectionist pressures in the United States also play a role. In the case of the Canadian Wheat Board, Victor Jarjour (Vice-President, Strategic Planning and Corporate Policy, Canadian Wheat Board) told the Subcommittee that Canada-U.S. trade disputes "are rooted in protectionist sentiment and motivated by political agendas. They reflect the lack of spirit of free trade, and in particular, a certain American constituency, which seems to be based primarily in North Dakota, has ensured that its politicians make careers on protectionist sentiment."

Witnesses told the Subcommittee that the United States is using several tactics that have undermined and delayed panel work and decisions, increasing the amount of time the government and Canadian businesses spend in litigation and reducing the benefit of legal victories. The result has been increasing pressure on Canada to give in to U.S. demands. According to Mr. Grenier, the United States has been "pursuing a coherent and long-term strategy to limit the impact of (Canadian) victories and to prevent their repetition and continuation." He noted that under the FTA, the United States attacked the substance of Chapter 19, including arguing

> … for increased deference to agencies; easier legal tests to find and countervail subsidies; and limited binational panel scope, particularly by restricting decisions to specific panel adjudication, reaching not even an administrative review from an investigation or a subsequent administrative review from an earlier one. Such restrictions were designed to force Canada to litigate the same programs, even dealing with the same merchandise repeatedly, notwithstanding final panel decisions and final determination on remand.

According to Mr. Grenier, "Since the extension of Chapter 19 in NAFTA from 1995 to the present date, the United States has redoubled and varied its efforts to take back what it regrets having given, even in compromise." These actions include:

- trying "to destroy Chapter 19 institutionally by financially starving the secretariat;
- underpaying panellists and delaying those payments;

- moving away from the appointment of international trade experts to these panels;

- politicizing panels by making rosters dependent upon congressional approval;

- changing the rules for extraordinary challenges;

- attacking directly the standard of review;

- impugning the integrity of Canadian and American panellists;

- ignoring rules and deadlines for the formation of panels and the filling of panel vacancies;

- abusing pre-emptory challenges; (and)

- rewriting trade laws."

As a result, said Mr. Potter, while Chapter 19 is still having some positive effects, "including the fact our administrative agencies on both sides of the border do a better job explaining what it is they're doing and being transparent," the benefits of Chapter 19 to Canada are being steadily eroded and "the perception of bias … and the perception of slowness" have returned.

ADDRESSING THE FLAWS IN CHAPTER 19

Witnesses were remarkably consistent in their criticisms, both of Chapter 19 and of what they saw as American exploitation of the letter of the NAFTA to violate the treaty's spirit. We now turn to their specific concerns.

A. Chapter 19 as a Tool for Protectionism and Harassment

One of the main flaws in Chapter 19 is that cases can be triggered automatically by complaints from private-sector actors, at relatively little cost to themselves. As Bob Friesen (President, Canadian Federation of Agriculture) noted, in the U.S. "when an organization decides to initiate trade action, they simply bring it in front of their Department of Commerce and the International Trade Commission. After the specific departments have decided that in fact they are going to go ahead with trade action, no further costs are incurred by the original organization. From then on, the costs are covered by the state." To illustrate the problem, Mr. Friesen told the Subcommittee:

> A few years ago I was at a NAFTA farm leaders' meeting and I talked to a gentleman from NPPC (National Pork Producers Council). He informed me that they were planning to do some sort of action against Canadian hogs.

> They hadn't quite figured out yet what their justification would be. I asked him why he would even want to initiate trade action, and he said for no other reason than that the Canadian industry had expanded and theirs had remained static.

Furthermore, the benefits to even a temporary AD/CVD finding can be substantial for complainants, who stand to benefit from reduced competition if AD/CVD penalties are imposed on their Canadian competitors, to say nothing of the duties they stand to collect under the illegal Byrd Amendment, which we discuss below.

There are also no penalties or incentives against the filing of frivolous lawsuits (beyond the direct cost of doing so), such as having to pay a deposit or costs should the complaining party lose. While requiring parties to pay costs should they lose a case or bring a frivolous case before the NAFTA would be an appropriate way to discourage frivolous complaints, Mr. Potter suggested that current procedures in Canadian and American law already require a justification for moving a case forward, and filing a complaint is already costly. He was also pessimistic about the political reality of fining initiators of frivolous complaints: "I don't hold out much hope of having countries agree to punish people whose complaints are found to be frivolous even if those complaints make it through, for example, the CBSA (Canada Border Services Agency)."

Neither did Sandra Marsden (Member, Board of Directors, Canadian Agri-Food Trade Alliance), who commented, "Concerning the legal costs going to the winning party, if we were the winning party, that would be great. I'm not sure whether that could be negotiated with the Americans." Instead she and Mr. Jarjour recommended that the federal government focus on, in Mr. Jarjour's words, "raising the bar concerning how these trade remedy mechanisms can be triggered … ."

The Subcommittee therefore recommends:

Recommendation 2:

That the Government of Canada work with its NAFTA counterparts to develop criteria to restrict the introduction of trade remedy challenges under Chapter 19 that are frivolous and/or without merit.

B. Panels' Inability to Set Precedents

Chapter 19 cases do not create precedents, meaning every case is tried in isolation. The American refusal to carry over a principle of collateral estoppel — meaning that once a court decides an issue of fact or law necessary to

its judgment, that decision may preclude relitigation of the issue — means that the same case can be tried over and over again.

For example, Mr. Potter described a Canada-U.S. dispute involving pork from the early 1990s, in which "every time a binational panel said that such-and-such a methodology was not on, America just waited until the next administrative review and did it again, so it had to be challenged all over again." Mrs. Elaine Feldman (Associate Assistant Deputy Minister, Trade Policy and Negotiations, Department of International Trade), referring to the dispute over softwood lumber, remarked that "nothing would prevent the United States from launching future cases after existing cases have concluded."

