"THE DOG THAT DID NOT BARK"

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The mystery of the missing dispute settlement chapter in the NAFTA

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INTRODUCTION

My presentation today is a conceptual exploration of certain themes related to NAFTA dispute settlement, rather than a critique of institutions or agreements that bind the Three Amigos or prescriptions in respect of other negotiations that might, or might not, be going on right now.

What I’m saying is, don’t think of an elephant whose name might be TPP.[1]

And just in case I say something that might, in a certain light, approach insight or substance, or worse, sound provocative or entertaining, please refrain from tweeting or live-blogging.

With the generic and specific disclaimers out of the way, I have a confession to make.

The title of this paper was meant to be catchy – and now that there are not one but two Sherlock Holmes TV series, somewhat topical to boot. But it is misleading, in at least two respects.

First, the dog in question, though somnolent, did, in fact, bark; three times, to be exact.

Second, there is another dog, the other half of my talk, that not only barks, but, according to some, like the Hound of the Baskervilles ravenously attacks everything in its orbit.

This, then, is the tale of two dogs: why the one, NAFTA Chapter 20, has lain dormant for much of its life, and what it is about the other, NAFTA Chapter 11, that demands our special attention.

In my talk today, I will try to figure out the solution to what might also be called The Mysterious Affair at NAFTA.

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[1] The Transpacific Partnership.

DISPUTE SETTLEMENT MECHANISMS UNDER THE NAFTA

Picture this: Washington, D.C., 1992. Recession. Election fever. Ross Perot. "Giant sucking sound".

It was the worst of times for concluding a free trade agreement – the first ever – with a developing country.

And yet, the Canada-US FTA had been a major success. Mexico was liberalizing. Each of the two candidates who had a chance of winning the White House was a committed free trader. If not now, when; if not this, what?

Yes, yes – getting to that. *It was the best of times.*

In dispute settlement terms, the results were revolutionary.

Structure

In the NAFTA, there are five mechanisms for the settlement of disputes. These are set out in the side agreements and Chapters 11, 19 and 20.

- Chapter 19 is, in its essence, a domestic judicial review mechanism parading as an international process. 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, likewise, are concerned with the application and enforcement of the domestic law of each Party. While a challenge is launched against one of the Parties to the agreement, the applicable law is that of the Party, and not internationally agreed substantive rules.
- The dispute settlement mechanisms under Chapters 11 and 20, the subjects of my talk today, apply international law.
- 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 provides a mechanism for the settlement of state to state disputes under the NAFTA. Interestingly, and of note, it may also be used to settle disputes under the substantive rules of the GATT and successor agreements. This, of course, is different from instances in which the substantive law of the GATT is directly

incorporated into the NAFTA – and so different from the three Canada – US FTA cases that had applied GATT disciplines.

Recourse

There is an enormous difference in usage as between the different dispute settlement mechanisms of the NAFTA. There have been three cases under Chapter 20, some 130 cases under Chapter 19, and nearly forty active or decided cases under Chapter 11.

Of course, numbers on their own don't tell you the full story.

For example, there are many more cases under Chapter 19 than under Chapter 20. Does, or should, that fact tell you anything about the relative "success" of the two dispute settlement mechanisms? Not really.

> **Chapter 19 cases are driven and led by private sector interests and on private sector terms. Chapter 20 cases are state-to-state disputes.**

Different parties; different dispute settlement considerations; different law; different processes; different numbers.

In the same vein, critics of investment disciplines point to the fact that there are 28 cases filed against Canada under Chapter 11. True, Canada is, in general, a law abiding and fairly open economy, and so we would not expect too many investment maltreatment claims against it.

But, the complainants are private interests advised and driven by private counsel; we would expect rather more claims under Chapter 11 than, for example, state-to-state claims.

If, therefore we were to stick to the numbers alone, I could end my talk now and we could all head to lunch.

I have to justify my trip up here, however and any event, truth be told, there is more.

The numbers highlight two curious facts.

