TRADE DISPUTES UNDER REGIONAL TRADE AGREEMENTS

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Case Analysis: The Supply Management case under Chapter 20 of the NAFTA

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INTRODUCTION

This note first sets out an overview of the various dispute resolution mechanisms of the NAFTA for context. It then discusses the only Chapter 20 dispute between Canada and the United States, *In the matter of Tariffs Applied by Canada to Certain U.S. Origin Agricultural Products*[1] in three parts: structure, substance, and outcome. It then concludes with three observations concerning the viability of regional dispute resolution as compared with dispute resolution under the WTO Agreement.

DISPUTE SETTLEMENT UNDER THE NAFTA

A. Background

The dispute settlement mechanisms of the NAFTA reflect three framework considerations:

- First, the two dispute settlement mechanisms of the Canada-US Free Trade Agreement ("CUSFTA")[2] (state-to-state dispute resolution under Chapter 18,[3] and the special trade remedy binational panel process under Chapter 19[4]) had proven relatively successful.
- Second, the NAFTA was the first free trade agreement between develop countries and a developing country. All parties – and in particular Mexico itself – had an interest in solidifying the liberalizing gains that Mexico experienced since it joined the GATT in 1986.[5]

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[1] "*Supply management* decision", CDA-95-2008-01.
[2] https://www.international.gc.ca/trade-commerce/assets/pdfs/agreements-accords/cusfta-e.pdf.
[3] There were five cases between the two countries between 1989 and 1993: https://can-mex-usa-sec.org/secretariat/report-rapport-reporte.aspx?lang=eng.
[4] There were 52 cases filed under the Chapter 19 process; 29 led to a panel decision.
[5] https://www.kslaw.com/news-and-insights/the-dog-that-did-not-bark.

- Third, additional substantive and institutional provisions were necessary to address the concerns of the incoming Clinton Administration.

In the NAFTA, the parties kept the CUSFTA's Chapter 19 process, made changes to the panel selection process of the state-to-state dispute resolution mechanism of CUSFTA's Chapter 18 (now incorporated into Chapter 20 of the NAFTA), and added three more dispute resolution mechanisms. In all, the five procedures are:

- **Chapter 19**: in essence, a domestic judicial review mechanism. The law it applies is the domestic law of each NAFTA Party, and in general, the disputing parties are private parties; the procedures reflect this fact.
- The side agreements on **labor** and the **environment**: likewise, these are concerned with the application and enforcement of the domestic law of each Party.
- **Chapter 11**: involves claims raised by investors of one Party as against the measures of another before arbitral tribunals governed by procedural rules under international law.
- **Chapter 20**: sets out a mechanism for the settlement of state-to-state disputes, with an innovative panel selection process.

B. NAFTA Chapter 20

There were three cases under Chapter 20, and only one between Canada and the United States in the almost-thirty years of the operation of the NAFTA.

In *Mexico – Soft Drinks*, Mexico argued that:

> *"4.91 [...] Unfortunately,* ***the critical element of automaticity*** *that differentiates the WTO's dispute settlement process from that of the GATT 1947 was not present in the NAFTA. Mexico therefore requested that the United States give its consent for the establishment of an arbitral panel.*
>
> *4.92 Mexico submitted a formal request for consultations, which took place but did not lead to a resolution of the dispute. Mexico then requested a meeting of the Free Trade Commission, the second step of the proceeding, which took place as well, but it too failed to resolve the dispute. Finally,* ***Mexico formally requested the establishment of an arbitral panel, but the United States refused its***

> ***establishment**. To date, the United States has blocked Mexico's efforts to resolve the dispute through the NAFTA institutional mechanisms."*[6]

The challenge arose because although the NAFTA parties established an innovative panel selection process, they did not fix, or at least they did not foresee, a key underlying problem.

The innovation was set out in Article 2011(1)(c): "Within 15 days of selection of the chair, each disputing Party shall select two panelists who are citizens of the **other** disputing Party."[7] The idea behind this selection procedure was to foster the nomination of the highest quality candidates to the roster (and, in particular, discourage each NAFTA party from having national champions on *its* own roster).[8] The difficulty was that the establishment of the *roster* from which automatic panel appointments could be made was subject to consensus.[9] And no Chapter 20 roster was established under the NAFTA.