The Subcommittee agrees with witnesses that the lack of Chapter 19 panels' ability to set precedents is a key weakness in the dispute-settlement process, while noting that there is likely a limit to how far the United States will go to address this issue. One possible solution was suggested by Mr. Potter, who recommended that instead of pushing for NAFTA panels to create precedents that would affect all cases, Canada could argue for having "some precedent in at least one case. If we're talking about pork or swine or lumber, within pork or swine or lumber one binational panel's ruling should have some precedent value over another binational panel's ruling for that product in that case, and at least get that. I would say to aim low."

We recommend:

Recommendation 3:

That the federal government collaborate with the United States and Mexico to give Chapter 19 panel rulings precedent value over subsequent panel rulings covering the same products.

C. Lack of Respect for Timelines

One of the main advantages of Chapter 19 over the use of the U.S. legal system was thought to be the relatively shorter timeframe of 315 days in which to settle cases. According to Paul Robertson (Director, Trade Remedies Division, International Trade Canada), "Those timeframes have been stretching out." While Mr. Robertson claimed that Chapter 19 cases still were shorter than those using the U.S. legal system, Mr. Grenier informed the Subcommittee that, "At 696 days on average, Chapter 19 proceedings involving Canadian imports are now longer than cases settled before the Court of International Trade, which average 641 days." In the case of softwood lumber, he said: "Instead of the 315 days from start to finish provided for in the Chapter 19 rules, we are now well into our 33rd month of litigation. … Had the original NAFTA appeals proceeded on schedule, even on a delayed schedule similar to the appeals in Lumber III, all judicial appeals and

procedures would now be reaching conclusions. The Canadian industry and provincial governments would not be answering new rounds of questionnaires."

Martin Rice (Executive Director, Canadian Pork Council) told the Subcommittee: "We are aware that for lumber and magnesium, and perhaps in other cases, those processes are not operating in as timely a basis as what was intended. (Early on, they) more or less did meet the 10-month objective, which was established in the original trade agreement for our cases, but I know lumber is dragging well beyond perhaps even two years."

These delays impose real costs on Canadian producers and workers. Speaking about Chapter 11 dispute settlement, but making a point that is applicable to the drawn-out Chapter 19 process, Mr. Paskal remarked, "these challenges require a team of high-priced lawyers who in many cases — and not our case — have no regard for time, because the dispute settling mechanism has no regard for time. Meanwhile, Rome burns. These challenges must take no longer than six months, or industries and governments will continue to hide behind what is fast becoming an artificial trade barrier."

On a related point, witnesses raised the possibility of making panel decisions binding, effectively removing the many delays associated with remanding, though others also raised the difficulty of getting the United States to agree to this action. The Subcommittee agrees that these problems are serious and therefore recommends:

Recommendation 4:

That the Government of Canada enter into discussions with its NAFTA partners to reduce the frequency of multiple remands on the same case.

As well, we agree with Mr. Herman's recommendation that "when a U.S. trade agency such as the International Trade Commission reports back on remand and questions the legitimacy of a panel decision, the Canadian government should take that up with the U.S. government at the political level." The Subcommittee agrees and recommends:

Recommendation 5:

That the federal government officially protest to the U.S. government and vigorously defend the legitimacy of Chapter 19 and the NAFTA when the United States undertakes actions that disrespect the legitimacy of panel decisions.

D. Use of the Extraordinary Challenge Committee

The change in the Extraordinary Challenge Committee from a panel designed only to deal with serious procedural issues, misconduct or gross misuse of power by panels to a de facto appellate court has both broadened its purpose and contributed to the lengthening of the process. According to Marc Boutin (Member, Canadian Lumber Trade Alliance), "it has practically become a second form of recourse for the Americans. So the very aim of the extraordinary challenge is being somewhat distorted."

Prof. McRae voiced a somewhat different concern regarding the ECC, telling the Subcommittee that its narrow focus and its unbroken record of ruling against complainants "does little to contribute to confidence in the Chapter 19 system or to the legitimacy." He pointed out that two ECC panels found problems with Chapter 20 cases, but could not throw out the initial rulings because the problems did not fall within the ECC's strict mandate, "and I don't think this does anything to encourage respect by the agencies for the process or to encourage public confidence in it."

As well, in contrast to the many witnesses who commented that the United States was using the ECC as a de facto appeals mechanism, Prof. McRae suggested that the ECC be expanded to become a de jure appeals mechanism that could also deal with cases in which panels incorrectly interpret domestic law that don't threaten the integrity of the panel process. Such a change, he argued, would increase the legitimacy of the entire Chapter 19 process, "and that could help eliminate some of this to-ing and fro-ing that goes on between panels and domestic agencies."

Dr. Feldman argued, however, that turning the ECC into a formal appeals process would introduce a "broad institutional change" and "could only be done at the deliberate sacrifice of one of the underlying principles of Chapter 19, which was expeditious review. The process now is taking longer than a case in the U.S. Court of International Trade but still has the redeeming feature that you're then, in theory, finished. … It would then mean that when you're before a binational panel, you would be building an appellate record for the purposes of appeal. It changes the entire character of the process, so it's something that has to be done, were it to be done, with a great deal of consideration, and with the rethinking of the original purpose for expeditious, inexpensive review."

The Subcommittee believes that the federal government should be aiming to return Chapter 19 to its intended purpose of providing a fair and timely alternative to the U.S. judicial system. We are therefore reluctant to recommend another level of complication to an already controversial and time-consuming process. We therefore recommend:

Recommendation 6:

That the federal government engage with its NAFTA partners to ensure that extraordinary challenge committees are used only in extraordinary circumstances and not as a general appellate court.

E. Lack of Institutional Infrastructure and Underfunding

The NAFTA was purposefully created with only minimal institutional infrastructure, as the NAFTA partners were not interested in European Union-style integration. The NAFTA Secretariat has only minimal staff and is split into three national sections. This lack of an institutional core has impeded the development of an effective oversight mechanism and has reduced the NAFTA panels' ability to address cases expeditiously. As a result, noted Mr. Herman, the Free Trade Commission, which is supposed to implement the NAFTA, "has certain treaty functions that it does not administer or discharge in a practical way, and I think this (Sub)committee should address them." Neither are the NAFTA secretariats "effectively functioning as secretariats: they are really post offices who supervise national panel systems and nothing more." Witnesses also criticized the United States for underfunding and understaffing its secretariat, slowing the work of the NAFTA.

