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Forms of Dispute Resolution in the North American Free Trade Agreement

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leadership and helping us cross this hurdle now which must be crossed if we are going to reach our full potential?

III. FORMS OF DISPUTE RESOLUTION IN THE NORTH AMERICAN FREE TRADE AGREEMENT

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What are the dispute resolution procedures and why were they formed?

> Chapter 19 of NAFTA deals with dumping and subsidies (Handled inside NAFTA)
> Chapter 11 of NAFTA addresses investment disputes (Handled mostly outside NAFTA)
> Chapter 14 covers resolution of financial disputes (If non-investment, moves into a Chapter 20 framework with possibility of Chapter 14 characteristics, using panelists with financial experience. If an investment financial issue, it goes outside the Chapter 11 process)
> Chapter 20 of NAFTA deals with all other disputes (Handled inside NAFTA)

All of these dispute processes, except the investment procedure, are processes where the *government* is challenging another *government*, referred to in the NAFTA as a Party. In the case of dumping under Chapter 19, it might be the U.S. government that has stepped in on behalf of the U.S. industry. In the case of Chapter 20, it is also the government that has stepped in, challenging the action of another government. The same is true in the financial dispute area, unless the dispute involves a financial *investment*.

Contrastingly, Chapter 11, which deals with investment, allows a *private* individual to bring an action against another government. Chapter 11 is proving to be a very serious problem within the framework of NAFTA.

Why were these dispute resolution procedures created? There is a fairly easy answer. If we did not create some kind of *international* resolution to these trade disputes, they would be dealt with by *national* courts. For example, if the dispute involved questions of dumping or subsidies, or other interpretations of a Party's trade law, national domestic courts would have to resolve the dispute. That might not be perceived as satisfactory to the foreign parties. Even though the domestic courts may function very well, there is often a perception of national favoritism. The NAFTA's dispute

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resolution procedures attempts to eliminate this problem, while creating processes that will be at least as efficient and competent as the national courts.

Consider each NAFTA dispute resolution process in that context. First, Chapter 19, which deals with dumping and subsidies. Assume the government of Mexico is alleged to subsidize the cement industry, and the industry itself is alleged to be dumping cement (selling it for less in the U.S. than in Mexico). If the alleged subsidy is intended to allow Mexico to export more, it would very likely be considered an illegal subsidy under United States trade law. United States trade law and Mexican trade law include dumping and subsidy provisions which essentially mirror, the language in the GATT/WTO agreements, and, of course, the NAFTA agreement as well.

The existence of dumping or subsidies, upon complaint usually from an affected industry, begins a process of a government determination as to whether or not dumping or subsidies exist. Furthermore, there must be a determination of *material* injury. That determination is not made in a binational panel. It is made by an administrative agency, in Mexico by SECOFI and in the United States by the ITA and the ITC. The ITA determines the existence or dumping or subsidies. The ITC determines whether or not there is *material* injury to the industry. The appeal from the administrative agency decision, would go, in the United States, to the Court of International Trade (CIT). In Mexico, it would go to the federal court in the federal district. Although these courts function quite adequately — I believe the CIT performs very competently — there may be a perception by the Mexican cement industry, and Mexican government, of nationalism. An appeal from the CIT would go to the Court of Appeals for the Federal Circuit (CAFC), which is a federal circuit parallel court, just as the CIT is the same level as a federal district court.

The Parties to NAFTA thought that there ought to be some way to resolve disputes on a binational or multinational basis. Both Chapter 19 and Chapter 20 of NAFTA dispute resolution have origins in the Canada-United States Free Trade Agreement (CUSFTA). That Agreement had a half-decade of existence before NAFTA. The CUSFTA established a binational panel system, which was largely adopted in NAFTA. It was adopted, I believe, because of the success of the CUSFTA. CUSFTA Chapter 18 and Chapter 19 (predecessors to NAFTA Chapters 20 and 19, respectively), handled perhaps thirty to forty cases. Most are generally thought to have been resolved properly. There were only three appeals to Extraordinary Challenge Committees (ECC). The ECC appeal is unique and very limited. The binational panel determines whether or not the government administrative agency performed its job correctly, in terms of whether it applied its own law correctly. The appeal to the ECC is not a second look at the agency determination, but a very narrow appeal that

deals with rather exceptional circumstances, such as that a member of the panel was guilty of gross negligence, gross misconduct, bias, or a serious conflict of interest, or otherwise materially violated the rules of conduct; or the panel seriously departed from a fundamental rule of procedure; or the panel manifestly exceeded its powers, and those actions materially affected the panel's decision and threatened the integrity of the binational panel review process. Thus, an appeal to an Extraordinary Challenge Committee is a serious challenge. Under the CUSFTA only three cases went to an ECC. Under the NAFTA, only one Extraordinary Challenge Committee request has been made, in the very contentious cement case.

