

## North American Free Trade Agreement, Dispute Settlement

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### A. The Dispute Settlement Mechanisms

- 1 The → *North American Free Trade Agreement (1992)* ('NAFTA') incorporates three distinct dispute settlement mechanisms within the main text of the agreement, and several additional mechanisms in its supplementary agreements.

#### 1. NAFTA Chapter 20

- 2 The principal dispute settlement mechanism is established by Chapter 20 of the NAFTA. This mechanism permits each of the State parties—ie, Canada, Mexico, and the US—to bring a claim against another regarding interpretation and application of the agreement. This mechanism is not open to private party claimants. Chapter 20 dispute settlement is in the nature of traditional ad hoc international → *arbitration*.
- 3 With respect to subject matter that is covered both by the NAFTA and the → *World Trade Organization (WTO)* agreements, the complaining party generally has the option to decide the dispute settlement forum in which it will initiate its complaint. Once the selection of forum has been made by the complaining party, that forum is the exclusive one for resolution of the dispute (Art. 2005 (6) NAFTA). That is not true, however, in relation to complaints under Section B Chapter Seven (Sanitary and Phytosanitary Measures) or Chapter Nine (Standards-Related Measures):
  - (a) concerning a measure adopted or maintained by a Party to protect its human, animal or plant life or health, or to protect its environment, and
  - (b) that raises factual issues concerning the environment, health, safety or conservation, including directly related scientific matters (Art. 2005 (4) NAFTA).
- 4 In such cases, the complained-against party may demand that a complaint be pursued under NAFTA Chapter 20. The right to require that dispute settlement with respect to environment, health, and safety matters be decided under Chapter 20 reflects that different rules with respect to dispute settlement may be prescribed by NAFTA and the WTO agreements. Most specifically, the NAFTA Chapters on sanitary and phytosanitary measures and technical standards expressly place on the complaining party the burden of proving that a complained-against measure is inconsistent with the agreement. While this may be consistent with present jurisprudence of the WTO Appellate Body, it was not clear at the time NAFTA was negotiated what the WTO rule would be, nor how that rule would be interpreted (see also → *International Courts and Tribunals, Rules and Practice Directions [ECJ, CFI, ECtHR, IACtHR, ICSID, ITLOS, WTO Panels and Appellate Body]*).
- 5 It is evident that there exists the possibility for conflicting decisions by the WTO dispute settlement bodies and NAFTA panels. Conflict may arise with respect to the same disputed subject matter. The WTO Understanding on Rules and Procedures Governing the Settlement of Disputes of 15 April 1994 (in WTO *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts* [GATT Secretariat Geneva 1994] 354–379) does include a forum selection provision comparable to that of NAFTA Chapter 20. WTO rules do not prevent a NAFTA party from initiating a dispute at the WTO notwithstanding that it initiated, or completed, under Chapter 20. From a substantive standpoint, there is no specific rule mandating that NAFTA panels follow WTO dispute settlement precedent. Nonetheless,

NAFTA dispute settlement decisions so far reflect considerable attention to WTO jurisprudence and efforts to achieve consistency. The WTO Appellate Body is not bound to follow NAFTA dispute settlement decisions, and so far the Appellate Body has not been of a mind to incorporate regional dispute settlement jurisprudence—NAFTA or otherwise—into its decision-making. In any event, as of mid-2009 there is no serious manifestation of problems arising from the complementary dispute settlement systems of the NAFTA and WTO, but of course this does not assure that such problems will not eventually arise.

- 6 The NAFTA generally permits each party to maintain its antidumping and countervailing duty rules, and subjects the application of those rules to review under Chapter 19 (discussed below). Nonetheless, these rules do not preclude a NAFTA party from challenging the WTO-consistency of antidumping or countervailing duty measures of other parties.
- 7 Chapter 20 provides for an initial period of → *consultation* during which the parties are encouraged to find an amicable solution to the subject matter of the dispute. If consultations do not resolve the matter, either party may request a meeting of the Free Trade Commission for the purpose of engaging its → *good offices* to encourage an amicable settlement. If neither consultations nor the good offices of the Commission are successful, the complaining party may seek establishment of a dispute settlement panel.
- 8 Five panellists are selected, preferably from a roster of 30 panellists to be agreed by consensus of the parties. As of 15 January 2009 this roster had not been agreed upon. The parties should endeavour to agree upon the presiding panellist. In the absence of agreement one of the parties selected by lot appoints the presiding panellist, who may not be a national of that party. Because the parties have not established an agreed-upon roster of panellists, the establishment of panels has been substantially delayed by negotiation of the five-member panels. Chapter 20 permits the parties to agree upon specific terms of reference for a dispute, but it also provides standard terms of reference.
- 9 Chapter 20 panels are directed to make findings and recommendation to the disputing parties. A party which is found to have acted inconsistently with the agreement is encouraged to bring its measures into conformity with the agreement. Chapter 20 decisions are not directly enforceable in the law of the parties. If a complained-against party fails to bring its measures into conformity, the complaining party may withdraw trade concessions equivalent to the level of impairment. A panel may be requested and convened to determine whether the level of suspension of concessions is ‘manifestly excessive’.
- 10 There is no appeal mechanism in the Chapter 20 arrangement. A party which considers that a decision has been wrongly taken against it may refuse to enforce it, leaving the other party to withdraw concessions.
- 11 As of November 2009, only three panel decisions had been rendered under the Chapter 20 procedure (see para. 23 below).
- 12 The ad hoc nature of Chapter 20 proceedings and the absence of direct enforceability of decisions ameliorate potential constitutional and political concerns in the parties about potential loss of sovereignty by the national courts. Art. III US Constitution provides that the judicial power of the US will be vested in the Supreme Court and in such inferior courts as the Congress may establish. This Constitutional provision, as well as a provision giving the Senate right to approve certain federal appointments by the President, has been argued in treaty approval debates, and in the courts, to preclude reliance upon foreign judicial or arbitral bodies for the resolution of disputes involving the federal government. Although US courts have never determined such reliance to contravene the Constitution, and such claims have been brought based upon the NAFTA, the absence of direct enforceability helps to avoid some difficult legal and political issues.

