Maine Law Review

Volume 40 | Number 2 Article 8

June 1988

Dispute Settlement Mechanisms Under the Free Trade Agreement

Ton J.M. Zuijdwijk

DISPUTE SETTLEMENT MECHANISMS UNDER THE FREE TRADE AGREEMENT

*Ton J.M. Zuijdwijk**

I. INTRODUCTION

The purpose of this paper is to review the dispute settlement mechanisms that are contained in the Canada-United States Free Trade Agreement.[1] The two countries reached agreement on the main features of the Free Trade Agreement on October 3, 1987. Thereafter, the elements of the Agreement were converted into the legal text of the Free Trade Agreement and signed by Prime Minister Mulroney and President Reagan on January 2, 1988. Legislation implementing the Free Trade Agreement has been introduced in the Parliament of Canada and in the United States Congress. In Canada the ordinary rules for legislative enactments will apply.[2] In the United States the "fast track" procedure will govern the passing of the legislation.[3] Thereafter, it is expected that the Free Trade Agreement will enter into force on January 1, 1989.[4]

The Free Trade Agreement is innovative in many areas. It goes far beyond eliminating tariffs between the U.S. and Canada; it deals, for instance, with investment (Chapter 16), services (Chapter 14), and energy (Chapter 9). In view of the considerable consequences that flow from the Agreement for both countries, it is not surprising that the dispute settlement mechanism also breaks new ground. The dispute settlement provisions of the Free Trade Agreement are contained in Chapters 18 and 19. Chapter 19 is a special chapter which deals only with dispute settlement in countervail and antidumping

---

* Senior Counsel, Legal Services, Department of Regional Industrial Expansion of Canada. LL.M., University of Leyden, Netherlands; LL.M., Columbia University; M.I.A., Columbia University; LL.B., University of Toronto; S.J.D., University of Toronto.

This paper was written in a personal capacity and does not necessarily reflect the views of the Government of Canada.

1. Canada-United States Free Trade Agreement, Jan. 2, 1988, *reprinted in* 27 INT'L LEGAL MATERIALS 281 (1988) [hereinafter Free Trade Agreement]. For the Canadian publication of the Free Trade Agreement, see CAN. DEP'T OF EXTERNAL AFFAIRS, THE CANADA-U.S. FREE TRADE AGREEMENT (1988) [hereinafter CAN. DEP'T OF EXTERNAL AFFAIRS, Free Trade Agreement].

2. Introduced in the House of Commons of Canada as Bill C-130 (the Canada-United States Free Trade Agreement Implementation Act), First reading, May 24, 1988.

3. The "fast track" procedure is set forth in 19 U.S.C. §§ 2112, 2191 (1982 & Supp. IV 1986).

4. Article 2105 of the Free Trade Agreement provides as follows: "This Agreement shall enter into force on January 1, 1989 upon an exchange of diplomatic notes certifying the completion of necessary legal procedures by each Party." Free Trade Agreement, *supra* note 1, art. 2105.

actions. It provides for binding rulings by ad hoc binational panels. Chapter 18 is the general chapter which establishes a Canada-United States Commission to monitor the implementation of the Free Trade Agreement. This Chapter also provides for dispute avoidance and dispute settlement mechanisms. The dispute settlement mechanism described in Chapter 18 provides for a ruling by an ad hoc binational panel that will not be strictly binding in international law unless both parties agree otherwise.

II. Dispute Settlement Relating to Countervail and Antidumping Claims

Although the Free Trade Agreement is a comprehensive agreement, it does not include provisions on government subsidies and unfair pricing. The General Agreement on Tariffs and Trade (GATT) and the subsequent Subsidies and Antidumping Codes,[5] elaborated in the Tokyo Round, impose discipline in these areas. Where subsidies or pricing practices are inconsistent with the GATT, other countries may impose countervail or antidumping duties.

