August 11, 2017

Canada's NAFTA Challenge and the Reality of Chapter 19

Dispute resolution has been a perennial hot-button in Canada-US trade talks for decades. And the upcoming renegotiation of the North American Free Trade Agreement is no different. Trade expert Lawrence Herman dissects the reality of NAFTA's Chapter 19 in this Communique from the C.D. Howe Institute. He reviews the history, usage and outcomes, providing an essential piece of analysis as negotiators and the broader Canadian public grapple with the complexities of the issue in in coming days.

Introduction – The Issues

Eliminating trade remedy (anti-dumping and countervailing duty) measures in Canada-US trade was one of Canada's major objectives in the original free trade talks in the mid-1980s.[1] The Reagan Administration's resistance to the idea provoked a Canadian walkout and almost led to a complete breakdown in those negotiations in 1987.[2]

In the end and virtually at the 11th hour, agreement was reached on the binational panel review process in the FTA, giving a party (either a government or private person through its government) the option of invoking these panels as an alternative to judicial review in domestic courts. The system was later replicated in Chapter 19 of the North American Free Trade Agreement.

NAFTA panel reviews are not full appeals but are substitutes for the more limited procedure of judicial review in which a domestic court can only require the agency concerned to re-consider its original

1 One of the driving forces behind the FTA was the spate of US trade actions in the 1980s against large swaths of Canadian exports, not only in softwood lumber but in *Groundfish* (USITC Publication 1750, September 1985), *Live Swine and Pork* (USITC Publication 1733, July 1985) and others.

2 Hart, M., et al., *Decision at Midnight* (UBC Press, 1994), pp. 298-342.

decision because of an error of law or an unreasonable conclusion of fact. Under Article 1904, panels are required to apply "the general legal principles that a court of the importing Party otherwise would apply to a review of a determination of the competent investigating authority".

From the outset, there have been pockets of opposition to Chapter 19 in the US, both on the political front and on legal and constitutional grounds. Additional opposition was churned by the US Lumber Coalition, angry over the losses sustained in some of the Chapter 19 panels in *Softwood Lumber IV* (2001-2005).[3]

The anti-Chapter 19 sentiment in the US was aided by a long dissenting opinion by the US member of an Extraordinary Challenge Committee decision in Softwood III in 1994 who tore into the system, arguing that it resulted in decisions contrary to US constitutional law.[4]

In its NAFTA renegotiation objectives issued on July 17, the US has demanded removal of the Chapter 19 dispute settlement mechanism from the Agreement in the forthcoming talks.[5] This would upset the carefully-crafted and delicately-negotiated balance in both the FTA and the NAFTA.

Some observers have said, contrary to what is generally perceived, that Canadian use of Chapter 19 has sharply fallen over the past decade, even when the importance of the Softwood Lumber dispute is considered, and that Canada shouldn't go to the wall in opposing its removal.[6]

Nonetheless, the Canadian government has made it clear in various ministerial statements that it considers Chapter 19 as a fundamental element in the entire NAFTA structure, virtually drawing a line in the sand.

A review of the history of Chapter 19 does indeed reveal that, apart from the lumber industry, there has been surprisingly limited use of binational panels by Canadian parties over the last decade or more. But at the same time, it suggests that US opposition to the binational panel review system is exaggerated and misplaced, largely because of the activities from a single opposition source – the US softwood lumber lobby.

---

3 Website at: **www.uslumbercoalition.org**.

4 *Softwood Lumber from Canada*, Extraordinary Challenge Committee, Memorandum Opinions and Order, August 3, 1994 (ECC-94-1904-01USA), dissenting opinion of Malcom Wilkey.

5 USTR, Summary of Objectives for the NAFTA Renegotiation, July 17, 2017, p. 14.

6 "Is Chapter 19 worth fighting for in NAFTA negotiations", *Globe and Mail* (Toronto), August 2,2017. The article reports the comments by Prof. Robert Wolfe of Queen's University.

Canadian Sectors Covered

Chapter 19 applications under Article 1904 between 1994 and 2017 originating in all three NAFTA countries have resulted in 73 final panel decisions.[7] Twenty-one of these 73 reviews were originated by Canadian parties, challenging US decisions (both by the Commerce Department and the US International Trade Commission).[8] This shows that Canadian parties have used the panel review process in less than one-third of completed cases.

Moreover, the scope of Canadian-initiated Chapter 19 reviews has been surprisingly narrow in terms of industry coverage. The list below covers only nine Canadian sectors or product categories, with the year in which the original Chapter 19 application was filed.