## **2. NAFTA Chapter 19**

- 13 In Chapter 19, the NAFTA establishes a distinct dispute settlement system for complaints involving antidumping (‘AD’) and countervailing duty (‘CVD’) measures. The substantive rules of the NAFTA with respect to AD/CVD, also found in Chapter 19, require only that the parties properly apply their own national rules in AD/CVD proceedings. However, Chapter 19 requires each party to authorize binational review under Chapter 19 as an alternative to judicial review of AD/CVD administrative determinations that would otherwise be available to an involved party, or to an involved private party. In this system, a party may bring a claim alleging that the complained-against party failed to properly apply its own AD/CVD laws in a particular case. State parties must authorize private parties that were involved in the underlying

national AD/CVD proceeding to require that the government initiate a Chapter 19 claim. Once the proceeding is initiated—whether on demand of an involved private party or not—a private party involved in the underlying national proceeding is entitled to appear and be represented by counsel before the Chapter 19 panel. As of 15 July 2009, approximately 60 Chapter 19 decisions had been rendered.

- 14 Unlike the results of NAFTA Chapter 20 dispute settlement proceedings, decisions of five-member Chapter 19 panels are directly enforceable as against the administrative authorities which render the initial decision. Therefore, if a national administrative authority in a party is found to have improperly applied its national rules, the panel may direct the administrative authority to revise its decision or undertake further proceedings consistent with the panel report. It is possible that the revised national administrative decision will be subject to further review by the Chapter 19 panel.
- 15 Also unlike Chapter 20, Chapter 19 establishes a mechanism for appeal of panel decisions, but only on very limited grounds. A party must allege:
- (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 set out in this Article, for example by failing to apply the appropriate standard of review, 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 (Art. 1904.13 NAFTA).
- 16 The so-called 'extraordinary challenge procedure' is heard by a panel of three members of an 'extraordinary challenge committee' selected from a roster of 15 judges or former judges from the federal level of each party—five such roster members coming from each party. This committee roster has been established. Although several extraordinary challenge procedures have been initiated, none has resulted in a finding against the panel; although in one such challenge the panel was found to have exceeded its authority in a way that materially affected its decision, but did not threaten the integrity of the binational panel review process (*Pure Magnesium from Canada*).

### 3. NAFTA Chapter 11

- 17 The third, and so far the most controversial of the NAFTA dispute settlement mechanisms, is the Chapter 11 investor-to-State mechanism (→ *Investment Disputes*). Pursuant to Chapter 11, a private investor from a party is permitted to forgo national court challenge of an alleged → *expropriation* or unlawful taking of an investment in another party (ie, diversity of nationality) and to initiate a claim against the host government at the → *International Centre for Settlement of Investment Disputes (ICSID)* (including under the Additional Facility) or under the rules of the → *United Nations Commission on International Trade Law (UNCITRAL)*. There is no requirement to exhaust local remedies (→ *Local Remedies, Exhaustion of*). However, when an investor initiates a Chapter 11 proceeding, it must waive its right to further proceedings in the national courts, except for limited circumstances, such as petition for injunction.
- 18 The law of unintended consequences has operated in respect to Chapter 11. Trade negotiators for the US considered the Chapter 11 investor-to-State dispute settlement procedure as a means to provide security for US investors concerned about the legal infrastructure in Mexico. What these negotiators did not foresee was that private investors from Canada and Mexico would use the procedure to challenge the integrity of US legislative and judicial processes with respect to matters such as changes in environmental legislation or due process in State judicial proceedings. → *Non-Governmental Organizations* ('NGOs') representing environmental interests have been particularly critical of a threat that they allege the Chapter 11 system poses to legitimate government regulatory interests. NGOs are not alone in criticizing Chapter 11. State, provincial, and municipal governments in the three parties have been subject to challenge through the Chapter 11 process, and have expressed concerns to their respective federal authorities. The three NAFTA governments have evidenced interest in finding a mechanism to limit the scope of Chapter 11 proceedings, but so far—as of 15 July 2009—they have not taken significant action. An interpretation was adopted by the Free Trade Commission in 2001 which clarified the standards of public international law to be applied in proceedings, but this was not a material change.