The Subcommittee was told that the federal government is already aware of this problem. According to Mr. Robertson, "there are issues being raised on how to increase the efficiency, reduce the timeframes, and bring the Americans to better staff and administer their side of the secretariat. These questions are being looked at. There is a working group on the Chapter 19 institutional process and things of that nature."

Dr. Feldman offered several recommendations in this area, "beginning with expansion of the national secretariats; upgrading them professionally; removing them from the physical, geographic, and fiscal control of agencies that appear before them; and extending to them at least the authority of respected clerks of the court. Incredibly, the secretariats of NAFTA have absolutely no powers, including powers to resist the illegal and improper instructions they are sometimes given by the national governments who presume to control them."

The Subcommittee believes that the functioning of the NAFTA institutions can and should be improved. We therefore recommend:

Recommendation 7:

That the federal government collaborate with Mexico and the United States on consolidating, adequately funding and

improving the competence of the NAFTA Secretariats, in order to provide the Free Trade Commission with the support that it requires to adequately administer its treaty functions.

F. Panel Bias and Selection

The Subcommittee heard conflicting reports on whether Chapter 19 panel bias is a problem. Prof. McRae told us that panels are mostly collegial, produce mostly unanimous decisions or decisions without dissent, and "frequently remand either in whole or in part," all of which suggests little or no bias: "But even if you did conclude that the United States did have a strategy of undermining impartial decision-making by panels, I think you'd have to say it's clearly not working."

On the other hand, Mr. Grenier asserted that "Canadians can no longer expect binational panel reviews to be fairer than (U.S. Court of International Trade) reviews, with U.S. panellists who are no longer experts in trade law, who are protected from appeal, and who are carefully selected to defend U.S. government agency prerogatives." This position was supported by Mr. Potter: "We have consistent attempts by the United States to make panels so deferential toward the (American) agencies that they won't overturn" the agencies' rulings.

According to Mr. Herman, Chapter 19 panels were supposed to be "expert bodies that had expertise in the trade law area and could address trade law issues on judicial review." The Subcommittee heard that the staffing of panels has become problematic due to relatively low pay, the lack of a permanent list of potential panellists and a small pool of potential panellists from which to draw, many of whom face potential conflicts of interest.

The difficulty in assembling panels, combined with the possibility of using this as an excuse to draw out the Chapter 19 process, contributes to the dysfunction of Chapter 19. An obvious solution would be to create a permanent panel system, which Mr. Herman told the Subcommittee "would help to create the core that is lacking in the NAFTA system."

Another intermediate solution would be to ensure that each country always has a full roster of panellists from which to draw. Canada, as Mr. Grenier suggests, "should commit to maintaining full rosters of panellists and extraordinary challenge committee members, and to selecting panellists and filling panel vacancies within the established deadlines."

According to Mr. Herman:

> The governments have to find persons who are prepared to serve and who are not conflicted out. And if they're not conflicted out, are they prepared to

> serve? That to some extent goes directly to the question of remuneration and backstopping services panellists can get. This can be addressed within the provisions of Chapter 19 as it exists now. It just takes some political will to address those issues.

As a final point, though the federal government has the ultimate responsibility to appoint panellists in Chapter 19, we note that industry has a strong interest in the formation of panels in trade-remedy cases. As Mr. Grenier remarked, Canada already consults industry on the selection of WTO panellists, while "the United States government has always consulted with its industry."

In light of this testimony, the Subcommittee recommends that:

Recommendation 8:

The Government of Canada work with its NAFTA partners to create a permanent roster of panellists, clarify the rules on who is allowed to serve on a panel, increase the remuneration of experts serving on Chapter 19 panels and ensure that each country has a full roster of panellists. The federal government should consult with industry when creating this permanent list.

G. American Trade Remedy Law

1. Section 129 of the U.S. *Uruguay Round Agreements Act*

The Subcommittee also notes the disturbing ability of the United States to use domestic law to negate NAFTA panel rulings. Specifically, according to Jon R. Johnson (Goodmans LLP), section 129 of its *Uruguay Round Agreements Act* created a panel to deal with WTO rulings that conclude that the American AD/CVD findings are inconsistent with WTO rules. In the softwood-lumber dispute, Canada essentially won its case at the WTO, though following this victory "(t)he matter went to a section 129 panel and the section 129 panel came out with an affirmative determination (i.e., it found that the United States was right to implement AD/CVD). In other words, they found threat of injury. The position that's been taken by the U.S. government is that an affirmative finding supercedes the negative NAFTA binational panel finding." In essence, the United States used a defeat at the World Trade Organization to negate the NAFTA panel's finding of no injury.

We believe that a loss in one tribunal (in this case, the WTO) should not be used by the losing party to defeat a similar loss in another tribunal (in this case, Chapter 19 of the NAFTA). The Subcommittee believes that acting in this way is a violation of the spirit of the NAFTA and recommends:

Recommendation 9:

That the Government of Canada pressure the U.S. to ensure that Section 129 of the Americans' *Uruguay Round Agreements Act* not be used to avoid the implementation of NAFTA panel determinations.

2. American Antidumping Rules and Investigations

Several agricultural producers also raised concerns about specific American trade remedy rules. According to Mr. Rice, American antidumping rules "have evolved to become very highly skewed to the domestic industry." Specifically, he and Mr. Jarjour criticized American use of production costs in calculating dumping where there is an integrated market. As Mr. Jarjour told the Subcommittee:

> Cost of production simply does not make sense in the agriculture sector, particularly in grain production. Costs are often known well before prices are determined. Grades are dependent on weather. Grades determine the value of a crop. Ultimately, input costs do not vary by grade. Global grain prices — grain prices are determined by markets — may mean that sales are unavoidably made at below cost because the farmer is compelled to sell in order to make a living. This should not translate into dumping.

