



LUMBER AND THE NAFTA CHAPTER 19 MESS

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Lessons from NAFTA Part I: The Softwood Lumber Dispute

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It is a great honor to be here, speaking on this topic at this time and in such illustrious company. I have been asked to speak briefly about the lumber dispute, and about Chapter 19 and its constitutionality.

Tonight's event is part of a series on "Lessons from NAFTA." To begin on that broader plane, I must say that I remain mystified – by the bitterness of the controversy NAFTA generated in 1993 and especially by the indigestion it has continued to cause over the ensuing dozen years. From an overall U.S. perspective, expanding the bilateral FTA relationship with Canada to include Mexico was a good idea and has had good results. Those points are not legitimately disputable – and yet they remain hotly disputed. One problem is that proponents insisted it was a *fabulous* idea and predicted *fabulous* results. That was never realistic, and it continues to give opponents today more ammunition than they ought to have. I hope we have learned, or will soon learn, the lesson about over-promising in the trade arena.

A good idea with good results: this does not mean, of course, that everything about the NAFTA was perfect. It contains a couple of, in my view, foolish mistakes. Chapter 19 is one of those. And it left some significant bilateral problems unsolved. The Softwood Lumber dispute is one of those.

I. The Lumber Dispute

On the lumber matter generally, just a few points. I have been a bit player in this dispute over the years, never slogging it out in the trenches as so many others have done. The case arises mainly from differing forestry management systems which give rise to sharply different input costs for lumber producers above and below the border. The U.S. lumber industry characterizes the Canadian approach as including a large element of subsidy, and, speaking as a subsidies geek, I agree. Canadian provinces provide a financial contribution to lumber producers by selling them stumpage rights, and a benefit by charging too little ("less than adequate remuneration"). The subsidy has significant output effects and can be criticized on environmental grounds as well. And U.S. economic actors affected by this subsidy are powerless to affect it by voting. Nor can they travel north to buy the cheap inputs themselves; a log export ban precludes that. This is one of many examples of how the border remains quite relevant notwithstanding the FTA relationship.

As for trade effects more specifically – that is, material injury to competing US producers and the causal role of subsidized imports – I can offer you little enlightenment, but we are fortunate to have Kevin Dempsey here tonight who has

probably forgotten more in this area than most people will ever know. There's also very little I can tell you about the dumping claims, which are new in this current round (the fourth) of lumber litigation. But the idea that the import relief obtained by the U.S. industry might go away because of *de minimis* subsidy findings is truly stunning to anyone familiar with the Canadian forestry system. The subsidy here is more obscure than some and harder to calculate than most – but it is not *de minimis*.

Of course, the Commerce Department doesn't think the subsidy is *de minimis* either. But Commerce doesn't have the last word here. A binational panel composed of U.S. and Canadian private sector trade law experts has forced Commerce to issue a *de minimis* finding that Commerce thinks is wrong. How, you may wonder, could *that* have happened?

II. The Chapter 19 System -- Its Origins and Nature

The Chapter 19 system was devised as a compromise when Canada during FTA negotiations asked to have its U.S.-bound exports exempted from the operation of the U.S. antidumping and countervailing duty laws. Unable to win a full exemption, Canadian negotiators asked for different decision-makers at the agency level, and when that too failed to gain traction, they accepted the U.S. government's offer to substitute a different appellate review scheme. Judicial review of agency determinations involving Canadian merchandise would now be replaced by a different type of appellate review, applying (notionally) the same legal standards but in an entirely different setting.

The premise was that the Article III courts otherwise charged with reviewing agency determinations under these laws – the U.S. Court of International Trade and its reviewing courts – were either too lax in their supervision of agency actions, or operated too slowly, to do their work in a sufficiently fair and prompt manner. As an FTA partner, Canada insisted, it should get something “better.”

Seen in this light, the Chapter 19 system is a startling affront to the Article III judiciary. It removes the affected appellate processes from the protected environment guaranteed by Article III, and into a different environment where (Canadian officials must have assumed – and they have been proven right) political and financial pressures can influence outcomes. For those who wonder why the forum matters, Article III provides structural guarantees of judges' independence and impartiality, including life tenure and protection against salary diminution. These factors are important in creating a forum in which citizens and government can litigate against each other on a level playing field.

You can have a legitimate argument about whether FTA partners should get special treatment under antidumping and countervailing duty law. For the most part, governments around the world have answered that question in the negative, as very few FTAs provide such special treatment. Personally, I do not believe that an FTA which does not remove the causes of an illness should tinker with the contracting governments' right to apply a cure. But, wherever you come out on

this question, it is hard to justify the specific technique of substituting a new appellate mechanism. The U.S. government seems to have recognized this by declining to replicate Chapter 19 in the many FTAs negotiated since the NAFTA.

Why? There are good reasons, and numerous precedents, for entrusting international panels to decide questions of international law; after all, when the meaning of an international agreement is disputed, it hardly makes sense to let the matter be resolved by an organ of one disputing party. But the Chapter 19 system gives international panels a task for which they are not even arguably well-suited – interpreting and applying national law. Deciding whether a challenged agency determination conforms to the “substantial evidence” standard or is otherwise contrary to U.S. law – daunting even for locally-trained jurists -- is not the sort of task for which a binational or international body can possibly be expected to have the right expertise.