The use of this form in Chapter 19 is interesting in that it deals with an area (dumping and subsidies) that ultimately will probably be abolished. One of the questions regarding the future of Chapter 19, as we move towards the proposed Free Trade Area of the Americas, is whether dumping and subsidy challenges should be allowed. The European Union does not permit one country to challenge another for subsidies or dumping. If there is a trade issue that appears to involve unfair trade, it is brought under the antitrust provisions of the Rome Treaty.

Before proceeding to Chapter 20, I ought to offer a disclaimer on Chapter 19. Currently Professor Pereznieto Castro and I are sitting on a Chapter 19 panel. He was initially appointed to the roster by Mexico, as I was by the United States. The appointment of the panel is made on a consensus basis, so he had the additional approval of the United States and I had the additional approval of Mexico. We will address further the appointment process, because it is one of the serious faults of the NAFTA alternative dispute resolution process.

The second form of dispute resolution is Chapter 20. Chapter 20 is much less specialized than Chapter 19. It essentially covers all interpretations of NAFTA except for those in Chapter 19 (subsidies and dumping), and Chapter 11 (investment). Chapter 20 may address issues which are similar to dumping and subsidies in that they review an agency determination. For example, one of the few cases decided to date under NAFTA on Chapter 20 is called the Broom Corn Brooms case. It is a safeguard or escape clause case. It dealt with brooms made of broom corn entering the United States from Mexico in such increasing numbers that the industry in the United States was allegedly *seriously* injured. *Serious* injury is more than *material* injury, the standard for dumping and subsidies. One might expect safeguard actions to be brought under Chapter 19, because they involve agency determinations similar to those in Chapter 19.

Chapter 20 goes much beyond the highly technical area of safeguards to include disputes in such areas as the two cases that are currently in process. They involve whether or not the United States has violated its NAFTA commitments by failing to open the borders to Mexican buses and trucks. One of the panels has been established, the other may have been

completed recently. Unlike the Chapter 19 panels, the composition of Chapter 20 panels is not announced. But a friend in Mexico City told me in March, "You know, I'm on the truck panel, under Chapter 20." I said, "You're not supposed to tell me that." But what tends to happen is that the panel composition appears in the paper the day after it is appointed. There have been some very substantial leaks.

Chapter 20 has been the subject of very few cases so far. It has presumably worked well. But it has not been fully tested. I think as we move from Chapter 19 to Chapters 20 and 11, we find experience and success with Chapter 19, but discover less experience under Chapters 20 and 11. I believe that Chapter 20 has functioned well in the two cases decided, the above mentioned Broom Corn Brooms decision, and the earlier decision involving an agricultural tariff issue. But it has not yet addressed the kind of issues that will create very serious questions about the viability of the NAFTA dispute resolution system. It has not yet dealt with the U.S. Helms-Burton law, which involves trade with Cuba.

There has been a request by Mexico and Canada that the Helms-Burton law, which has been very strongly condemned by most nations, including an 11-0 vote in the judicial committee of the OAS finding the law to violate international law. The United States member, highly respected international practitioner Keith Highet, cast his vote with the unanimous group.

Helms-Burton in NAFTA is on hold, mainly because the Europeans also challenged the Helms-Burton law in the WTO, under that panel process, and the Canadians and the Mexicans thought it would be better for the success of NAFTA, if they were to defer pressing the case. About four years ago, I moderated a panel in Mexico City that also included the ambassadors to Cuba from Mexico and Canada, and the U.S. advisor to President Clinton on Cuba. I asked the Mexican and Canadian ambassadors privately whether their nations were considering challenging the Cuban Democracy Act, which at that time was quite new. One of them said, with the other concurring, "That's absolutely hands-off. We do not want to bring Cuba into the NAFTA and make any challenges dealing with Cuba through the NAFTA." The passage of time and especially the enactment of Helms-Burton in 1996 brought about a significant change in that view, since both Mexico and Canada have said that the adoption of the Helms-Burton law has taken the issue a step beyond where they did not want to get involved. I do not believe we yet know what will be the limits of Chapter 20.

