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Dispute Resolution Under a North American Free Trade Agreement

*by Louis B. Sohn**

We have been told repeatedly during this conference that a North American free trade area can become a reality only if both the decision makers and the industry on each side of the border believe that there will be a secure and predictable access to the markets on the other side of the border for their products, services, and investments. To achieve that end, there must be an agreement on the basic rules governing such access and on an adequate system of resolving conflicts relating to the interpretation and application of these rules. Neither the rules nor the dispute settlement system can exist in a vacuum; they depend on each other. There must be both procedures for interpreting rules, and rules to be interpreted. At present, there are many disputes between the two countries, but there are few agreed rules providing a basis for resolving them. Even where there is some law available, there are no effective means for interpreting and applying it.

It has been assumed for too long that any problems between Canada and the United States, two friendly allies sharing the longest undefended border in the world, can be easily solved by our excellent diplomats and will quickly disappear. Unfortunately, this is a dream, not the truth. It takes a large amount of time and many painful efforts to solve a dispute between these two countries, and many conflicts languish forevermore, and after a while are only remembered by the keepers of the national archives.

In fact, there are too many disputes between the United States and Canada, perhaps several hundred of them; not all are important enough to rate headlines in the newspapers, but all of them are of importance to some persons, individuals or corporations, who are affected by some acts of one government or the other. These disputes do not stop coming; before one is solved, another arises, in the same area or in a completely different one. Ordinarily, most of these disputes are of intermittent concern only to a few officials on both sides of the border, and sooner or later many of them are satisfactorily solved. Only some of these disputes rise to a higher level, catch attention of Congressmen or Senators, or of those newspapers which thrive on pointing out that things are not what they seem to be, and do not hesitate to point out that one of the two countries

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is not complying with international obligations, and that grave injustice has been inflicted by it on the citizens of the other country.

What is being done about it? What can be done about it? Over the last few centuries, diplomats and international lawyers devised various ways of dealing with international disputes, and they are very proud that in a preponderant majority of situations they have worked quite successfully. At the same time, it has become quite obvious that in a variety of cases these methods are not satisfactory, and that in the area of international economic relations—in particular those involving trade and investment across the border between Canada and the United States—there seems to be a breakdown in efforts to settle problems, whether big or small. The big issues are too political, too dangerous to touch; they have to be defused, brought to a lower level where the general public and the press will be less conscious of them, and only then is it possible to handle them in a more professional way. As far as the small issues are concerned, they are often swept away as not deserving attention of the overworked public servants; the old Roman maxim, *de minimis non curat praetor* (the magistrate is not concerned with small matters), is still a guiding principle of international relations. There has to be a significant, substantial, or serious effect, impact, or injury before governments become interested in a particular situation.

If we assume, however, that the problem before us falls within the middle range, and is neither too big nor too small, what is going to happen to it? It would seem obvious that whenever existing methods are not good enough, the two governments would find some better ones; but unfortunately, the governments seem to be unable to take positive steps in that direction.

It might be useful, therefore, to take an inventory of existing methods to find why they are no longer working, and to try to find a way of improving them. It is too often forgotten that there are many tried and true methods for resolving international disputes, and that the choice of a proper method may expedite the settlement of a dispute.[1]

The usual progression is from the simpler methods to the more complicated, starting with negotiation and proceeding through consultations, good offices, mediation, commissions of inquiry, conciliation commissions, and arbitral tribunals, to international courts. Most disputes are solved on the lower levels, and only a few intractable ones reach the highest one; but, of course, as noted before, many disputes fall between the cracks, are not solved by negotiation, and, for one reason or another, never reach the next level. For them there is still one more possible solution—resort to national courts or administrative agencies—which often

[1] For recent reviews of the international dispute settlement methods, see J. MERRILS, INTERNATIONAL DISPUTE SETTLEMENT (1984); L. SOHN, *The Future of Dispute Settlement* in MACDONALD & JOHNSTON, THE STRUCTURE AND PROCESS OF INTERNATIONAL LAW: ESSAYS IN LEGAL PHILOSOPHY, DOCTRINE AND THEORY (1983).

results in objections by the other country and in escalating the dispute to an international level. In fact, it is the discovery of these remedies, which have been multiplied by national legislators anxious to help their constituents, that has brought the whole situation to our present impasse.