Live Swine (1994)
Colour Picture Tubes (1997)
Corrosion Resistant Carbon Steel Flat Products (1997)
Brass Sheet and Strip (1998)
Pure Magnesium (2000)
Softwood Lumber (2002)
Carbon and Alloy Steel Wire Rod (2002)
Durum and Hard Red Spring Wheat (2003)
Supercalendered Paper (2015)

In this tabulation, Chapter 19 reviews within the same product category and subsequent proceedings flowing from the original case, i.e., where panel reviews were requested in decisions that emanated from the original determinations of the Commerce Department or US International Trade Commission, are subsumed under one industry category.

7 While here have been more than 200 reviews requested by exporters from the three NAFTA parties, almost half of these requests have been terminated by withdrawal or by consent of the parties. NAFTA Secretariat, Canadian Section: **https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Decisions-and-Reports**. See also: WorldTradeLaw.net.

8 Chapter 19 panels involving both Commerce Department and USITC decisions (e.g., in expiry reviews) based on the same petition and original investigation, are counted as a single review in this total.

As an illustration, in *Steel Wire Rod*, the last panel review was requested by the Canadian party in 2009 with the panel decision being issued in 2014. However, that case really began in 2002 and these subsequent Chapter 19 decisions flowed from the original decision.

Similarly, the series of Chapter 19 cases in *Softwood Lumber IV* began with Commerce Department countervailing duty orders originally published in 2002. The case went through many phases, with the last Chapter 19 panel review occurring in 2006. But the case remains as a NAFTA proceeding within that single industry.

So while the USTR demands the removal of Chapter 19 and a few US interest groups argue about the alleged perfidy of binational panels, Canadian use has been confined to a limited range of industry sectors. *Supercalendered Paper*, begun in 2015,[9] is the first newly-added Canadian industry sector in Chapter 19 proceedings since *Durum and Hard Spring Wheat* in 2003.

As noted, the Canadian softwood lumber industry has been by far the largest Canadian user of Chapter 19. Of the total of 21 completed Canadian-initiated reviews under the NAFTA, five were by the softwood lumber industry. These five review applications resulted in 14 separate panel remand decisions between 2002 and 2006.[10] Contrary to what some may believe , NAFTA panel decisions have thus been largely concentrated in a single Canadian industry sector.[11]

Canadian Products Covered

While the foregoing speaks about sectoral use of Chapter 19, trade remedy investigations are directed to specific products, with the targeted imports carefully-defined in the original petition (in Canada called "complaints") by the affected industry.

This means that not only is the scope of Canadian-originated NAFTA panel decisions confined to a limited number of sectors, panel proceedings involved tightly-defined products within those sectors.

9 USA-CDA-2015-1904-01, requested on November 18, 2015.

10 In one of the softwood lumber cases involving the Commerce Department's subsidy decision, there were six separate panel review decisions: *Certain Softwood Lumber Products from Canada (Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination)*, USA-CDA-2002-1904-03. **https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Decisions-and-Reports.**

11 While much about the softwood lumber issue is unique and in a sense sui generis, it is a high-profile one because of the high dollar value of exports, some C$6.0 billion annually.

When the record is considered in terms of products, whether it be 2x4 lumber or types of wire rod or other goods, Chapter 19 panel reviews have involved a very small percentage of annual Canadian exports to the United States.

The above doesn't purport to be an exhaustive or definitive analysis of the use of NAFTA Chapter 19 by Canadian exporters. It doesn't include Chapter 19 cases that were initiated but later withdrawn by the Canadian party or examine the extent to which Chapter 19 may have had had a dampening impact, if you like, on US trade remedy petitions or agency decisions.

Yet there are grounds for concluding that the advent of the binational panel system has had a disciplining effect and resulted in many fewer trade remedy cases directed against Canada than in the pre-FTA period. Softwood lumber aside, US trade actions against major Canadian export sectors appear to have substantially receded since the introduction of the panel system in 1988.[12]

US Experience

On the US side, Chapter 19 applications challenging Canadian agency decisions have been much less frequent. From 1994 to 2016, there were 11 applications by US parties for reviews involving Canadian agency decisions, the last completed case being in 2002.[13]

This is not surprising. Canadian trade remedy complaints against US imports have been much fewer in absolute numbers than US trade actions involving imports from Canada, with the expected result that there were fewer American parties' challenges of Canadian agency decisions than vice versa.

However, after a fairly long hiatus, in 2015 US producers of gypsum board requested a Chapter 19 panel to review the findings of the Canadian International Trade Tribunal that dumped US-origin imports had injured a western Canadian producer of drywall. While those proceedings have since been

12 The dampening impact of Chapter 19 on US trade petitions and agency decisions is difficult to prove empirically. However, in a July 2017 comment, Chad Bown of the Peterson Institute, Washington, DC, says that the "legal disincentives" provided by NAFTA Chapter 19 " . . . likely contributed to the relatively low levels of US use of such laws against imports from Canada and Mexico." "Trump's Renegotiation Could Take the 'Free' Out of NAFTA's Trade". **https://piie.com/blogs/trade-investment-policy-watch.**

13 *Certain Refrigerators, Dishwashers and Dryers, Originating In or Exported from the United States of America:* CDA-USA-2000-1904-04.

terminated by the applicants, the case does suggest a continuing interest in the US in taking advantage of the Chapter 19 process.