Article 1907 of the Free Trade Agreement commits both parties to a process by which they will try to agree on rules regarding government subsidies and unfair pricing.[6] Article 1906 clearly demonstrates the intention that such rules be agreed upon no later than seven years from the effective date of the Free Trade Agreement.[7] Since Canada and the United States agreed to elaborate rules on government subsidies and unfair pricing in the future, the countervail and antidumping legislation of each country will continue to apply to the other.[8]

Article 1902, paragraph 2(a), states that for the future any amendments to United States and Canadian countervail and antidumping legislation will not apply to goods from the other party unless the legislation expressly so provides.[9] If such amendments expressly apply to goods from the other party, formal notification and, if requested by the other party, consultation are required.[10] The Free Trade Agreement requires that such amendments not be inconsistent with

---

5. *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (Subsidies Code)*, 18 Int'l Legal Materials 579 (1979); *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (Antidumping Code)*, 18 Int'l Legal Materials 621 (1979).

6. Free Trade Agreement, *supra* note 1, art. 1906.

7. *Id.*

8. *Id.* art. 1902, para. 1.

9. *Id.* art. 1902, para. 2(a).

10. *Id.* art. 1902, para. 2(b), (c).

1) the General Agreement on Tariffs and Trade, the GATT Antidumping Code and the GATT Subsidies Code; and
2) the object and purpose of the Free Trade Agreement.[11]

In support of this requirement, the Free Trade Agreement provides a procedure by which either party may obtain a declaratory ruling by a binational panel on whether any future amendment is consistent with the GATT, including the Subsidies and Antidumping Codes; whether the amendment is consistent with the object and purpose of the Free Trade Agreement; and whether the legislative amendment has the "function and effect" of overturning a prior binding decision of a panel under article 1904 (Review of Final Antidumping and Countervailing Duty Determinations).[12] The panel ruling with regard to legislative amendments is not binding. In case the panel finds that the legislative amendments do not conform to the standards set forth in the Free Trade Agreement, formal consultations are prescribed.[13] If no solution is found between the parties through consultations, article 1903, paragraph 3, provides that the party who successfully challenged the other party's legislative amendments may take "comparable legislative or equivalent executive action" or, it may terminate the Free Trade Agreement on sixty days notice.[14]

Furthermore, in recognition of the political problems that have been generated in the past through countervail and antidumping proceedings conducted before national administrative tribunals and national courts, article 1904 introduces, as an innovative feature, review by a binational panel of final countervail and antidumping duty determinations.[15] In its review the panel will apply the *national* rules of the importing country.[16]

The review mechanism for countervail and antidumping actions is set forth in Chapter 19. Article 1904 contains several interesting features worth noting: 1) private parties have an opportunity to plead their case before a binational panel (although the establishment of a binational panel has to be initiated by either of the two Governments);[17] 2) the decision of a panel is binding on the United States

---

11. *Id.* art. 1902, para. 2(d)(i), (ii).

12. *Id.* art. 1903, para. 1(a), (b). *See infra* notes 22-33 and accompanying text for a discussion of the rules concerning the establishment of such a panel. The rules on the establishment of binational panels are set forth in Annex 1901.2 of the Free Trade Agreement. The panel procedures under Article 1903 are set forth in Annex 1903.2.

13. Free Trade Agreement, *supra* note 1, art. 1903.

14. *Id.* art. 1903, para. 3(a), (b).

15. *Id.* art. 1904, paras. 1, 2.

16. *Id.* art. 1904, paras. 2, 3 (emphasis added).

17. *Id.* art. 1904, para. 7. Article 1904, paragraph 5, states, "Either Party on its own initiative may request review of a final determination by a panel and shall, upon request of a person who would otherwise be entitled under the law of the importing

and Canada;[18] 3) the binational panel will apply the national standards of review of the importing party;[19] and 4) precise time limits will be incorporated into the rules of procedure for the binational panels so that a final decision will be reached within 315 days from the date on which either party makes a request for the establishment of a panel.[20] The United States and Canada have undertaken to establish permanent Secretariat offices in Washington and Ottawa, respectively, to facilitate the operation of the panel procedure relating to countervail and antidumping.[21]