As well, Mr. Rice remarked that, currently, American antidumping investigations examine only one year, while a production or business cycle can stretch over several years. He noted that "it happens to be that one in every three years is bad in our industry in terms of prices relative to costs, so we would urge that at least something that's more closely related to the production cycle of that industry be used to calculate the cost of production."

The Subcommittee agrees with these complaints and recommends:

Recommendation 10:

That the federal government explore all avenues to achieve a common definition of dumping in the agricultural sector that excludes production costs in integrated markets, as well as a common timeframe for the investigation of dumping charges that reflects the production or business cycle.

MAKING THE NAFTA WORK FOR CANADA

As the number of recommendations this Subcommittee has already made demonstrates, there is a great deal of work to be done if Canada is not to lose the benefits of Chapter 19 and the NAFTA. While we are under no illusion that fixing Chapter 19 will be anything but complex and difficult, we note that the NAFTA itself

includes several tools for addressing these issues that the federal government has underused in the past.

In considering how to fix Chapter 19, Canada faces several options, ranging from consultations to abrogation of the agreement. No witnesses recommended abandoning the NAFTA. At the same time, witnesses recommended against reopening the NAFTA, which would put the rest of the agreement at risk. Instead, they recommended working within the NAFTA framework to address Canadian concerns.

A. Making Use Of Article 1903

Article 1903 of the NAFTA allows a NAFTA country to challenge changes in another country's AD/CVD laws in front of a binational panel if it believes that the change is inconsistent with the NAFTA. If the panel recommends modifications to the amending statute, the two countries "shall immediately begin consultations and shall seek to achieve a mutually satisfactory solution to the matter within 90 days of the issuance of the panel's final declaratory opinion. Such solution may include seeking corrective legislation … ." If corrective legislation or other mutually satisfactory solution is not enacted within nine months of the end of the consultation period, the country that requested the panel has the option of taking "comparable legislative or equivalent executive action" or, more severely, terminating the NAFTA with respect to the offending country following 60 days' written notice.

As Mr. Grenier remarked, "Most notably, perhaps, Canada has never invoked NAFTA's article 1903 protections against changes in U.S. trade law, even as the United States changed its laws several times with the explicit objective of overturning NAFTA panel decisions. … (n)or has Canada invoked article 1903 against U.S. trade laws that impact Canada and, moreover, violate international obligations, such as the Byrd amendment of 2000."

In keeping with our call for the federal government to more actively defend Canada's NAFTA interests, we recommend:

Recommendation 11:

That the federal government actively consider using Article 1903 in instances where its NAFTA partners change their laws with the goal of negating their NAFTA obligations.

B. Challenges Under the NAFTA: Article 1905

Under the NAFTA, Canada can challenge U.S. treatment of Chapter 19 in two ways. Article 1905 effectively suspends binational panel review of AD/CVD

rulings (i.e., it suspends Chapter 19) if a panel finds that the offending party has used its domestic law to impede the functioning of a Chapter 19 panel. A positive finding would thus effectively wreck much of the NAFTA; none of the trade experts heard by the Subcommittee recommended what Mr. Potter called "the 'atomic bomb' scenario," and neither does this Subcommittee.

C. Chapter 20 Consultations: "Visible and Persuasive"

The second way to challenge the U.S. is through the use of Chapter 20, that chapter of the NAFTA that covers disputes over the agreement's interpretation and application. With the exception of Mrs. Feldman, who noted that Canada does not "need a Chapter 20 formal consultation to raise with the United States issues related to their payment of the NAFTA Secretariat or issues related to what they're doing with respect to Chapter 19," the Subcommittee heard from witnesses that the federal government should avail itself of Chapter 20 consultations. As law firm Baker & Hostetler remarked in their submission, "Canada's goal through Chapter 20 dispute settlement would be to compel the United States to eliminate the administrative impediments to expeditious Chapter 19 panel review, and to cease its dilatory tactics."

Specifically, Canada could initially seek consultations under Article 2006. Should these fail, Canada would have recourse to mediation under Article 2007, followed by arbitration under Article 2008.

Chapter 20 has two main benefits. First, it is a more direct forum in which to deal with the United States than informal consultations; as Dr. Feldman remarked, its hearings are, "visible and persuasive." Second, it provides Canada with the ability, should the Chapter 20 case make it to arbitration and should the United States not implement the arbiters' ruling, to suspend trade concessions provided to the United States under the NAFTA.

1. Making the Problem Visible

As Dr. Feldman told the Subcommittee:

> Chapter 20 is an invitation, but a very public one, to address the issues that arise from the difficulties with Chapter 19. Until now, the view of the Government of Canada has been that there is a continuing dialogue with the United States; people talk about these things all the time, and they're trying to work them out.
>
> In our view, this kind of informality is working against Canada's national interest, on these matters at least. Canada needs to be more public and outspoken, and that's the issue of embarrassment to which I referred earlier. Through that public process of requiring consultations, which the United States would then be obliged to accept and participate in, there

> would be the opportunity to address all the kinds of issues that everyone at this panel has discussed--institutionalization of panel procedures, changing the appellate structure. All those kinds of solutions would be on the table in a Chapter 20 proceeding.

Furthermore, Dr. Feldman argued that Canada's harmonious relationship with the United States is an asset, not only to Canada, but to the U.S., which depends on it to build goodwill with other countries. In the economic sphere, according to Mr. Potter, "the free trade agreement, the NAFTA, is an example used by the United States in order to negotiate not only the Free Trade (Area) of the Americas, but other bilateral treaties. If we start asking what the point of entering into a treaty like that is if it's not going to be followed and obeyed not only in its letter but in its spirit, I think that's something the United States would rather not have noised about."

The Subcommittee recommends:

Recommendation 12:

That the federal government immediately trigger Chapter 20 consultations with the United States regarding the Chapter 19 concerns raised by witnesses in this report.