Returning to the means available to Canada and the United States for the settlement of disputes between them, the foremost among them is negotiation. It is generally agreed that negotiation is the primary, most frequently used, method for settling international disputes. All diplomats give a priority to it, and most international agreements on the settlement of disputes require that a dispute should be settled, as far as possible, by negotiations. Only if a dispute is not resolved by negotiations does resort to other means become necessary. It is a basic axiom of diplomacy that with patience and perseverance, all disputes will be resolved sooner or later. Most trade disputes are sensitive, however, to delays, as economic losses are usually proportionate to the length of a delay. For instance, if a trade dispute delays the entry of a loaded ship into a harbor for a few months, the losses may reach even a million dollars. An opportunity for a sale may be missed or an entire cargo may be spoiled.

To avoid such dangers, several methods for expediting negotiations have been developed. The simplest one is the establishment of a special channel for constant trade consultations. For this purpose, a bilateral permanent commission might be appointed, with commissioners and staff working together: to anticipate problems; to stop an incipient dispute at the earliest possible moment, before it escalates into a bitter dispute; to find an equitable solution for a particular dispute or for a group of disputes; or to decide what other dispute settlement procedure should be used to find such solution.

Sometimes, without relinquishing its jurisdiction, such a commission might invite a specially qualified person to join the commission, and by his or her good offices help the parties to narrow the gap between their positions. In other situations, such a person may be invited to engage in mediation, and to resolve the dispute by making a variety of proposals, one of which might prove to be acceptable to the parties. When a dispute involves contested facts, the commission may appoint a joint group of experts to elucidate the facts, or arrange for the appointment of a commission of inquiry, which would conduct an impartial and conscientious investigation and present a report on the facts ascertained thereby.

If none of these approaches results in a settlement of the dispute, the parties still have three other avenues open: conciliation, arbitration, and judicial settlement. The common feature of these procedures is that a third-party element is involved. While parties might appoint their nationals to participate in these procedures, the final determination is in the hands of a neutral person or group of persons. A conciliation commission tries first to bring about an agreement between the parties by suggesting to them various terms of settlement. If it does not persuade the

parties to accept a settlement, the commission presents a report containing its findings with respect to facts and the law, and its recommendations for a friendly settlement of the dispute. The main difference between conciliation and the two other third-party methods is that its recommendations are not binding, while an arbitral tribunal or a court usually renders a binding decision.

An arbitral tribunal is established in a similar manner as a conciliation commission, and the principal difference between it and an international court is that it is established specially for a particular dispute or group of disputes, while a court is usually a permanent body, composed of judges previously elected, and the parties ordinarily have only a minor influence on the composition of the court (for instance, by adding to it national judges, each party selecting one). The decisions of arbitral tribunals and courts are binding on the parties to a dispute, and they are usually final, as appeals are seldom allowed in international proceedings.

All these methods can, of course, be applied to trade disputes, and each method has some advantages and some disadvantages. If the parties are cooperative and really want to find a solution for their problems, any one of them can lead to a result acceptable to both of them. It is, however, a rather disconcerting fact that a government might find it difficult to accept a solution which some influential groups in its country might find objectionable, and at the end of the lengthy proceedings a government might find it necessary to refuse to follow a recommendation of a conciliation commission, and even reject a binding decision of a tribunal or a court.

In the "good old days," if a government refused to comply with a decision of an international tribunal, a major power could enforce the decision by using military force. Of course, this remedy was not available to a small country against a big one, unless a friend intervened on its behalf. In the world of the United Nations, where use of force has been almost completely prohibited, the international community would not condone the use of force even for the purpose of executing a tribunal's decision. The dangers of escalation are too great, and there is no economic loss that would justify provoking a nuclear war.

We need to go back now to our drawing board, and reconsider the various means at our disposal and see how we can use them best to deal with the trade disputes between the United States and Canada under the proposed free trade agreement. We do not approach the issue with clean hands. There are in front of us many unresolved disputes, embittering our relations, and antagonizing various groups in Canada or the United States, and often in both countries.

As was noted earlier, a system for the settlement of disputes cannot exist in a vacuum. The negotiators of the free trade treaty between Canada and the United States have agreed to work first on the rules which would provide the law to be applied by those called upon to settle a dispute under the free trade treaty. It is clear that the main reason for many

conflicts is the lack of clear provisions or a gap in existing provisions (e.g., those of the General Agreement on Tariffs and Trade), and that better rules are needed.

Once a basic agreement is reached on the rules to be applied, the next step will be to agree on the procedures and institutions which would apply them. At present, in the gray areas where the rules are unclear, both the rules and remedies are provided mostly by national legislation and national courts, to the great dissatisfaction of the other country which considers it below its dignity and a violation of the sovereign equality of states that the court of another country would judge the validity of its acts and would take steps against its nationals on the basis of its own legislature's interpretation of the applicable rules.