The procedure to establish binational panels is set forth in detail in Annex 1901.2 of the Free Trade Agreement.[22] A roster of fifty candidate panelists will be established; the United States and Canada will each appoint twenty-five citizens of their respective countries. Apart from the citizenship requirement, the Free Trade Agreement mandates: "Candidates shall be of good character, high standing and repute, and shall be chosen strictly on the basis of objectivity, reliability, sound judgment, and general familiarity with international trade law."[23] Furthermore, the candidates must not be "affiliated with either Party."[24] Judges from Canada and the United States are expressly declared not to be "affiliated with either Party" and therefore are eligible to be placed on the roster.[25] A five-member panel will hear the appeal or review of the countervail or antidumping decision,[26] and a majority of the panelists on each panel must be lawyers in good standing.[27]

Normally the parties will appoint panelists from the roster, but outside panelists meeting the same requirements may be appointed instead.[28] Each side has the right to make four peremptory challenges to candidates proposed by the other side.[29] If a party fails to appoint its two members within thirty days, or if a candidate is eliminated as a result of a peremptory challenge and no alternative panelist is selected within forty-five days, the remaining panelists

---

Party to commence domestic procedures for judicial review of a final determination, request such review." *Id.* art. 1904, para. 7.

18. *Id.* art. 1904, para. 9.

19. *Id.* art. 1904, paras. 2, 3.

20. *Id.* art. 1904, para. 14.

21. *Id.* art. 1909. There is a potential role for the Secretariat under Chapter 18 insofar as article 1909, paragraph 7, provides that the Secretariat may provide support for the Canada-United States Commission, established under Chapter 18, article 1802, if the Commission so directs. *Id.*

22. *Id.* Annex 1901.2.

23. *Id.* Annex 1901.2, para. 1.

24. *Id.*

25. *Id.*

26. *Id.* Annex 1901.2, paras. 2, 3.

27. *Id.* Annex 1901.2, para. 2.

28. *Id.*

29. *Id.*

will be selected by lot from that party's candidates on the roster.[30] The parties must jointly decide on the selection of a fifth panelist. If they are unable to agree, the four appointed panelists must select the fifth panelist by lot from the roster excluding candidates eliminated by peremptory challenges.[31] Once the fifth member of the panel has been appointed, the panelists must select, by majority vote, a chairperson from the lawyers on the panel.[32] If they cannot agree on a chairperson, one will be appointed by lot from among the lawyers on the panel.[33] The panel will make all decisions by majority vote, in writing and with stated reasons,[34] including any concurring and dissenting opinions.[35]

While the panel ruling under Chapter 19 is binding on the parties, the Free Trade Agreement provides for an extraordinary challenge procedure, which is in essence an appeal on limited grounds to a binational panel of three judges or former judges.[36] If either party alleges that a panel procedure was seriously flawed, it may have the case heard by an extraordinary challenge committee, made up of three judges or former judges. Each nation's government will appoint one member of the committee. The member must be selected from a special roster established pursuant to Annex 1904.13. This roster is made up of ten judges or former judges, five each from Canada and the United States. The two members of the committee appointed by Canada and the United States must then choose a third member from the roster. If they cannot decide, the appointment will be made by lot from the roster.[37]

The extraordinary challenge committee must decide if the panel's decisionmaking process was seriously flawed. The criteria for making this determination are set forth in article 1904, paragraph 13:

> a) i) a member of the panel was guilty of gross misconduct, bias, or a serious conflict of interest, or otherwise materially violated the rules of conduct,
> ii) the panel seriously departed from a fundamental rule of procedure, or
> iii) the panel manifestly exceeded its powers, authority or jurisdiction [as set forth in article 1904], *and*
> b) any of the actions set out in subparagraph (a) has *materially affected* the panel's *decision* and *threatens the integrity* of the binational panel review process . . . .[38]

---

30. *Id.*
31. *Id.* Annex 1901.2, para. 3.
32. *Id.* Annex 1901.2, para. 4.
33. *Id.*
34. *Id.* Annex 1901.2, para. 5.
35. *Id.*
36. *Id.* art. 1904, para. 13, Annex 1904.13.
37. *Id.* Annex 1904.13, para. 3.
38. *Id.* art. 1904, para. 13(a), (b) (emphasis added).