2. Retaliation

Should the United States fail to comply with an arbiter's decision under Chapter 20, Canada could withdraw NAFTA benefits. As economists note, the downside to retaliation is that you end up inflicting some damage on your own consumers and economy. As well, there is often the fear of tit-for-tat reciprocal American retaliation. As Mr. Johnson remarked, "you always have domestic issues with (retaliation), because somebody is going to get hurt by it."

Sometimes, however, one is left with no choice but to retaliate: not to retaliate sends an even more damaging message. As Mr. Potter told the Subcommittee: "The minute Canada decides it is too frightened to retaliate because they're frightened for the relationship, that is the minute the United States will know they can do anything at all." As well, "We have to make an issue when we win a case. If we win a case and do nothing, what's the purpose of winning it?"

Mr. Johnson suggested that "The U.S. really should have a choice. They can either negotiate with Canada and comply with respect to Chapter 19, so that Canada gets what it originally bargained for, and if they don't do that, then Canada would have the right to retaliate by withdrawing other NAFTA provisions, at least the benefit of other NAFTA provisions, vis-à-vis the U.S. The U.S. should either give Canada what Canada originally bargained for, which was very important to

Canada — namely, a viable Chapter 19 — or the U.S. should lose the benefit of aspects of NAFTA that they particularly value."

Unlike the World Trade Organization, under Chapter 20 of the NAFTA Canada can automatically choose which benefits to withdraw without seeking permission. According to Mr. Johnson, "Under NAFTA there's various other things you can go after that the Americans are particularly concerned about, for example, energy security, investment protection, that kind of thing."

The Subcommittee recognizes that retaliation under the NAFTA is a serious undertaking not to be considered lightly. Nonetheless, should the United States refuse to respect the spirit of the NAFTA, we echo our witnesses in our belief that Canada must retaliate in order to preserve the benefits we negotiated under the NAFTA.

Recommendation 13:

That, should the United States lose a Chapter 20 case and fail to implement its NAFTA obligations, the federal government give serious consideration to withdrawing NAFTA benefits in conformity with NAFTA Article 2019 from the U.S. until such time as it complies with its NAFTA obligations.

D. Support for Canadian Businesses

In the struggle to get Chapter 19 to live up to its promise, Canadian businesses and workers are caught in the middle. While they would benefit as much as anyone from successful resolution of the problems of Chapter 19, expensive litigation and the interim elimination of their U.S. markets could make any Canadian victory a pyrrhic one. As Mr. Potter remarks, "You cannot ask industry to shoulder the burden of that kind of litigation — which is, after all, for the benefit of all Canadian exporters — and say to them that the government will not help."

The federal government has provided some assistance to Canadian industry. In 2003, the federal government delivered $14.9 million to softwood lumber industry associations for part of their legal costs. More recently, on April 15, 2005, the government announced a further $20 million toward these associations' legal costs. Prior to this announcement, Mr. Boutin called on further relief for the softwood lumber industry, since "we are now entering into the final phase in the legal proceedings, which will be the most intense phase in the softwood lumber dispute." While the Subcommittee supports the $20 million announcement, we note that it falls short of the industry's need for predictable, ongoing funding for the duration of the trade dispute.

In other industries, Mr. Rice told the Subcommittee, "we do want to put on the record our compliments to the governments of Canada and the provinces for recognizing and adapting our safety net programs to satisfy the criteria not only of U.S. trade law, but also, in many cases, world trade rules … ."

The argument for aiding Canadian industry (and not just the softwood lumber industry) caught up in the battle over Chapter 19 is compelling: it would not be in Canada's interest to lose those industries that have attracted American attention precisely because they are successful. As well, all Canadians benefit from efforts to reform Chapter 19 and strengthen our rights under the NAFTA; in the case of the softwood lumber industry, Mr. Perkins remarked that it "cannot be left carrying the burden on a legal battle that is essentially about the interests of all Canadian exports." Neither, we remark, should the industry depend solely on one-off legal aid from the federal government. The Subcommittee therefore recommends:

Recommendation 14:

That the Government of Canada develop a long-term, consistent policy of legal-aid support for Canadian softwood lumber associations until such time as the dispute is ended, in recognition of their high legal costs. Furthermore, we recommend that the government devote more of its own resources to the prosecution of the softwood lumber dispute. As a general rule, the federal government should provide financial support (e.g., assistance for the payment of legal fees and provision of loan guarantees) to those industries adversely affected by NAFTA trade remedy cases.

E. Mobilize Public Support

A successful defence of Chapter 19 and the concept of free trade in general must recognize the reality that the U.S. political system is much more diffuse than Canada's. The U.S. President is an important player in trade policy, but Congress, agencies and state governments are just as important, sometimes more so. As Prof. McRae remarked, "the problem is hydra-headed. Part of (the problem) is the question of lobbying. Part of it is the question of the way the domestic agencies function. They will not listen to binational panels. Part of it is the fact the United States is simply domestically unable to control Congress. The United States Executive can't control what Congress is going to do.

"So any kind of strategy has to look at the fact that you have to deal with the different aspects of the United States differently." Furthermore, as Mr. Herman pointed out, there is a high level of bipartisan support for current trade remedy laws, which limits what is currently possible to achieve in terms of true free trade.

While the complex U.S. political system makes it difficult to address Canadian trade concerns, it also provides several openings, notably in working with domestic U.S. interests. Mr. Grenier told the Subcommittee: "There are powerful U.S. groups who, when properly alerted and mobilized, can become very effective allies, with the freedom to use the full range of political action within the U.S. to oppose border restrictions detrimental to their own interests. Working with these groups takes time and effort, but in the long run we believe that such an approach is the best insurance policy against U.S. unilateral disregard of international trade rules."