THE CANADA-US CASE UNDER CHAPTER 20

The first, and only, case under the NAFTA was in respect of the application, following the WTO tariffication exercise, of tariffs to supply-managed goods (dairy, eggs, and chicken) imported from the United States. The United States argued that the NAFTA had eliminated all tariff measures as between the parties; Canada considered that under

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[6] *Mexico – Soft Drinks*, WT/DS308/R, bold added.

[7] Article 2011(2)(c) sets out the situation where there is more than one complaining party:

> "(c) Within 15 days of selection of the chair, the Party complained against shall select two panelists, one of whom is a citizen of a complaining Party, and the other of whom is a citizen of another complaining Party. The complaining Parties shall select two panelists who are citizens of the Party complained against."

[88] Article 1807(3) of the Canada-US Free Trade Agreement provides:

> "The panel shall be composed of five members, at least two of whom shall be citizens of Canada and at least two of whom shall be citizens of the United States. Within 15 days of establishment of the panel, each Party, in consultation with the other Party, shall choose two members of the panel and the Commission shall endeavour to agree on the fifth who shall chair the panel. **If a Party fails to appoint its panelists within 15 days, such panelists shall be selected by lot from among its citizens on the roster described in paragraph 1.** If the Commission is unable to agree on the fifth panelist within such period, then, at the request of either Party, the four appointed panelists shall decide on the fifth panelist within 30 days of establishment of the panel. If no agreement is possible, the fifth panelist shall be selected by lot from the roster described in paragraph 1." [bold added]

[9] Article 2009(1) provides:

> "The Parties shall establish by January 1, 1994 and maintain a roster of up to 30 individuals who are willing and able to serve as panelists. The roster members shall be appointed by consensus for terms of three years, and may be reappointed."

Chapter Seven of the NAFTA a special trade regime applied to agricultural goods and, in particular, measures that had been required to be tariffied in the run up to the conclusion of the Uruguay Round. In the light of its experience with the CUFTA and its strategic trade policy decision to make the NAFTA Chapter 20 procedure work, Canada agreed to the establishment of a panel despite the fact that there was no agreed roster.[10]

A. Panel Selection

Panel selection proceeded smoothly. After an exhaustive review of each prospective panelist's record of publications,[11] Canada selected two eminent professors of international law and international trade law in US universities. The United States also selected two university professors. As we understand, although selecting the first candidate (Professor McRae) was not difficult, finding a second candidate proved challenging, as USTR did not have as in-depth an exposure to Canadian law schools as Canadian officials did to US experts. Each of Canada and the United States put forward candidates for Chair, who was eventually decided by a coin toss.

Unique among all trade disputes between Canada and the United States, the panel was composed entirely of university professors, with one added twist – which became important in the oral hearing – that the Chair had considerable experience in international commercial arbitration.

Finally, because the NAFTA does not have a standing Secretariat,[12] the panelists appointed assistants to help with research and drafting.[13]

B. The proceedings

The first US submission to the panel was ten pages long, with three paragraphs of legal argument. It relied on three propositions:

a) Upon the entry into force of the WTO, Canada had converted its agricultural non-tariff measures to tariffs, and applied these tariffs to US-origin goods.

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[10] Sidney Picker, Jr, "The NAFTA Chapter 20 Dispute Resolution Pr A Chapter 20 Dispute Resolution Process: A View from the Inside", 23 Canada-US Law Journal 525 (1997), p. 529 https://scholarlycommons.law.case.edu/cgi/viewcontent.cgi?article=1885&context=cuslj.

[11] The author did the full review.

[12] See also Dale E. McNeil, "The NAFTA Panel Decision on Canadian Tariff-Rate Quotas: Imagining a Tariffying Bargain", Yale Journal of International Law Vol. 22: 345, p. 379 https://core.ac.uk/download/pdf/72839042.pdf.