The decision of the extraordinary challenge committee is binding on both nations. If the committee finds that one of the grounds has been established, it has the option to vacate the panel decision, followed by a new panel procedure, or to remand it to the panel "for action not inconsistent with the committee's decision."[39] If the committee finds that none of the grounds of article 1904, paragraph 13, has been established, then it will confirm the panel's decision.[40]

III. Other Dispute Settlement Mechanism(s)

While a *binding* form of dispute settlement has been established with regard to countervail and antidumping claims (albeit that an international panel applies the standard of review of the importing party), the rest of the Free Trade Agreement, with the exception of the Chapters on Emergency Action (Chapter 11) and on Financial Services (Chapter 17), is subject to a *non-binding* form of dispute settlement set forth in Chapter 18. Chapter 17 (Financial Services) is exempted from the dispute settlement mechanism of Chapter 18. Chapter 11 (Emergency Action) is expressly made subject to a *binding* form of arbitration under Chapter 18.[41] It should be appreciated that much of Chapter 18 is devoted to dispute avoidance rather than dispute settlement, and that Chapter 18 is entitled "Institutional Provisions" rather than "Dispute Settlement." In this connection it is useful to look at the role of the Canada-United States Trade Commission established under the Free Trade Agreement.

Article 1802 establishes a Canada-United States Trade Commission (the Commission).[42] Generally, its role is that of monitoring the implementation of the Free Trade Agreement. However, the Commission is also given the express mandate to resolve disputes that may arise over the interpretation and application of the Free Trade Agreement.[43] The Commission, based on the model of mixed commissions found in many bilateral treaties, is made up of representatives of the two parties to oversee the implementation of the Free Trade Agreement. The principal representatives of the parties will be the Minister for International Trade of Canada and the United States Trade Representative, but participation by other ministers or

39. *Id.* art. 1904, Annex 1904.13, para. 3.

40. *Id.*

41. The scope of dispute settlement is set forth in article 1801, paragraph 1, of the Free Trade Agreement. There are, however, other specific provisions elsewhere in the Free Trade Agreement that deal with dispute settlement. Article 1608, paragraph 1, exempts from the mechanism of Chapter 18, decisions by Canada on foreign investment following review under the Investment Canada Act. Article 1504, paragraph 2, restricts the applicability of Chapter 18 with respect to questions that may arise under Chapter 15 (Temporary Entry for Business Purposes). On matters arising under Chapter 11 (Emergency Action), see article 1806, paragraph 1.

42. *Id.* art. 1802, para. 1.

43. *Id.*

cabinet members is not precluded.[44]

Chapter 18 contains a notification procedure by which a party undertakes to provide written notice to the other party of "any proposed or actual measure that it considers might materially affect the operation of this Agreement."[45] This is a useful mechanism to avoid disputes in that it gives the other side advance warning of potential problems.[46] The notification provision ought to be read in conjunction with the provision on consultations in article 1804. Once a measure has been notified, the other party may ask further questions[47] and/or request formal consultations under article 1804.[48] Notification is *not* a prerequisite for consultations. Either party may request consultations concerning any measures taken by the other side affecting the operation of the Free Trade Agreement, regardless of whether such measures had previously been notified.[49] Should such a matter not be resolved through consultations, either party may refer the matter to the Commission.[50] If the matter cannot be settled, the Commission may refer a disagreement to binding arbitration but only if *both* governments agree.[51] As to disagreements concerning Chapter 11 (Emergency Action), there is no discretion in the Commission: the Commission *has to* refer such a matter to *binding* arbitration.[52]

Chapter 18 also establishes a procedure for *non-binding* arbitration. A roster of potential panelists is set up, similar to the one established pursuant to Chapter 19. Normally, the panelists will be chosen from the roster. Article 1807 sets forth the criteria panelists must meet to be appointed: "In all cases, panelists shall be chosen strictly on the basis of objectivity, reliability and sound judgment and, where appropriate, have expertise in the particular matter under consideration. Panelists shall not be affiliated with or take in-

---

44. *Id.* art. 1802, para. 2.