Indeed, properly understood, the disputes at issue here are not international disputes at all but entirely domestic ones. On one side sits the U.S. government whose findings have been challenged. On the other side sits either a domestic taxpayer (it is after all the importer of record, a U.S. entity, whose duty liability is at issue) or a domestic industry interested in maintaining import relief that has been provided for by statute.

The Chapter 19 system empowers panels of foreigners and private citizens to decide these disputes, with no possibility of court review at any point in the process. It replaces judges who are subject to Senate confirmation and thereafter have life tenure, protection from salary diminution, and other guarantees of independence, with (for the most part) practitioners who regularly appear as advocates before the very agencies whose determinations are at issue. These individuals are screened for technical expertise but not for judicial temperament or any of the other characteristics typical of Article III judges. In practice they have yielded too readily to the understandable (but not excusable) tendency of advocates named “judge for a day” to be over-zealous, to substitute their own judgment for that of the investigating agencies, and generally to re-do, rather than deferentially review, the investigating agencies’ work. I won’t recite the litany of panel errors here, but they are serious and involve both factual determinations and legal interpretations. Allegations of personal and/or issue conflicts have also surfaced with disturbing regularity. And the ECC mechanism has served little purpose except to highlight some of the more glaring panel errors and then leave them uncorrected.

As you will doubtless hear other speakers emphasize tonight, the political branches of the U.S. government agreed on this Chapter 19 approach. Maybe the U.S. officials at the time honestly believed that binational panels would replicate (more speedily) the results the Article III judiciary would have delivered, or maybe they secretly intended to give what Canada really wanted – more freedom to ship dumped and subsidized merchandise without facing offsetting remedies. Either way, they chose an unwise method to effectuate their wishes. Is that method also unconstitutional?

III. Constitutionality

All I can really do here is give you a flavor of the constitutional arguments regarding Chapter 19, saving perhaps a little bit of detail for Q&A. There is a vast law review literature on this subject, focusing mainly on whether the Chapter 19 system satisfies the conditions laid out in U.S. precedents on non-Article III adjudication, and on whether it violates the Appointments Clause in Article II. I personally agree with both the Art. III and Appointments Clause arguments against Chapter 19, and I say this bearing in mind the presumption of constitutionality that attaches when the government's political branches act in concert as they did here.

Article III: There have been various efforts over the years to move categories of cases (*e.g.*, bankruptcy disputes, broker-dealer counterclaims) out of the Article III judiciary, yielding a line of precedents on non-Article III adjudication under which the complete preclusion of judicial review is almost by definition unconstitutional. The need for some recourse to Article III courts seems to be taken for granted; the question typically is what degree of deference courts should show to non-Article III decisions. The Chapter 19 system, however, permits no role whatsoever for Article III courts. One leading case, *CFTC v. Schor* (1986), recognizes the right of litigants to have claims heard at some point by a judge who is “free from potential domination by other branches of government” (*i.e.*, by an Article III judge), and also articulates a “balancing test” which seems likely to be very difficult for the Chapter 19 system to pass.

It is worth recalling again that AD/CVD disputes are, at bottom, over taxes. Somewhere there is an importer of record whose duty (tax) liability will either rise, fall, or disappear. I believe it was mainly to ensure an appropriately neutral forum for hearing tax cases that the Founders originally devised the structural protections found in Article III.

Appointments clause: It also seems plain that panelists in the Chapter 19 system, although seated temporarily for one case at a time, exercise “significant authority” under U.S. laws and thus qualify as “officers” for Appointments Clause purposes. But they are not installed consistently with the Appointments Clause requirements. The appointment of Chapter 19 panelists follows neither the path for “principal” officers, who are subject to Senate confirmation, nor that for “inferior” officers, who can be “appointed by the President alone, by the heads of departments, or by the Judiciary.” This problem was first identified, I believe, by the Reagan Administration's Justice Department during 1988 congressional hearings on the Canada-US FTA. In practical terms, the Chapter 19 system delegates the appointment function in a way that frustrates political accountability. Supreme Court precedents show little sympathy with such tactics.

Due process: The current constitutional challenge includes a third claim that has (to my knowledge) attracted little attention in the literature but might play a surprisingly prominent role in the outcome: that the Chapter 19 system violates the 5th Amendment's Due Process clause because it allows import relief, in which

domestic firms attain a “property interest,” to be removed without a hearing by a neutral and detached decision-maker. This claim raises numerous uncomfortable questions, such as whether panelists might feel pressure to rule in favor of the party that appoints them and pays them for serving; whether they may have a pecuniary incentive to issue certain types of rulings in order to increase the likelihood of being named again in the future; and whether panelists who are also practitioners may be able to serve despite the presence of significant issue conflicts. The U.S. lumber industry, in its court papers, has correctly noted that NAFTA Annex 1901.2(6) allows even a provably conflicted panelist to be removed only with the consent of both governments involved.

IV. Lessons from NAFTA?

Returning now to the broader program theme, the most important “lesson learned” is that negotiators should work until they reach substantive agreement in any given area rather than papering over disagreement with an international dispute mechanism that is not backed up with any international rules.

Interestingly, the tactic used in Chapter 19 was in essence replicated in the NAFTA’s labor and environmental side agreements. In these areas, too, common standards and real government-to-government obligations could not be agreed (at least not with Mexico), but rather than leave these issues out of the agreement as one might have expected, negotiators felt compelled to “do something” and so erected a binational apparatus tasked with deciding whether domestic law has at least been “correctly” applied. Both in theory and in practice, the results are no more pleasing than those of Chapter 19.

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It was a great honor to appear here today, and I look forward to your questions.