We note with approval that the federal government has begun to recognize the importance of building and working with coalitions of like-minded Americans who can help influence Congress. Minister Peterson told the Subcommittee that he viewed advocacy — parliamentarians lobbying members of Congress by reminding them of the importance of Canada to their constituents — as "absolutely critical. … This is why we've advocated that the prime minister establish the Advocacy Secretariat in Washington, which opened up in September [2004]." Already, the federal government has sponsored an "advocacy day" in which parliamentarians went to Washington, D.C., to lobby Congress.

Parliamentarians, as the representatives of Canadians, can play a useful role in building coalitions in the U.S. Congress and throughout the United States. Currently, parliamentarians are provided with a number of travel points they can use to travel to Washington, D.C., to lobby on behalf of Canadians on issues such as trade disputes. As we were reminded throughout these hearings, however, it is sometimes easier and more productive to build coalitions and make contacts with politicians and interest groups outside of Washington. We therefore recommend:

Recommendation 15:

That the federal government increase its use of parliamentarians as advocates in trade disputes, and that Parliament broaden the use of members' travel points beyond Washington, D.C., to travel throughout the United States on official parliamentary business.

While Congress might be more protectionist than not, Mr. Grenier told the Subcommittee that his group has managed, with the help of domestic American interests "to get 150 Congress members in the United States to object to these restrictions [on softwood lumber] in writing. It's important, and it's the first step. We must carry on, and do more."

Part of the solution, as this Subcommittee was reminded, involves not waiting until a trade dispute flares up; there is a great deal of wisdom in educating Americans about the benefits arising from free trade with Canada and giving them a

better understanding of the Canadian system so that, as Mr. Rice remarked, “where Americans feel their interests are damaged, they’re much more likely to look kindly at the idea of trying to limit these trade cases happening in the first place.”

Trade is a two-way street. As Mr. Mitchell told the Subcommittee, “For every successful Canadian business person who's involved in a transaction with the Americans there is an American who's the person who you would assume is as equally happy with that transaction. We have to motivate and bring together those people, both in their districts, across the United States and in Canada.” The Subcommittee agrees wholeheartedly and recommends:

Recommendation 16:

That the federal government increase support to programs that build coalitions with interested American groups and sensitize Americans, especially American state and national politicians, to the benefits of trading with Canada.

F. Remembering Mexico

Canadians have a tendency to treat the North American relationship as a bilateral relationship between Canada and the United States, with Mexico often treated as an afterthought. This is a mistake, not only because the NAFTA is a trilateral agreement, but because Canada and Mexico often have mutual interests. Mexico has already signalled its interest in Chapter 19 reform. According to Dr. Feldman, in the current softwood lumber case “the Government of Mexico filed a brief in the extraordinary challenge proceeding involving Canada and the United States. No one knew it was coming. It’s a brief that is entirely supportive of the Canadian position. I’ve subsequently been in touch with senior officials in the Mexican government. They are very concerned about Chapter 19. So I think if there was a question raised with President Fox, he would be sympathetic.”

Mr. Potter confirmed this sentiment: “There are several Mexican complaints about the operation of NAFTA. Not all of their complaints are the same as Canada’s, but there will be a great sympathy in Mexico for dealing with the United States on a two-on-one basis. Whether it’s lumber or generally, Canada should be doing much more to be approaching NAFTA together with Mexico.”

The Subcommittee agrees with Mr. Potter’s opinion, and therefore recommends:

Recommendation 17:

That the Government of Canada, with the active participation of parliamentarians, engage formally with Mexico to address joint concerns about the American treatment of NAFTA Chapter 19.

G. Greater Cooperation to Avoid Disputes

Representatives from the Canadian Lumber Trade Alliance recommended the creation of a "NAFTA dispute prevention committee of stakeholders to detect potential disputes between the parties and fractures in the agreement, then engage in government facilitation of the stakeholder committee to dissipate disputes and focus on the overarching objective of NAFTA, that is, to secure continental free trade." They further recommended "that when large trade disputes arise, monitors representing each of the national governments should immediately be appointed on an ongoing basis. The appointment of monitors will help to ensure that the mechanical aspects of litigation do not eliminate the possibility of settlement and that domestic politics do not stop progress."

While the Subcommittee fully agrees with the necessity to work to end trade disputes before they begin, we note that a dispute prevention committee would be tantamount to adding another level onto an agreement that is already lacking in resources and shackled by lengthy delays. However, the Subcommittee agrees with the general thrust of the Alliance's recommendation and supports more frequent interaction between senior government officials from NAFTA member countries, in consultation with affected industries, in order to address current and upcoming trade disputes, and to avoid future ones.

THE RETURN OF SOFTWOOD LUMBER DUTIES AND THE BYRD AMENDMENT

Given the evolving nature of the softwood lumber dispute and the Subcommittee's previous related work, this report is directed more toward Chapter 19 as a whole. We feel, however, that U.S. statements that it will not return over $4 billion in Canadian duties paid since May 2002 — $2 billion of which comes from British Columbia alone — should it lose the current extraordinary challenge pose such a grave risk to the integrity of the Chapter 19 process that it requires comment.

In all previous cases in which American trade remedies were found to violate the NAFTA, the United States has always returned collected duties. This time, however, the U.S. Administration is taking the position that NAFTA panels do not have the power to compel the U.S. to return collected duties; only domestic entities (i.e., the U.S. Court of International Trade) can do so. In short, said Mr. Johnson, if this interpretation stands:

> … you don't get your money back if you use NAFTA, but you do get your money back, or have a better chance of getting your money back, if you use the domestic U.S. procedures — no one would ever use Chapter 19. There would be absolutely no incentive to. That is a killer.

As Mr. Perkins remarked, this "absurd" interpretation effectively "means that even where a cash deposit is paid pursuant to an order that is illegal, the American government will retain the deposit." Mr. Potter went even further, arguing that this NAFTA-domestic court double standard actually leaves Canada worse off than if it had never signed a free trade agreement with the U.S.:

> What we now have is the U.S. administration saying that because you are a privileged NAFTA partner, you will be treated less well than if you were Korea. If you were Korea and did it under their domestic tribunals and won, you'd get your money back. But because you're a privileged NAFTA partner the U.S. is going to keep your money, and not only keep it but give it to your competitors, by the way. That hardly seems very principled.