45. *Id.* art. 1803, para. 1.

46. This mechanism has been successfully used under the Canada-USA Memorandum of Understanding as to Notification, Consultation and Cooperation with respect to the Application of National Anti-Trust Laws, *reprinted in* 23 INT'L LEGAL MATERIALS (1984). The present Anti-Trust Memorandum of Understanding was signed on March 9, 1984. Earlier Understandings were reached in 1959 and 1969. The first Understanding was reflected in a statement by the Honourable E.D. Fulton, Minister of Justice of Canada, in the House of Commons of Canada. *See* 1 PARL. DEB., CAN. H.C. (1959) 617-19. The second Understanding was reflected in a Joint Statement, Canada-United States: Joint Statement on Cooperation in Anti-trust Matters, *reprinted in* 8 INT'L LEGAL MATERIALS 1305 (1969).

47. Free Trade Agreement, *supra* note 1, art. 1803, para. 3.

48. *Id.* art. 1804, para. 1.

49. *Id.*

50. *Id.* art. 1805, para. 1.

51. *Id.* art. 1806, para. 1.

52. *Id.*

structions from either Party."[53]

The procedure for establishing a panel is similar to that of Chapter 19: both parties appoint two panelists, and the Commission will attempt to agree on the fifth member, who will chair the panel. Provision is made for the unlikely situation in which one government does not appoint its two members; such panelists will be selected by lot from that government's citizens on the roster. If the United States and Canada cannot agree on a chairperson, the four appointed panelists will decide on the fifth panelist. If the four cannot agree, then the fifth panelist will be selected by lot from the roster.[54]

A panel under Chapter 18 is also expected to assume the role of a conciliator. Following the hearings, the panel will present the parties with "an initial report." This report must contain: 1) the panel's findings of fact; 2) its determination as to whether the measure at issue is or would be inconsistent with the obligations of the Free Trade Agreement, or cause nullification or impairment in the sense of article 2011; and 3) its recommendations, if any, for the resolution of the dispute.[55]

At this point it may be useful to elaborate on article 2011 (Nullification and Impairment). The term "nullification and impairment" comes from article XXIII of the GATT. It provides GATT members with an opportunity to argue that other countries have unjustly withheld benefits, even if the members cannot invoke a violation of a specific GATT provision.[56] Article 2011 is similar in nature. It provides, in paragraph 1, that "[i]f a Party considers that the application of any measure, *whether or not such measure conflicts with the provisions of this Agreement*, causes nullification or impairment of *any benefit reasonably expected to accrue to that Party, directly or indirectly under the provisions of this Agreement . . .*," that party may invoke the consultation and dispute settlement mechanisms of Chapter 18.[57]

Coming back to the procedural aspects, the panel must, where feasible, give the parties an opportunity to comment on the preliminary findings of fact before the initial report is produced in full.[58] Once the initial report has been produced, if either government disagrees with any part of the report, it may present its objections to the Commission in writing.[59] The panel may thereafter invite the views of both parties, reconsider its report, examine further aspects

53. *Id.* art. 1807, para. 1.

54. *Id.* art. 1807, para. 3.

55. *Id.* art. 1807, para. 5.

56. *See* J.H. JACKSON, LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 425 (1977).

57. Free Trade Agreement, *supra* note 1, art. 2011, para. 1.

58. *Id.* art. 1807, para. 5.