Polarization of Issues

Aiding the softwood lumber lobby are pockets of US opposition who claim that the Chapter 19 panels lack constitutional legitimacy,[15] in spite of the fact that their role and jurisdiction is enshrined in a treaty ratified by the US and enshrined in US statute.

Opposition arguments were further stimulated in *Softwood Lumber IV*, where the USITC refused to follow the remand decision of a five-person panel (composed of a majority of Americans). In its Second Remand Decision, August 31, 2004, the frustrations of the panel were strikingly clear, where it stated,

> "... the Commission has refused to follow the instructions in the First Panel Remand Decision. ...The Commission has made it abundantly clear to this Panel that it is simply unwilling to accept this Panel's review authority under Chapter 19 of the NAFTA and has consistently ignored the authority of this Panel in an effort to preserve its finding of threat of material injury. This conduct obviates the impartiality of the agency decision-making process, and severely undermines the entire Chapter 19 panel review process. . . .
>
> Accordingly, in the face of the Commission's regrettable position, this Panel specifically precludes the Commission on remand from undertaking yet another analysis of the substantive issues. . . . the only remedy that is consistent with the mandate of Rule 2 of the NAFTA Article 1904 Panel Rules to secure the just, speedy review of final determinations is for this Panel to issue an Order explicitly instructing the Commission to make a determination consistent with the decision of this Panel. . . ."[16]

14 *Certain Gypsum Board Originating in or Exported from the United States of America (Injury):* CDA-USA-2017-1904-01.

15 Gantz, D., "The United States and NAFTA Dispute Settlement: Ambivalence, Frustration and Occasional Defiance", *University of Arizona Legal Studies, Discussion Paper No. 06-26, June 2009*, p. 381. The author points out that political opposition to the panel system is mostly centred on the softwood lumber file and suggests constitutional challenges by some of these interests groups are likely to continue.

16 USA-CDA-2002-1904-07, pp. 3-4.

This direction has been latched onto by US groups opposing Chapter 19, arguing that US agency decisions are being frustrated by Chapter 19 panels, improperly substituting their views for those of statutory bodies created by US statute. But is this criticism justified?

Different Standards of Review

Under NAFTA Article 1904, the panel review process is not an appeal. Rather, Article 1904 provides for judicial review by panels, a limited proceeding confined to whether the agency concerned erred in fact or law. Panels can issue remand orders only, applying the laws and "the general legal principles that a court of the importing Party otherwise would apply".

American opposition to Chapter 19 focuses on a few remand decisions made by panels that have required the Commerce Department or the ITC to review their original decision in light of the panel's decision and report back on the remand. That is the same process involved in domestic review proceedings before US courts.

Lost in the criticism in the US over some of the panel decisions is that the American standard of review and the Canadian standard are materially different. Canadian courts are more deferential to lower agency decisions then US courts. So remand orders are less frequent when Canadian decisions are being reviewed than vice versa.

The US standard has been explained in many Chapter 19 cases. In *Softwood Lumber IV,* the panel said,

> "The standard of review applicable here is found in Section 516A(b)(1)(B) of the *Tariff Act* of 1930 . . . which requires the Panel to "hold unlawful any determination, finding, or conclusion found…to be unsupported by substantial evidence on the record or otherwise not in accordance with law…". This Panel is limited to reviewing the "administrative record" compiled by the investigating authority. In addition, while conducting its review, this Panel is bound by the laws of the United States, including its "statutes, legislative history, regulations, administrative practices, and judicial precedents", decisions of the Court of Appeals for the Federal Circuit and decisions of the United States Supreme Court."[17]

17 *Certain Softwood Lumber Products from Canada*, USA-CDA-2002-1904-07, September 5, 2003, pp. 8-9.

The panel went on to say,

> The determination of whether an agency determination, finding or conclusion is unsupported by "substantial evidence" turns on the meaning of substantial evidence. This term has been the subject of much judicial treatment that has sought to clarify the statutorily prescribed standard. The U.S. Supreme Court has stated that substantial evidence is "more than a mere scintilla [of evidence] and is "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion". The Supreme Court subsequently elaborated on the standard by saying that substantial evidence could be "something less than the weight of the evidence and the possibility of drawing two inconsistent conclusions from the evidence does not prevent an administrative agency's finding from being supported by substantial evidence."
>
> ". . . The reviewing body must look to ensure that a reasoned basis supports the agency's decision. The reviewing body must not defer to an agency's determination that is premised on inadequate analysis or faulty reasoning . . . "[18]

Superficially, it might seem that the US review standard is close to the Canadian standard of whether the decision meets the test of "reasonableness". However, there is a notable difference between that standard and the American requirement for the decision under review to be based on "substantial evidence" on the record.