It has to be remembered that law seldom stands still. Assuming that we succeed in clarifying and codifying all the necessary rules, they will still have to be interpreted and will have to be applied to constantly changing economic situations resulting in consequential changes in the terms of trade and investment. The institutions engaged in applying these new rules cannot be purely national, as even with the best intentions the interpretations on both sides of the border are likely to start to diverge almost immediately.

Many proposals have already been made for joint institutions that would be capable of dealing with the complex relations between Canada and the United States in the light of the proposed free trade area agreement.[2] This is not the place and there is no time to analyze them all. I shall restrict myself to a selection of those ideas which appear in some other free trade area agreements,[3] adding here and there a few ideas being discussed right now by a Joint Working Group of the American and Canadian Bar Associations which a few years ago presented a compre-

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[2] For an excellent review of the substantive problems involved in the free trade agreement, see Finlayson & Thomas, *The Elements of a Canada-United States Comprehensive Trade Agreement*, 20 INT'L LAW 1307-34 (1986). See also S. Battram, Canada-United States Trade Negotiations: Continental Accord or a Continent Apart? (Paper presented to the Conference of Int'l Trade, Texas Bar Ass'n and Int'l Trade and Practice Section of the A.B.A., Dallas, Tex., Feb. 6, 1987); FRIED, *Barriers to United States-Canadian Trade: Problems and Solutions, The Canadian Perspective*, 19 GEO. WASH. L.REV. 433-41 (1985).

[3] For the dispute settlement proposals contained in the MacDonald Report, see REPORT OF THE ROYAL COMMISSION ON THE ECONOMIC UNION AND DEVELOPMENT PROSPECTS OF CANADA (1980) at 320-322. For the views of former U.S. Ambassador to Canada, Ken Curtis, see 3 Int'l Trade Rep. (BNA), 1429 (1986). A comprehensive analysis of the issues involved may be found in F. STONE, INSTITUTIONAL PROVISIONS AND FORM OF THE PROPOSED CANADA-U.S. TRADE AGREEMENT (1986); *see also*, ONTARIO MINISTRY OF INDUSTRY, TRADE AND TECHNOLOGY, DISPUTE SETTLEMENT MECHANISMS IN A FREE TRADE AGREEMENT (1986). This paper takes into account dispute settlement provisions in the following free trade area agreements: Agreement Establishing a Free Trade Area, Dec. 14, 1965, Ireland — United Kingdom, art. XVII, 565 U.N.T.S. 60. Closer Economic-Trade Relations, Mar. 28, 1983, Australia — New Zealand, art. XXII, 22. I.L.M. 945; Free Trade Area Agreement, Apr. 22, 1985, art. XVII-XIX, 24 I.L.M. 65. Similar provisions are found in Reciprocal Trade Agreement, Nov. 15, 1935, Canada-United States, art. XI, 49 Stat. 3960, E.A.S. No. 91, 6 Bevans 75.

hensive report on the settlement of disputes between Canada and the United States.[4] It is now engaged in adapting the ideas developed at that time to the special requirements of a free trade area agreement. It is hoped that its report will be available in the near future. The co-chairmen of that group are two persons present here, Henry King and Brad Smith, to whose persistence and untiring efforts in pursuing this elusive goal the lawyers of the two countries owe a great debt of gratitude.

It is generally agreed that crucial political decisions will continue to be made by the heads of the two governments and their top ministers and special trade advisers. It is not likely, however, that these high personalities will be able to devote much attention to the constant flood of problems that require solution and that are technical and legal. It has been, therefore, proposed that a permanent joint trade commission be established, similar to the Canada-United States International Joint Commission which for almost 80 years has dealt successfully with boundary waters and related problems.[5] This commission would monitor the progress of implementation of the agreement; it would be a "watchdog," with access to all relevant information sources on a routine basis. Its primary duty would be to keep informed about current developments, to discover promptly any trouble spots that may be developing, and to immediately advise the two governments on the need to deal with them quickly before they develop into a dispute or a dangerous situation. The two governments may decide to deal with the problem through diplomatic channels, to start negotiations or to establish a working group for more thorough consultations on the subject. Ordinarily, however, they will authorize the joint commission to establish a joint working group of experts on the particular topic in dispute. The experts will submit to the joint commission their report on the facts underlying the dispute and on the ways similar disputes have been resolved elsewhere, together with suggestions for resolving the dispute studied by them. The joint commission may then decide that the report is satisfactory or that some additional studies, economic, legal or technical, are necessary and may appoint an additional working group or groups, for that purpose. Once the joint commission is satisfied that it has all the necessary facts, evalua-

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[4] Report and Recommendations of the American and Canadian Bar Associations Joint Working Group on the Settlement of International Disputes between Canada and the United States (presented Mar. 20, 1979, adopted by A.B.A. Aug. 15, 1979, adopted by CBA Aug. 30, 1979).