First, there has been only one case under the NAFTA between Canada and the United States in the past twenty years; there were five cases in the preceding five under the FTA. Were we more litigious back then and less so now? Did the NAFTA usher in a period of

trade peace and harmony as between the United States and Canada? Or were the NAFTA disciplines somehow clearer than those of the FTA, giving rise to fewer challenges? Or less binding?

Let's dismiss peace and harmony as an explanation right off the bat: In the same period, there were 11 cases between Canada and the United States under the WTO Agreement – six or seven cases, depending on how you count, on Softwood alone. Now, as I will explain shortly, the *Softwood* cases give you a plausible semi-explanation as to why this state of affairs prevails, but it is a somewhat curious situation.

Second, there have been active 37 investment disputes under Chapter 11 of the NAFTA. There are no comparable figures for the Canada-US FTA because, of course, it did not include an investor-state dispute settlement mechanism. So far so unremarkable.

Here is the curious fact: of all Chapter 11 cases filed as of 2013 (some of which are inactive or pending), 19 are against Mexico, 19 against the United States, and 28 against Canada.

Why curious?

Let me explain.

Todd Weiler notes that,

> A rather paternalistic view still appears to linger in the corridors of some governmental agencies that the NAFTA was only ever intended to protect Canadian and American investors from the hands of the Mexican State.

The lingering might be paternalistic, but as to the parties' intentions at the time of the negotiations, the context suggests that the view was not, perhaps, ill-founded.

Mexico is now such a fixed feature of WTO dispute settlement – with an Appellate Body member, and active participation in both disputes and negotiations on the rules – that it's hard to believe it joined the GATT in 1986 – the same year the Uruguay Round of negotiations was launched, barely six years before the NAFTA entered into force.

We – Canada, the US and in fact all developed countries – are so enmeshed in complex webs of multidirectional – North-South, TransPacific, Mediterranean, Americas – free

trade agreements that we forget that the NAFTA was the *first* free trade agreement between a developing country and developed countries.

These days [2013], the richest man in the world, by some accounts, is a Mexican telecoms tycoon; the issue of the day in the 1980s in Mexico was protecting the Mexican government's privatization policy.

There were real concerns about Mexico's history of treatment of investments. The expectation was, as Ross Perot's "giant sucking sound" would tell you, that there would be an influx of investment to the south; that investment had to be protected.

> **That is, all parties to the negotiations on the inclusion of investment rules in the NAFTA were concerned, if not necessarily about protecting investors from Mexican policies, at least about potential Mexican regression from the liberalizing path it was on.**

And yet, the investment arbitration mechanism they devised is now used equally as against all three. Here's Barry Appleton on this curious development: "No one quite understood or anticipated where it would go."

THE ISSUE

One dog stopped barking; the other turned on its putative masters.

What happened? Is it as simple as, "no one quite understood"? Not the negotiators, not the lawyers, not the politicians, not the legislators, not the stakeholders, not the experts, not the academics – no one anticipated and no one understood?

More to the point – does it matter?

Should it matter why Chapter 20 has not been used often? Or is this simply a curious fact in search of an academic explanation of no practical consequence or intellectual import? That was a rhetorical question.

It matters because of the elephant you should not be thinking about. And then there is the Appleton comment: beware of trade negotiators bearing dispute settlement mechanisms.

OK – so here is the problematique:

- On the one hand, you have a mechanism that is not being used. It is not because there are no disputes – they are just taken elsewhere. It is not because the agreement as a whole is defective, because in fact its other dispute settlement mechanisms are working well.
- On the other, mechanisms and disciplines developed for one purpose are now serving quite a different one. I am dating myself here, but every time I think of Chapter 11, I am reminded of the immortal words of Diana Ross: "Do you know where you're going to?"

What can this tell us about either mechanism, or dispute settlement generally in trade agreements?

When the dog stopped barking

Let me first turn to the headline topic: the dog that stopped barking.