The result is that Canadian courts are more deferential to lower agency decisions then US counterparts under the Canadian review standard. As stated by the Supreme Court of Canada in *Dunsmuir v. New Brunswick*:[19]

> "[47] . . . A court conducting a review for reasonableness inquires into the qualities that make a decision reasonable, referring both to the process of articulating the reasons and to outcomes. In judicial review, reasonableness is concerned mostly with the existence of justification, transparency and intelligibility within the decision-making process. But it is also concerned with whether the decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law."

18 *Ibid.*, pp. 10-11.

19 [2008] 1 SCR 190, 2008 SCC 9.

The different review standards means that the US Court of International Trade tends to be more likely to remand in judicial review proceedings than Canada's Federal Court of Appeal. An added factor is that the Federal Court, unlike the Court of International trade, is not specialized in trade law, resulting in greater deference to CBSA and Canadian International Trade Tribunal decisions than in the analogous case in the United States.

The result of the less deferential American review standard means that Chapter 19 panels applying the US standard, perforce, will be more probing and more inclined to issue remand decisions than in the Canadian situation.

This has resulted in several panel remands, especially in *Softwood Lumber IV*, and in turn spawned misdirected criticisms of the entire binational panel system, with vested interests using the argument that the panels are somehow leaning against the United States.

This is a mischaracterization of the record, distorted by emphasizing *Softwood Lumber IV* and ignoring results in other panel reviews. While a full review of the NAFTA record is required, it is clear that remand decisions over the history of the NAFTA have been a mixed bag, with the Canadian side achieving some, but only partial success on some points and being rejected in others.[20]

Chapter 19 Panels involving Mexico

US interest groups like the lumber lobby criticize Chapter 19 across the board, not just confined to Canada but targeting remand decisions by panels involving review applications by Mexican parties as well.

There have been 15 US challenges of Mexican decisions, several of which have resulted in panel remand orders. There have been a larger number of Mexican challenges of USITC and Commerce Department

20 As a few examples, *Live Swine from Canada* (USA-CDA-1994-1904-01), September 27, 1995; *Color Picture Tubes* (USA-CDA-1995-1904-03), June 5, 1996; *Corrosion Resistant Steel* (USA-CDA-1998-1904-01), August 24, 2001), *Carbon and Alloy Steel Wire Rod* (USA-CDA-2009-1904-01), April 29, 2014.

decisions under Chapter 19, some 20 completed cases.[21] While the record bears further analysis, as in the Canadian situation, Mexican challenges have been confined to a relatively limited number of industry sectors.[22]

As well, several high-profile Mexican challenges under Chapter 19 came to naught, with the panels turning down applications and affirming the Commerce Department and ITC decisions.[23]

Conclusions

The foregoing is a brief and somewhat superficial review of the Chapter 19 record.

What this overview attempts to do is to explain some of the underlying points that are glossed over in the US when complaints are levied against the binational panel system, showing the confined use of the system by Canadian parties in terms in industry sectors and, importantly, in terms of product covered, involving a very small volume of total Canadian exports,

Another factor is the differing review standards in Canada and the US, one of the key reasons why remand orders appear to be more common where US decisions are reviewed than in the Canadian situation.

This overview leads to the conclusion that Chapter 19 panel reviews involving Canadian products are a minor factor in the overall scheme of things. American opposition to the system focuses on softwood lumber, a unique and possibly *sui generis* situation. Moreover the panel results in that case have been mixed, which hardly supports the position that Chapter 19 panels have been biased against the United States.

The bottom line is that when it comes to the binational panel system, the US doesn't really have much to complain about.

21 **https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Decisions-and-Reports.**

22 Portland cement and Oil Country Tubular Goods and other pipe products comprise the bulk of Mexican cases brought against the US.

23 In the long-running *Oil Country Tubular Goods* NAFTA case (USA-Mex-01-1904-03 and 05), as an illustration, there were a series of Chapter 19 applications from Mexico, several of which resulted in the panel upholding most of the Commerce Department's decisions. Other cases brought by Mexican parties have also been successful in part only. The point is that these cases were mixed in terms of results, much like Softwood Lumber.

I am grateful for the very helpful comments and suggestions I received in preparing this paper from Daniel Schwanen, Jon Johnson, Gary Hufbauer and Konrad von Finckenstein.

Lawrence Herman is a principal at Toronto-based Herman & Associates. He practises international trade law and is a senior fellow of the C.D. Howe Institute.