Chapter 11 is the most difficult dispute resolution section, because it allows individual investors to sue a foreign government, without permission of the individual's own government to go forward. In Chapter 19 and Chapter 20 cases, the government brings the action. It may do so representing an allegedly injured industry, as in the Broom Corn Brooms case, or on it is own, as in the Helms-Burton challenge. Chapter 19 and 20

are government-to-government. But in a Chapter 11 investment dispute, it is an individual investor versus the foreign government. There have been about ten Chapter 11 cases filed. It may be a fair observation that few if any were the type of cases contemplated by the drafters as Chapter 11. Contemplated in the sense that none of them were cases which were discussed as potential Chapter 11 cases. They fall into two categories. The first are cases dealing with environmental issues. Although there is an environmental side agreement, with its own dispute resolution process, the first series of cases that were brought under Chapter 11 were environmental cases.

For example, the Metalclad Corporation of the United States, through its Mexican subsidiary, Química Omega, received a permit from the Mexican government to construct and operate a hazardous waste landfill in San Luis Potosí, Mexico. Metalclad undertook an expensive cleanup. But the company was prohibited by the State government from opening the landfill. The State governor stated that the site was part of a 600,000-acre ecological zone. State police physically blocked access to the facility. The company withdrew its investment, and filed a $65 million claim against the Mexican government for expropriation of its property.

Chapter 11 may have made the meaning of expropriation very elastic. The meaning of expropriation seems to be extending into regulatory processes more than one might have thought it would. Had these cases been predicted during the negotiations, Chapter 11 might look very different. But there is a more serious problem with Chapter 11. It is exemplified by a fairly recent case that was filed that has been in the news. It is the Chapter 11 case initiated by the Canadian funeral home Loewen Group, Inc. The company opened up funeral homes in various areas of the United States including Mississippi. A private Mississippi funeral home owner believed Loewens was competing unfairly, and initiated suit. He indicated that he would be happy to "sell-out" for a million dollars or so, but the Loewens company was disinterested. They are kind of a "McDonald's" of the funeral industry, if you will. Loewens was sued in a state court in Mississippi. Negative connotations were made regarding Loewens being Canadian, and that the company would not bury minorities. There was a mixed-race jury. The end result was a verdict of $500 million ($400 million punitive). The funeral home owner was obviously pleased, and stated that he would have been pleased to sell out earlier for about a million. In order to appeal, the Canadian company was required under Mississippi law to post a cash bond of 125% of the value of the judgement. They said they did not have it. They settled for $150-175 million, and soon thereafter brought the Chapter 11 action. It is *Loewens v. United States* not *Loewens v. Mississippi*. It seems that the U.S. government does not have adequate control over its state judicial systems, and in this case the judicial system in Mississippi had run amock. The Mississippi legal system has

characteristics not used in Canada, such punitive damages, very high bond appeal requirements, civil juries, etc. Should Loewens have had to face these alien legal characteristics? It is not at all clear how the case will come out. The U.S. is currently contesting jurisdiction.

How should we view the NAFTA dispute process to date? First, Chapter 19. I would divide Chapter 19 into two areas. I would grade (as a law faculty member, I am programmed to give grades) the quality of the decisions of Chapter 19 a "B" or "B+". The decisions have generally been well received. But the problem is that those decisions have come about far later than they ought to under the time framework. The convening of Chapter 19 panels has taken far more time than it should. Professor Pereznieto Castro and I are on a panel that was initially requested on August 17th, 1998. We received the initial notice from the Secretariats on August 27th, a few days later, stating that we were being considered for membership on the panel. Everyone on each nation's roster received a similar letter. We both replied, stating that we did not believe we had conflicts and were available. The panel should have been formed by October 13th, 1998. We were appointed to this panel on December 2nd of 1999, fourteen months late. That is not all of the problem, and as Steve Powell can tell you so well, the politics of the selection of the initial five people on the panel is quite an interesting story in itself. After the group of five is selected they receive the briefs and other papers, with some confidential information removed. The papers in our case filled a large carton. Reading these papers may tell you that you indeed have a conflict. For an academic, that is very unlikely. But for a practitioner in Washington, two of whom were selected for our panel, a conflict may be disclosed. One of our panelists discovered that there was a conflict within his law firm. The same thing happened with the other Mexican panelist. Thus, those two panelists had to withdraw. We have not yet had two other panelists selected. We are back into that political process of trying to get a consensus to get two more panelists. The panel selection process deserves an "F" for its undue delay. But, I would give the quality of the panels a pretty solid "B+".