Three numbers: five, one, 19. The FTA, the NAFTA and the WTO.

I've sandwiched the NAFTA between the FTA and the WTO not just for chronological reasons. But to highlight that the paucity of use is not because trade disputes between Canada and the United States magically vanished in 1992. Rather, the question is why are the numbers so lopsided? Now, the question becomes even more puzzling when we consider that under the NAFTA, the Parties may engage the dispute settlement mechanism to settle disputes in respect not only of GATT obligations directly incorporated into the NAFTA, but also those under GATT and WTO obligations.

Under the FTA, this particular feature was used three times – 60% of the cases under Chapter 18. (The other two cases related to the specific disciplines of the FTA.)

> **As any standard choice of forum analysis would conclude, where the applicable law is the same, the determining factor is likely to be the institutional set up.**

And, of course, any standard history of the GATT would support such a conclusion. Its dispute settlement mechanism was not working. Here was a chance to show that a new model of trade dispute settlement could be effective. And, indeed, it was. In the GATT,

panels could not even get established, and it is this upstart FTA that has five panels in five years.

Not bad that.

Then came the NAFTA, with innovative panel selection and panel procedures, some of which even find their way into the DSU, which came into force three years later …

In 1995, someone looking at the dispute settlement terrain between Canada and the United States could not have predicted with too much confidence in which direction the pendulum of dispute settlement use would swing.

True, the NAFTA was untested, but it had good pedigree; true, the new WTO was untested, but both Canada and the US had managed to get many of their asks hardwired into the new organisation. Within a year, Canada and the US were embroiled in two disputes in both fora. They were being tested alright. Which way?

Still not clear. The NAFTA case was about the tariff elimination provisions of the NAFTA; Canada would be more vulnerable in the WTO in respect of its cultural industries, hence the WTO case against it in Periodicals.

By the end of the 1990s, NAFTA Chapter 20 was dead and Canada and the US had a half-dozen active cases against one another in the WTO.

The culprit, whispered the corridors of the Academy and of Trade Policy, the *Supply Management* case under the NAFTA. Here was an ironclad case for the complaining party – the US was so confident that its first submission had a grand total of three paragraphs of legal argument – that five "pure academics" sitting in judgement managed to blow. Yes, three of the five were the choice of the United States, but why quibble over details like that?

Well, not quite whispered. Here is a former USDA General Counsel writing in the Yale Journal of International Law, arguing that a panel comprising five law professors and presiding over a dispute governed by basic rules of procedure:

> chose not to consult the GATT legal secretariat, which might have provided informal advice about the GATT tariff regime and possibly even a formal letter of legal advice.

And, because the likes of Eli Lauterpacht and Don McRae evidently lacked it:

> the parties might consider creating a legal staff, either located in the NAFTA secretariat or on retainer, to ensure that panels have access to the needed legal expertise.

All this because the Panel failed to buy the principal US argument:

> Canada abandoned its use of absolute quotas to defend supply management, relinquished the protection of FTA article 710, and gambled the fate of its protected industries on winning a favorable decision from a NAFTA dispute-settlement panel.

The gamble paid off, of course – if, that is, one considers that countries "gamble" about public policy. In a sense, irrelevant. The US, the story goes, simply lost faith in the NAFTA dispute settlement process and, taking its marbles, turned its energies to the WTO.

This narrative got a major boost in 2005, oddly enough because of a WTO case.

The case is *Mexico – Soft Drink*. It's a US dispute, in the WTO, against certain Mexican taxes on US-origin soft drinks. Mexico argued that the genesis of the dispute is in the NAFTA and so the panel should exercise its discretion to defer to the NAFTA dispute settlement process and, consequently not to hear the case. Why? This is where it gets interesting:

> 4.91 Mexico and the United States disagreed over the letters exchanged in 1993. Mexico had generated a surplus and believed that it had a right to export larger amounts of sugar to the United States' market than the United States was prepared to admit. Mexico therefore took steps during the late 1990s to resolve the dispute through the NAFTA general dispute settlement mechanism stipulated in Chapter XX. 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.