59. *Id.* art. 1807, para. 6.

of the matter, and issue a final report, which only then becomes a *public document.*[60] Either government may request that its written views be published simultaneously.[61]

The parties are not under a legal obligation to comply with the ruling of the panel. Article 1807, paragraph 8, states that "[u]pon receipt of the final report of the panel, the Commission shall agree on the resolution of the dispute, which *normally* shall conform with the recommendation of the panel."[62] The paragraph goes on to say that "[w]henever possible, the resolution shall be non-implementation or removal of a measure not conforming with [the Free Trade Agreement], or causing nullification or impairment in the sense of Article 2011 or, failing such a resolution, compensation."[63]

Should the parties fail to agree upon a solution, then the party who considers that fundamental rights or benefits under the Free Trade Agreement are being withheld, may suspend application of "benefits of equivalent effect" to the other party.[64] An analogous provision exists in the GATT, where the ultimate sanction is the withdrawal of benefits by other parties.[65]

Disagreements to which Chapter 18 applies might, in the alternative, be resolved under the GATT dispute settlement mechanism if any of the substantive rules of GATT apply. Article 1801 leaves open this possibility.[66] Once a party initiates either the Free Trade Agreement dispute settlement provisions or the GATT dispute settlement mechanism, however, the procedure chosen will be used "to the exclusion of any other."[67]

In the context of a comparative analysis of the different dispute settlement mechanisms of the Free Trade Agreement, article 1808 should also be considered. Article 1808 mentions the possibility of both parties to the Free Trade Agreement agreeing on the interpretation of certain clauses of the Free Trade Agreement and putting these agreed positions forward in judicial or administrative proceedings where the interpretation of such clauses is at issue.[68] Through joint intervention in judicial or administrative proceedings of either country, the parties to the Free Trade Agreement may be able to prevent disputes that might otherwise arise from the unilateral interpretation of certain clauses of the Free Trade Agreement and cor-

60. *Id.* art. 1807, paras. 6, 7. The Commission has the option *not* to publish the final report.

61. *Id.* art. 1807, para. 7.

62. *Id.* art. 1807, para. 8.

63. *Id.*

64. *Id.*

65. General Agreement on Tariffs and Trade, Oct. 30, 1947, art. 23, 61 Stat. A3, A64-A65, T.I.A.S. No. 1700, 55 U.N.T.S. 187, 266, 268.

66. Free Trade Agreement, *supra* note 1, art. 1801, para. 2.

67. *Id.* art. 1801, para. 3.

68. *Id.* art. 1808, para. 1.

responding Canadian or United States domestic legislation.

IV. CONCLUSIONS

The Free Trade Agreement provides many useful examples of alternative dispute resolution mechanisms. First of all, the drafters of the Free Trade Agreement have gone to great lengths to build mechanisms and procedures to prevent, rather than to resolve, disagreements and disputes. The mechanisms of notification and consultation are very useful in this regard.

As to the dispute settlement mechanisms, the drafters of the Free Trade Agreement have produced a carefully balanced mix of procedures resulting in legally binding and non-legally binding rulings. The review by a binational panel of countervail and antidumping measures under Chapter 19 and of safeguard measures under Chapter 18 will produce rulings binding in international law. The other panel rulings will not be binding in international law unless both parties have agreed otherwise before the panel is established. The drafters of the Free Trade Agreement have, however, done their utmost to indicate in the text of the Agreement that such rulings *normally* should be followed.

Like the other areas of the Free Trade Agreement, the provisions on dispute settlement are the result of compromise, but I submit it is a *good* compromise, well thought out and based on the common experience of Canada and the United States in the GATT and under other instruments such as the Canada-United States Anti-Trust Memorandum of Understanding.[69]

With the political will of both governments making the Free Trade Agreement work, recourse to the panel procedures of the Free Trade Agreement should be rare. Canada and the United States have had a long tradition of settling disagreements through diplomacy and bilateral consultations. There is also, however, a long tradition of the United States and Canada resorting to dispute settlement procedures for disputes that cannot be resolved through diplomacy.[70] The dispute settlement provisions of the Free Trade Agreement reinforce that tradition and will serve Canada and the United States well should the need to settle any disagreements arise in the future.

---

69. *See supra* note 46.

70. *See generally* Wang, *Adjudication of Canada-United States Disputes*, 19 CAN. Y.B. INT'L L. 158 (1981).