For Chapter 20 panels, the quality of the two decisions seems to merit the same high grades as for the Chapter 19 decisions. But, I am concerned that the tough cases have not yet come before Chapter 20. If the Helms-Burton case is revived, under either the WTO or the NAFTA, the United States has argued that it will use the national security defense. That means it will claim that Cuba poses a national security threat to the U.S. The quality of the Chapter 20 panels also deserves high grades, but like Chapter 19, the appointment process has been very slow. There has not even been a Chapter 20 roster appointed by the U.S. The panels have been made up as the cases arise.

Chapter 11 deserves an "Incomplete." We have not really seen where it is going, but it does not seem to be going in the direction that people thought it was going. It has been used to challenge regulatory environmental processes, and it has been used to challenge the fundamental nature of legal systems, neither of which was an appropriate or intended use of Chapter 11. Another difficulty with measuring Chapter 11 is that the cases do not have to be reported. As in the case of many arbitration proceedings, the parties may decide to keep the cases secret. But not when the United States government is a party. In such case, as in Loewen, the Freedom of Information Act forces disclosure.

Let me end with a comment about a call from an attorney with a U.S. office in the executive branch soon after the Loewens case was filed. The lawyer said, "Could you think of two Chapter 11 investment hypotheticals, one that would really irritate the Canadians and another that would really irritate the Mexicans?" I said, "I could think up something about a funeral home" and the attorney said "No, no, no. No funeral homes." I did think up one that would challenge the whole system of *amparo* in Mexico, a very fundamental constitutional process, and a second that challenged the whole system of timber and forestry in Canada. Chapter 11 is on hold. The Canadians have said very clearly that they will not permit a Chapter 11 parallel to appear in the Free Trade Area of the Americas, if it allows an individual to challenge a government.

One of our difficulties is that we really cannot measure these alternative dispute resolution procedures only from the perspective of NAFTA. We must be thinking of them as suitable or unsuitable for the proposed FTAA. Dispute resolution is one of the FTAA working groups. The framework of the NAFTA system is certainly a framework that we might use in the FTAA, just as we used the framework of the Canada-United States Free Trade Agreement for the NAFTA. But Chapter 11 has no roots in the CUSFTA. It is a creation of the NAFTA, and it may be unfit for further application.

Let me leave you with a thought that the past decade has witnessed United States thinking North-South seriously for the first time in its history, not to scold but to negotiate. NAFTA is important because it tells us whether or not we can get along with our closest neighbors in free trade. If we cannot get along with Mexico and with Canada, how can we possibly get along with countries further to the South?

NAFTA is an experience that *must* be successful. Considering the alternative dispute resolution system thus far, for the most part it receives passing grades, and in some cases very fine grades. The problems with Chapters 19 and 20 are mainly the delays in panel selection, not the quality of the decisions. This is correctable by using the language of the NAFTA and selecting panels without consensus. The problems with Chapter 11 are

far more substantive and require changes to the language. That will be more difficult.

Michael W. Gordon

PANEL DISCUSSION

I am always a little concerned about speaking on elevated platforms. One of the first moderations of a panel that I did was in 1974, in Washington D.C., where we had an elevated platform at the annual meeting of the American Society of International Law. On my left was the American Attorney General, and on my right was the Mexican Attorney General, and we had the legal counsel from the ACLU. We were talking about the drug issue between the two countries. Just before the panel started — there were two or three hundred people present — I was standing at the very edge of the platform, talking to someone on the platform, and someone tapped me on the back. I turned around and fell off the platform. I thought I ought to say something when I got up to begin the program, and I said "I really shouldn't feel so bad, this is, after all, April of 1974 — the height of Watergate issues. There are an awful lot of people in this city who have fallen much further recently." I did not realize that on my left, the Attorney General for the U.S., Richard Kleindienst, had been indicted that morning. So I will be careful what I say.

Perhaps the secular institutions which we most revere in the United States are the courts. It is a legacy from our English common law. Reverence for the courts is diminished or absent in many nations. Many civil law nations continue to struggle to restore the respect for the institutions and persons of the law, which was a troubling consequence of the French Revolution.

In our quest for a peaceful life under the rule of law, in both common law-and civil law-tradition nations, we speak of judicial independence as a pre-condition to fulfilling this quest. If the public perception is that judicial independence does not exist, the courts become useless as impartial arbiters of disputes. As a famous English Lord Justice remarked, "It is better for justice to be seen to be done than to be done." Whether it is politics, corruption, or incompetence that affects our courts, disputants will seek out alternative forms of resolution.