4.93 Mexico and the United States have also held consultations and negotiations at various times over the past decade. However, they have been unable to reach an agreement through that channel either. It warrants noting that it was in the interests of certain parties to prolong the dispute. As long as the Mexican market remained in a state of disequilibrium, the Me xican industry would be subject to greater financial stress and exits from the Mexican sugar industry would be that much more likely. This in turn could be expected to reduce Mexico's ability to generate a surplus. Thus, the longer it would take to resolve this dispute, the better for certain United States interests.

Indubitably, the skeptics intoned.

> **Now we know why the dog isn't barking: it's been euthanized.**

The Hound unleashed

My apologies for the gruesome image, but now that I am treading this path, let me push the metaphor to its limit.

There was one beast the NGO community, at any rate, would have been perfectly pleased to put down, and that was Chapter 11. This was not, to be sure, a specific dislike of Chapter 11 itself – I mean, it encompassed the whole NAFTA thing, and then the multilateral agreement on investment, and then of course Seattle – in the 90s, there was a veritable embarrassment of choices if you were prone to throwing bricks through shop windows in protest against international law development on trade and economic issues.

The Chapter 11 mechanism started out well enough – as expected, the first cases were against Mexico. It did not help that the company that launched the case had a name right out of a cheesy science fiction movie. Nor that the measure at issue was, apparently, the designation of a piece of property as an "ecological zone". But, it was more or less expected that there were going to be cases against Mexico, and here was a case against Mexico. Chapter 11 was working as intended.

Then came *Ethyl*. Now, I had a tangential involvement in the case, and so will refrain from commenting on the substance – and, in fact, I don't propose to go into the substance of any of the disputes. But the context was important and remains relevant.

In *Ethyl* the measure at issue was the Canadian ban on the importation and interprovincial trade, but not the use, of MMT, a gasoline additive. Among its more charming qualities, MMT is a suspected neurotoxin, and some claimed that it interfered with onboard environmental diagnostics of automobiles. *Ethyl* – a perceived "environmental" case – was followed by others in the same vein: *SD Myers*, about a ban on the exportation of PCBs, another highly toxic substance. *Sunbelt*, about British Columbian measure on the protection of water – and only Anne Murray and Sidney Crosby are more sensitive topics in Canada.

And that was just in Canada. Barely a year after *SD Myers,* a Canadian chemical company challenged California's phase-out of MTBE – a gasoline additive that, according to California, had contaminated ground and surface water throughout California.

By the time Y2K arrived, for the environmental and anti-investment agreement NGO community, Chapter 11 had morphed into "The Sum of All Fears." And there were (and largely remain) three:

1) Chapter 11 was yet another means for corporate interests to attack environmental measures;
2) foreign corporate entities had more rights than domestic interests; and
3) third, because Canada and the US were being targeted, Chapter 11 was being used in ways not intended by the parties.

For me, the most interesting – I am trying to use a neutral word – is the case filed on January 25, 2012: *Detroit International Bridge Company. v. Government of Canada*. The website of the Department of Foreign Affairs and International Trade of Canada describes the case as follows:

> The Detroit International Bridge Company complaint concerns legislation passed by the Government of Canada that gives the Government of Canada authority over the construction, operation and ownership of international bridges.

Maybe Barry Appleton was right: "No one quite understood or anticipated where it would go." Chapter 11, the narrative goes, is a wild hound on the loose: witness the monopolist owner of the Ambassador Bridge suing the Government of Canada for paying for a new bridge, and highways, spanning the Detroit River.

AN ALTERNATIVE THEORY

The moral of the Standard Unifying Narrative of the NAFTA, it would seem, is this: "beware of trade negotiators bringing you dispute settlement chapters."

This is the point at which, in an Agatha Christie novel, Inspector Japp saunters over to the Great Belgian Detective and says, "Well, Poirot, looks like the mystery is solved."