We note International Trade Minister Jim Peterson's comments in 2004 that the U.S. position "strikes a blow to the credibility and legitimacy of NAFTA dispute resolution proceedings. Were Canada and Mexico to be afforded lesser protections than are available through judicial review in U.S. courts, the binding binational panel review that made the free trade agreement and NAFTA possible would be called into question."

The issue is complicated by the Byrd Amendment, which allows antidumping/countervailing duties to be distributed to American companies that claim injury from subsidized imports. This redistribution provides a direct financial incentive for American companies to bring claims against foreign industries and firms, at very little cost with potentially a very big reward. As Mr. Boutin noted,

> If the U.S. parties succeed in obtaining even part of these deposits, the U.S. will have a great incentive to launch new litigation, because even if it loses a case, it will be rewarded twice — once by the investigation itself, which is a costly and time-consuming impediment to Canadian lumber exporters, and then by the illegal distribution of duty deposits, which actually belong to us, the competitors in Canada.

The Byrd Amendment has been found not to be compliant with WTO rules, and while the U.S. Administration has promised to abide by the WTO ruling, repealing the law is up to Congress, which has, to date, shown no inclination to do so. To date, the United States has distributed about US$5 million in softwood lumber duties to American lumber producers.

Canada has committed to bringing a suit in the U.S. Court of International Trade challenging the applicability of the Byrd Amendment to the NAFTA countries, a move supported by the Subcommittee. Canada and six other WTO member countries have been authorized by the WTO to retaliate against the United States

for the Byrd Amendment. Canada's approved level of retaliation is between US$10 million and US$20 million per year for the next three years. Following consultations with Canadians, on March 31, 2005, the federal government announced that it would levy, as of May 1, 2005, a retaliatory 15% surtax on U.S. live swine, cigarettes, oysters and certain specialty fish.

The Subcommittee believes that the Byrd Amendment and the American refusal to return softwood lumber duties are very serious illegal measures that risk undermining confidence in the whole of the NAFTA. The current situation is one that must be addressed. We therefore recommend:

Recommendation 18:

That in the event the United States is unsuccessful in its extraordinary challenge, the federal government pursue to the full extent of its abilities the return of Canadian softwood lumber duties and that the return of 100% of these duties, with interest, be a fundamental condition of any negotiated softwood lumber settlement.

Recommendation 19:

That Canada work with Mexico to (a) conclude an understanding with the United States that explicitly provides for the return of duties collected in cases where the application of trade remedies is found to violate the NAFTA and (b) discontinue the Byrd Amendment's application to Canada and Mexico.

Recommendation 20:

That the federal government continue to pursue all avenues open to it, including retaliation under the World Trade Organization, the U.S. Court of International Trade and the NAFTA, in response to the illegal Byrd Amendment.

CONCLUSION

The debate over Chapter 19 is taking part in the context of a larger debate on Canada's place in North America and the world. Many far-reaching proposals for greater North American integration or for a renewed commitment to multilateralism have been suggested over the past several years. We hope that this report serves as a reminder that in the pursuit of grand strategies and great visions that we should not neglect the maintenance of our existing institutions. We

believe that strengthening Chapter 19 and holding the United States to what it agreed to in negotiating the original Canada-United States Free Trade Agreement is in Canada's national interest and will, in the end, serve as a solid foundation from which Canada can securely consider its place in North America and the world.

LIST OF RECOMMENDATIONS

Recommendation 1:

That the federal government move beyond informal consultations with the United States on NAFTA trade dispute settlement matters, and actively and formally engage the United States to the extent necessary, but particularly through the use of the NAFTA's Chapter 20 (see Recommendation 12), to ensure that the original intent of Chapter 19, and thus the NAFTA, is respected.

Recommendation 2:

That the Government of Canada work with its NAFTA counterparts to develop criteria to restrict the introduction of trade remedy challenges under Chapter 19 that are frivolous and/or without merit.

Recommendation 3:

That the federal government collaborate with the United States and Mexico to give Chapter 19 panel rulings precedent value over subsequent panel rulings covering the same products.

Recommendation 4:

That the Government of Canada enter into discussions with its NAFTA partners to reduce the frequency of multiple remands on the same case.

Recommendation 5:

That the federal government officially protest to the U.S. government and vigorously defend the legitimacy of Chapter 19 and the NAFTA when the United States undertakes actions that disrespect the legitimacy of panel decisions.

Recommendation 6:

That the federal government engage with its NAFTA partners to ensure that extraordinary challenge committees are used only in

extraordinary circumstances and not as a general appellate court.

Recommendation 7:

That the federal government collaborate with Mexico and the United States on consolidating, adequately funding and improving the competence of the NAFTA Secretariats, in order to provide the Free Trade Commission with the support that it requires to adequately administer its treaty functions.

Recommendation 8:

The Government of Canada work with its NAFTA partners to create a permanent roster of panellists, clarify the rules on who is allowed to serve on a panel, increase the remuneration of experts serving on Chapter 19 panels and ensure that each country has a full roster of panellists. The federal government should consult with industry when creating this permanent list.

Recommendation 9:

That the Government of Canada pressure the U.S. to ensure that Section 129 of the Americans' *Uruguay Round Agreements Act* not be used to avoid the implementation of NAFTA panel determinations.

Recommendation 10:

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Recommendation 12:

That the federal government immediately trigger Chapter 20 consultations with the United States regarding the Chapter 19 concerns raised by witnesses in this report.

Recommendation 13:

That, should the United States lose a Chapter 20 case and fail to implement its NAFTA obligations, the federal government give serious consideration to withdrawing NAFTA benefits in conformity with NAFTA Article 2019 from the U.S. until such time as it complies with its NAFTA obligations.