Even if judicial independence is generally perceived as a characteristic of a specific legal system, and I like to think it is a characteristic of ours, another reason for rejecting the courts may exist. It is that they were created and have functioned almost exclusively as *national courts*. It may be easier to establish the perception of judicial independence than of judicial impartiality, when one of the disputants is from a foreign nation. If the perception endures that national courts favor nationals, or national interests, disputants will seek alternative forums.

Thus, even if the courts of the United States are characterized as fulfilling the goal of judicial independence, they are clearly not characterized from abroad, and indeed, from minority groups within, as being judicially impartial.

Our panel is going to explore the use of very different alternatives to resolve very different breakdowns in the functioning of national courts. Let me introduce the panelists:

In my thirty-four years of teaching, thirty-two years here, a principle interest has been the rule of law in the United States and Latin America. As a more practical matter, in Latin American nations within a two-hour flight from Florida. One's focus must have practical limitations. It is cheaper, and thus more likely to be funded by one's institution, to fly to Costa Rica than to Buenos Aires. One might even drive, as my wife and two children and I have done, in Volkswagens, to Mexico and beyond to Guatemala or Costa Rica on eight different occasions in the 1970's and 1980's. That might help you understand why our panel is here from Guatemala and Mexico.

In 1977, as a Fulbright Professor in Guatemala, I met Maria Luisa Beltranena (de Padilla), on my immediate left. She taught in a summer program we conducted in Guatemala. She was a rising star and would, in the years to come, become the first woman Dean of a Guatemalan law school, Rafael Landivar, with whom we conducted our program. She would become the first woman to serve on the Guatemalan Supreme Court, and the first woman to serve as President of the Supreme Court. She would become the second woman to serve in the Cabinet — she served as Minister of Education. She reached the height of success more recently when she declined the Ambassadorship to Great Britain, because she prefers her current work as a law professor at Francisco Marroquin University, in Guatemala City. Professor Beltranena honored us two months ago by coming as a visiting professor for three weeks.

We were supposed to have, on the far right, Professor Maritza McCormack, who is on the law faculty of the University of Havana in Cuba. I visited her university about a year-and-a-half ago, and talked with the Dean of the Law School, who was involved in a very unique mediation program. It is a program which uses mediation for family matters and real estate issues in Havana, in order to avoid the political nature of the Cuban courts. We thought this to be a quite remarkable program, and thought we had the backing of our government. But unfortunately, Professor McCormack remains in Havana because of the disinclination of our government to permit her to leave the country. Curiously, her government gave her permission to come here and talk about the political problems of Cuban courts, and how mediation is a good alternative, but our government did not think it was that good an idea.

In our quest to build our international law programs here at the UF, we hired two exceptional scholars and practitioners this year. It is the first time, as far as I can recall, that we have been so successful in my three decades here in developing our international programs. One of them is Steve Powell, who will be moderating the next panel on trade. The other is to my right, Professor Berta Hernandez, who adds to our public international law and human rights efforts a dimension previously lacking. She has a remarkable scholarly record and a reputation unexcelled in her work on issues facing women in Latin America.

On my far left, is Professor Leonel Pereznieto Castro, who is a professor at several law schools in Mexico City, as well as in ITAM, the technological institute, which is a highly-regarded institution. He is a graduate of the Escuela Libre in Mexico, the institution with which we have a formal exchange agreement. Three of our faculty have taught there in the past year, three of their faculty have taught here. Professor Pereznieto has been here before on programs. He is one of the most prolific authors in Mexico. Indeed, he has two new books out this year on International Private Law. He is the pre-eminent lawyer in Mexico dealing with private international law issues. He recently stepped down from service as one of the first Commissioners on the Comisión Competencia, the commission that is responsible for antitrust and trade restraint issues. We are delighted to have him here. He will speak on Mexican courts and arbitration.

I think the best way to proceed is to have Professor Beltranena talk first, and Professor Pereznieto Castro second, because they will speak about alternatives within a nation addressing issues of failures in their domestic courts. After they have finished, Professor Hernandez and I will talk about the use of alternatives where the issues are more international in nature. I have asked our panelists to consider the following questions:

1. The basic characteristics of the alternatives that have been developed,
2. Why they have been developed rather than using traditional national courts,
3. The experience to date, and
4. If they have prophecies as to how these institutions will evolve in the future.

Let me start by asking Professor Beltranena to talk about the Guatemalan Constitutional Court — a very unique structure.