[13] *Supply management* decision, footnote 1.

b) Article 302(1) of the NAFTA provided that, "Except as otherwise provided in this Agreement, no Party may increase any existing customs duty, or adopt any customs duty, on an originating good."

c) Nothing in the NAFTA "otherwise provided".

Canada's defence was based on the principles of treaty interpretation in customary international law and, in particular, *lex specialis*, *lex posteriori*, and effectiveness:

a) The NAFTA did, in fact, "provide otherwise", in Chapter Seven.

b) Chapter Seven of the NAFTA incorporated Chapter Seven of the CUSFTA by reference.

c) Article 710 of the CUSFTA provided that:

> *"Unless otherwise specifically provided in this Chapter, the Parties* ***retain*** *their* ***rights and obligations*** *with respect to agricultural, food, beverage and certain related goods under the General Agreement on Tariffs and Trade (GATT) and* ***agreements negotiated under the GATT****, including their rights and obligations under GATT* ***Article XI****."*
>
> This meant that:
>
> i. In context and given the reference to "agreements negotiated under the GATT", "retain" had a dynamic sense and was not frozen in time as of the entry into force of CUSFTA.
>
> ii. What was "retained" was a **balance** of "rights and obligations" in respect of market access for certain products, including measures taken under Article XI.
>
> iii. The WTO Agreement was an "agreement negotiated under the GATT".

d) That negotiated balance, or "bargain",[14] was found in Article 4.2 and footnote 1 of the Agreement on Agriculture: the *obligation* not to maintain non-tariff measures was inseparable from the *right* to apply the converted tariffied measures.

[14] The panel adopted this term, at para. 185:

> "Thus, in the Panel's view, an examination of the course of the negotiations on agriculture in the Uruguay Round as evidenced by the Dunkel Draft and the Modalities Document leads to the conclusion that the arrangement under which agricultural non-tariff barriers were eliminated rested on a simple **bargain**. States agreed to eliminate their non-tariff barriers as the quid pro quo

e) The "bargain" protected the tariffs agreed to at the conclusion of the Uruguay Round, even if those tariffs did not result from the conversion of pre-existing non-tariff measures.

In response, the United States dismissed the concept of a "bargain". It argued that Canada had been well aware of the potential interaction between the NAFTA and tariffication, and simply "gambled" away its supply managed sector. US counsel referred to his own participation in the negotiations as support – entirely unremarkable in trade disputes; the Chair wondered whether counsel was acting as his own witness, a somewhat challenging proposition in international commercial arbitration.

Finally, in the course of the interim review, the United States submitted three large volumes of negotiating history, attacked the panel's findings as "unreasonable" and "bereft of logic", and sought the reversal of those findings.

C. The Final Report

The panel found that the United States had not established its case under Article 302 of the NAFTA.

The panel agreed with Canada's proposed "dynamic" interpretation of Chapters 3 and 7 of the NAFTA and Chapter 7 of the CUSFTA. It underlined the core of the "bargain" and agreed that "tariffication" had been agreed despite widespread inconsistency in respect of the underlying "converted" measures. As to the "gamble", the panel observed:

> *"In this regard, there appears to the Panel to be an unresolved inconsistency in the United States position. The United States has argued that Canada 'gambled' that it could convince participants in the Uruguay Round to preserve the right to maintain agricultural quotas. But, if FTA Article 710 had frozen GATT rights and obligations as of 1989 or 1994, then there can have been no 'gamble' by Canada at least in relation to the United States. Whether or not GATT Article XI was modified under the Uruguay Round to Canada's satisfaction, Canada would still have had the right under the NAFTA, by virtue of a 'frozen-in-time' FTA Article 710, to continue with quotas. The*

for the right to replace them with "tariff equivalents". That is, they were replacing protection in the form of quotas or other non-tariff barriers with protection in the form of tariffs. This right to establish such tariffs was also subject to certain reduction and volume commitments, including a commitment to phase those tariffs down over time." [bold added; footnote omitted]

'frozen-in-time' theory preserves GATT Article XI in its pre-Uruguay Round version as between Canada and the United States."[15]

ASSESSMENT

A. What can we learn from the NAFTA Chapter 20 experience

Four general conclusions may be drawn from the experience of the parties with NAFTA Chapter 20.