Recommendation 14:

That the Government of Canada develop a long-term, consistent policy of legal-aid support for Canadian softwood lumber associations until such time as the dispute is ended, in recognition of their high legal costs. Furthermore, we recommend that the government devote more of its own resources to the prosecution of the softwood lumber dispute. As a general rule, the federal government should provide financial support (e.g., assistance for the payment of legal fees and provision of loan guarantees) to those industries adversely affected by NAFTA trade remedy cases.

Recommendation 15:

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That the federal government increase support to programs that build coalitions with interested American groups and sensitize Americans, especially American state and national politicians, to the benefits of trading with Canada.

Recommendation 17:

That the Government of Canada, with the active participation of parliamentarians, engage formally with Mexico to address joint concerns about the American treatment of NAFTA Chapter 19.

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Recommendation 20:

That the federal government continue to pursue all avenues open to it, including retaliation under the World Trade Organization, the U.S. Court of International Trade and the NAFTA, in response to the illegal Byrd Amendment.

APPENDIX A
LIST OF WITNESSES

Associations and Individuals	Date	Meeting
Department of International Trade Canada	16/11/2004	2
Stephen de Boer, Acting Director, Investment Trade Policy		
Paul Robertson, Director, Trade Remedies Division		
Privy Council Office		
Graham Flack, Director of Operations, Border Task Force		
Sara Wiebe, Policy Analyst, Borders Task Force		
Canadian Lumber Trade Alliance	12/07/2004	5
Marc P. Boutin, Member		
Free Trade Lumber Council		
Carl Grenier, Executive Vice-president and CEO		
Karl Neubert, Secretary-Treasurer		
Quebec Forest Industry Council		
Georges Courteau, President		
Canadian Agri-Food Trade Alliance	14/12/2004	7
Sandra Marsden, Member, Board of Directors		
Liam McCreery, President		
Canadian Cattlemen for Fair Trade		
Jack de Boer, Vice-chair		
Rick Pascal, Chairman		
Canadian Federation of Agriculture		
Bob Friesen, President		
Canadian Pork Council		
Edouard Asnong, Chair, Trade Actions Reference Group		
Martin Rice, Executive Director		
Canadian Wheat Board		
Victor Jarjour, Vice-president, Strategic Planning and Corporate Policy		
Dairy Farmers of Canada		
Yves Leduc, Director, International Trade		
Bruce Saunders, First Vice-president		
Department of International Trade Canada	22/02/2005	13
Elaine Feldman, Associate Assistant Deputy Minister, Trade Policy and Negotiations		

Associations and Individuals	Date	Meeting
Quebec Forest Industry Council	22/02/2005	13
Marc P. Boutin, Director, International Trade		
As Individual		
Carl Grenier		
Baker & Hostetler	08/03/2005	14
Elliott Feldman		
Cassels, Brock & Blackwell LLP		
Lawrence L. Herman, Counsel, International Trade		
Goodmans LLP		
Jon R. Johnson		
McCarthy Tétrault LLP		
Simon V. Potter, Partner		
University of Ottawa		
Donald McRae, Hyman Soloway Professor of Business and Trade law		
B.C. Lumber Trade Council	11/04/2005	20
Keith Mitchel, Legal Counsel		
Canfor Corporation		
Ken Higginbotham, Vice-president, Environment & External Relations		
West Fraser Timber Co. Ltd.		
Bill LeGrow, Vice-president, Transportation & Energy		
Weyerhaeuser Company		
Paul Perkins, Vice-president, Policy & Planning		

APPENDIX B
LIST OF BRIEFS

Baker & Hostetler

Canadian Agri-Food Trade Alliance

Canadian Pork Council

Canadian Wheat Board

Cassels, Brock & Blackwell LLP

Dairy Farmers of Canada

Department of International Trade Canada

Free Trade Lumber Counci

Goodmans LLP

Privy Council Office

University of Ottawa

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 2, 5, 7, 13, 14, 20, 24 and 28 of the Subcommittee on International Trade, Trade Disputes and Investment and No. 41 of the Standing Committee on Foreign Affairs and International Trade, which includes this report*) is tabled.

Respectfully submitted,

Bernard Patry, M.P.
Chair

MINUTES OF PROCEEDINGS

May 17, 2005
(*Meeting No. 41*)

The Standing Committee on Foreign Affairs and International Trade met at 9:03 a.m. this day, in Room 269 West Block, the Chair, Bernard Patry, presiding.

Members of the Committee present: Hon. Maurizio Bevilacqua, Stockwell Day, Francine Lalonde, Hon. Lawrence MacAulay, Alexa McDonough, Hon. Dan McTeague, Ted Menzies, Pierre A. Paquette, Bernard Patry, Beth Phinney and Kevin Sorenson.

In attendance: *Library of Parliament*: Gerald Schmitz, Principal; James Lee, Analyst; Marcus Pistor, Analyst.

Appearing: Hon. Pierre Pettigrew, Minister of Foreign Affairs.

Witnesses: *Department of Foreign Affairs*: Kathryn E. McCallion, Assistant Deputy Minister, Corporate Services; Marie-Lucie Morin, Associate Deputy Minister, Foreign Affairs; Ross Hynes, Ambassador for Mine Action.

Pursuant to Standing Order 81(4), the Committee commenced consideration of the Main Estimates 2005-2006: Votes 1, 5, 10, 15, 20, L25, L30, L35, 40 and 45 under Foreign Affairs referred to the Committee on Friday, February 25, 2005.

The Minister made a statement and, with the witnesses, answered questions.

On motion of Dan McTeague, it was agreed on division, — That the Main Estimates under Foreign Affairs be adopted.

By unanimous consent, it was agreed, — That the Chair report the Main Estimates to the House.

The Committee proceeded to the consideration of matters related to Committee business.

The Chair presented the First Report from the Subcommittee on International Trade, Trade Disputes and Investment.

By unanimous consent, it was agreed, — That the Subcommittee's report be adopted.

By unanimous consent, it was agreed, — That the Chair present the report to the House.

At 10:53 a.m., the Committee adjourned to the call of the Chair.

Andrew Bartholomew Chaplin
Clerk of the Committee