## B. The North American Agreement on Environmental Cooperation and the North American Agreement on Labor Cooperation

- 19 In addition to the settlement mechanisms established under the main text of the NAFTA, the Supplemental Agreements on the Environment and Labor each include dispute settlement mechanisms (→ *Environmental Dispute Settlement*; → *Labour Law, International*).
- 20 Pursuant to the → *North American Agreement on Environmental Cooperation (1993)* ('NAAEC'), each party has an obligation to effectively enforce its own environmental laws. The NAAEC authorizes a party to initiate a proceeding against another party on grounds that the latter has persistently failed to effectively enforce its own environmental laws. Under this procedure the NAAEC Council, by a 2/3 vote, may decide that a panel of five expert arbitrators, to be drawn from a roster of 45 candidates selected by consensus, will be established to decide a dispute. The panel will examine allegations concerning a persistent pattern of failure to enforce environmental laws and, upon a finding of violation, the panel's recommendation 'normally shall be that the party complained against adopt and implement an action plan sufficient to remedy the pattern of non-enforcement' (Art. 31 (2) (c) NAAEC). If the parties are unable to agree on an action plan, and if the panel finds that the losing party's proposed plan is inadequate, a plan may be imposed by the panel. If a party is found by a panel to have failed to implement the approved action plan, then the panel shall impose a monetary penalty against that party. The maximum amount of potential monetary penalty is .007% of the total trade between the parties during the most recent year for which data is available. The monetary penalty is to be paid into a fund to 'be expended at the direction of the Council to improve or enhance the environment or environmental law enforcement in the party complained against, consistent with its law' (Annex 34 Art. 3 of the NAAEC). As of 15 July 2009, this procedure has so far not been invoked by any party.
- 21 In addition to the foregoing dispute settlement procedure, the NAAEC incorporates a mechanism pursuant to which a non-governmental organization or other person may request the Secretariat to prepare a 'factual record' regarding an allegation that a party is failing to effectively enforce its environmental law. Upon an affirmative recommendation from the Secretariat, the Council, by a 2/3 majority vote, may instruct the Secretariat to prepare a factual record on the matter. Upon a further 2/3 majority vote, the Council may direct the Secretariat to make the factual record public. There is no legally enforceable consequence to the preparation and publication of the factual record. However, it might be used to exert political pressure, or as evidence in a national administrative or court proceeding aimed at correcting the deficiencies.
- 22 The → *North American Agreement on Labor Cooperation (1993)* ('NAALC') requires each party to effectively enforce its own labour law. Like the NAAEC, it provides a dispute settlement mechanism with respect to an allegation that a party has persistently failed to effectively enforce its labour law. However, there is an additional hurdle under the NAALC before a dispute settlement panel. First, an Evaluation Committee of Experts ('ECE') must be convened to prepare a report concerning the allegations. That report will ordinarily be made public. Following preparation of the report, a party may request that a panel be established to decide whether another party has persistently failed to enforce its labour law. The panel procedure and remedies are essentially equivalent to those under the NAAEC. However, unlike the NAAEC, there is no mechanism under the NAALC for private parties to petition the Secretariat to prepare a factual record.

## C. Observation and Conclusion

- 23 NAFTA Chapter 20 dispute settlement has played a very limited role in implementation of the agreement. The major dispute in which it was invoked, the case of *Cross-Border Trucking Services*, does not stand as a model for effective dispute settlement. That decision was rendered in 2001, and the US as of mid-2009 still has not implemented its obligations. Perhaps even more tellingly, as of mid-2009 the US has yet to agree to appointment of a roster of panellists. The likely reason for the parties' lack of reliance on NAFTA dispute settlement is the ongoing close diplomatic and economic relations between them. It may be evident to politicians and diplomats on all sides that the legislatures of the respective countries will not be easily persuaded to modify their rules on the basis of decisions by ad hoc arbitrators. If solutions are to be found, the politicians and diplomats will need to find them. Chapter 19 has been more heavily used, mainly because it can be invoked by private disputants, but even here when the economic stakes are large, as in the *Certain Softwood Lumber Products from Canada* cases (see → *North American Free Trade Agreement, Case Law*), the parties tend to rely on diplomatic solutions. The relative lack of weight given to NAFTA dispute settlement, as compared for example with the role played by the European Court of Justice (→ *European Communities, Court of Justice [ECJ] and Court of First Instance [CFI]*), flows from a conscious decision by NAFTA parties not to pursue a close level of institutional integration. The role so far played by the NAFTA dispute settlement system is consistent with its design.

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