First, the failure of the parties to agree to a roster upon the entry into force of the NAFTA gave rise to at least the appearance of a crisis of confidence in the Chapter 20 mechanism. As noted below, there are more complex reasons why Chapter 20 was used as much as Chapter 18 under the CUSFTA, but this is a contributing factor. The parties to the new Canada-US-Mexico Agreement (CUSMA) have already established a roster for its general dispute resolution mechanism.[16]

Second, in a non-paper distributed among WTO Members in the context of DSU reform negotiations,[17] Canada observed that "dispute settlement should, in principle, be rooted in the obligations set out in the agreement". In this light, although it is the case that the dispute settlement institutions of the NAFTA were less certain than those of the WTO, a review of the *substance* of the disputes between Canada and the United States since the entry into force of the WTO suggests a different underlying reason for the parties' failure to use Chapter 20: most of the WTO disputes between Canada and the United States relate to obligations that are not in the NAFTA at all or that are less developed in the NAFTA than in the WTO Agreement.

Third, this is not to say that institutional structures are not relevant. The fallout from the *Supply management* decision highlights a key reason for the insistence of many Members of the WTO for a functioning appellate review mechanism: no matter how eminent the panelists, the absence of appellate review opens the process to potentially debilitating *legitimacy* concerns. After all, in *Supply management*, three of the panelists (including the Chair) were selected by the United States and the other two were American university professors. In our view, US disappointment with the results of a single panel could not have determined its national policy in respect of the NAFTA dispute settlement

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[15] *Supply management* decision, para. 160.
[16] https://can-mex-usa-sec.org/secretariat/dispute-differends-controversias/members-membres-miembros.aspx?lang=eng.
[17] Treaty Drafting Guidelines, April 2002.

mechanism as a whole, but to the extent that this had an impact, it was because of the *finality* of the report rather than the panel process itself.

Finally, the relative success of CUSFTA Chapter 18 and the failure of NAFTA Chapter 20 can be explained, at least in part, by institutional *alternatives*. The CUSFTA operated in the later stages of the GATT; even the 1989 mid-term reforms to the GATT dispute resolution mechanism failed to revive it. Given the dysfunctions of the GATT, Canada and the United States made an effort to make Chapter 18 function. By the time the *Supply management* case was decided, the WTO dispute resolution mechanism was not only in full force, but also being used actively by all the major players, including the United States. It was, institutionally, a far more sophisticated system than Chapter 20; from a trade policy perspective, legal gains in a WTO case involving non-NAFTA partners could have positive systemic and policy consequences in unrelated cases, including those against NAFTA parties.

B. Path forward

To ensure that a dispute resolution mechanism in a regional trade agreement functions well, at least three requirements must be met:

a) the RTA dispute resolution mechanism must be structured to address substantive disputes that are distinct to the RTA;

b) institutionally, the RTA must have mechanisms in place to preserve and enhance the mechanism's legitimacy; and

c) the disputing parties must agree to use the system rather than available alternatives.

[i] **Rambod Behboodi** has over twenty-five years of experience as a trade diplomat, negotiator, and litigator under both the WTO and NAFTA. In postings to Brussels and Geneva as a Canadian diplomat he gained particular insight into multilateral and bilateral trade diplomacy as well as key issues shaping global trading relations (IP, non-tariff barriers, institutional reform, trade and environment, and regulatory cooperation). As General Counsel at Canada's Finance Ministry, he participated in and advised on CETA negotiations. At the Competition Bureau, he established the Competition Promotion Branch and led the Branch's efforts in international cooperation agreements and economic advocacy. He served as Counsellor at the WTO and as international trade Partner at the global firm of King & Spalding before launching GenevaTradeLaw.com. He has taught international trade law in universities in Canada and Europe, and in the past five years has been deeply involved in training and capacity-building, and writing on trade, competition law, and climate change.