Whereupon Poirot, brows furrowed, looks into the distance and mutters, "*Eh bien, mon ami*, perhaps you have reason. And yet, it was a solution too easy …"

Don't get too comfortable, though. Because a Bobby is about to run into the room to announce that a new body has been found in the library, the vicarage or the mews. It's the handyman, the maid, the elderly doctor.

> **"*Non, non, non*!" Poirot would exclaim, "I have been an imbecile abominable. Hastings, please to review the evidence!"**

Let me turn to the NAFTA first.

It is true, as Mexico argued in *Soft Drinks*, that the dispute settlement institutions of the NAFTA are less certain than those of the WTO, with automaticity of panel establishment being, arguably, the most significant challenge. And yet: we know that the same lack of automaticity existed under the FTA and the old GATT, and panels did get established even then, and reports adopted and implemented.

It is true that the US was disappointed with the results of the *Supply Management* panel. But with a little bit of preparation, the parties in a dispute have control over the choice of panelists; disappointment with the results of a single panel cannot, and does not, determine national policy in respect of an entire treaty organization.

And it is true that the parties have had a lot of disputes under the WTO.

Here is the thing. It's when you look at the substance of those disputes – not the dispute settlement mechanism, not panel selection or the Appellate Body or automaticity – that you get a true sense of why the disputes ended up in the WTO and not NAFTA Chapter 20.

Between Canada and the United States, all of the WTO disputes relate to obligations that are not in the NAFTA at all or that are less developed in the NAFTA than in the WTO Agreement. *Magazines*, *Dairy*, *Softwood* … Especially *Softwood* - six or seven cases under the SCM Agreement, depending on how you count, in respect of matters on which there are no substantive rules in the NAFTA.

I suggested that in 1995, looking at the two cases before the two institutions and the nature of the dispute settlement mechanisms, you could not predict which way the pendulum would swing. But if you looked at the *pattern* of disputes between the parties and the nature of the obligations in the two agreements, you could and probably would have predicted a heavy tilt in favour of the WTO.

And what about Chapter 11? Here is a remarkable number. In 2011, foreign direct investment in Canada amounted to just over $600 billion. Of which more than half originated in the US and Mexico.

The total value of damages awarded or claims settled in Canada amount to under $200 million over the life of the Agreement – or an average of one third of one tenth of one percent of total investments. A number of the disputes, moreover, had to do with the Softwood dispute, which has its own economic logic.

And the two celebrated environmental cases? Ethyl was settled for $13.5 million, and in SD Myers the company was awarded $5 million in damages.

The wonder of Chapter 11 is not that it has been used too often; it is that it has hardly been used, and then with such negligible effect on the balance of trade and investment between Canada and its NAFTA trading partners.

And, of course, to the extent that it has been used relatively sparingly as against Mexico demonstrates the soundness of the initial Mexican impetus for agreeing to the disciplines in the first place.

So here we are, almost at the end of the journey.

I began with Holmes and end with Poirot; and like the Great Belgian himself in Murder on the Orient Express, I have offered you alternative solutions. I close by making the following observation.

If you agree with what I have called the Standard Unifying Narrative, you will end up spending a great deal of time in each trade agreement fine-tuning the dispute settlement mechanism. This is because you will agree with the proposition that the NAFTA Chapter 20 mechanism failed because of its institutional weaknesses, and that those who negotiated Chapter 11 basically had no clue about its direction and impact, and so we should be extra-vigilant about future such provisions.

If, however, you agree with the alternative look at the evidence that I have set out before you, you will concentrate rather more on getting the substantive rules right, anticipating that dispute settlement will follow a pragmatic path along the negotiated rules.

The choice is yours. I thank you for your patience.

[i] Presentation at the Faculty of Law, Columbia University on 8 April 2013. At the time of the presentation, the author was General Counsel, General Legal Services, Department of Finance Canada. The views expressed here are the author's own and did not necessarily represent those of the Government of Canada.

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.