For a comment on the Report and Recommendation *see* E. Wang, *Adjudication of Canada-U.S. Disputes*, CAN. Y.B. INT'L L. (1981), at 158-228.

[5] For the 1909 Boundary Waters Treaty, *see* Use of Boundary Waters Treaty, Jan. 11, 1909, Canada-United States, 36 Stat. 2448, TS 551, 12 Bevans 319. Concerning the accomplishments of the International Joint Commission, *see* L. BLOOMFIELD: G. FITZGERALD, BOUNDARY WATERS PROBLEMS OF CANADA AND THE UNITED STATES (1985), *The Regime of Boundary Waters: The Canadian United States Experience*, 1975 Recueil de Cours 219-340; THE INTERNATIONAL JOINT COMMISSION SEVENTY YEARS ON (R. Spenser, J. Kirton & K. Nossal eds. 1981); 3 DIGEST OF INTERNATIONAL LAW 813-71 (M. Whiteman ed. 1964). *See also*, M. Cohen, *Canada and the U.S.: New Approaches to Undeadly Quarrel*, INT'L PERSPECTIVES, Mar./Apr. 1985, at 16-22.

tions and recommendations before it, it would prepare a final report, with its own recommendations, for the two governments. These recommendations may relate to the substance of the dispute or to the procedure to be followed in solving it. The joint commission may consider, for instance, that the situation cannot be resolved by the two parties alone, and may recommend that a mediator or a conciliation commission be appointed, or it may conclude that the dispute cannot be solved without obtaining the advice of an international arbitral tribunal or an international court on some of the legal issues involved, especially on questions of interpretation of the free trade agreement. Depending on the character of the dispute, at that point the two governments might take over the problem and reach a solution on the basis of the studies and recommendations received from the joint commission. If a settlement is not agreed upon, the two governments may refer all or some of the issues to one of the institutions suggested by the joint commission, or return the matter to that commission for the selection of the mediator, conciliation commission, arbitral tribunal, or court.

To properly fulfill its functions, the joint commission would have to be a semi-autonomous body, authorized to consider each problem as objectively as possible, not in an adversarial but a collegial mode. While its members will be appointed by the governments and would remain in sufficiently close contact with the two governments in order to remain familiar with the governments' attitudes and positions with respect to matters considered by the commission, their primary task will be to jointly find the best, the most reasonable and equitable, solution for each issue so that the two governments would find it difficult to reject it. Although most proposals suggest that each government appoint three commissioners, the possibility might also be considered that each government appoint four commissioners, so that the commission would be able to work in two sections, one in Ottawa and one in Washington, each of which would be composed of two nationals of Canada and two nationals of the United States. One section would deal with issues arising primarily in Canada, and the other with those arising primarily in the United States. Modern technology should enable the two sections to work closely together, to share all the documentation and data, to consult constantly, and to meet frequently to consider together questions that require direct personal contact and collegial action.

The joint commission should have small but sufficient and highly qualified binational, integrated staff. It should also have available a joint advisory group of experts from various government departments, universities and agricultural, commercial and industrial enterprises. This group would be especially helpful in advising on the selection of experts for particular studies.

The joint commission would also establish a list of third-country experts, both technical and legal, acceptable to both governments, from

which mediators and members of conciliation commissions and arbitral tribunals would be chosen.

Mediators and conciliators would usually be chosen for each particular case, but the two governments may wish to establish a special joint arbitral tribunal that could give them an impartial and authoritative interpretation of the free trade agreement. The two governments have in the past resorted, relatively frequently, to the special panels established under the General Agreement on Tariffs and Trade, not so much against each other, as against the European Economic Community and some states in other regions. They have not been completely satisfied with that experience, and there seems to be a consensus that something stronger is definitely necessary for the interpretation of the free trade agreement. Instead of a constant procession of different tribunals, it would be preferable to have a permanent tribunal of five or seven judges able to develop a consistent jurisprudence, thus giving to the whole system a stability which is needed not only by the two governments, but even more by the business interests involved whose expensive plans for future development depend considerably on the existence of a common interpretation system that is a reliable one, and not on unilateral interpretations which the other country is likely to reject quite often.

In addition, such a tribunal might enable the governments to get out to some extent of the dispute settlement operation by putting the burden of obtaining the correct interpretation of the free trade agreement on the real parties to the dispute, the economic interests on both sides of the border. The private persons, natural or legal, that are directly concerned, may be authorized to obtain directly from the joint tribunal a solution for their problem, without bringing their governments into the fight. This method has solved many problems in the European Economic Community,[6] and may prove equally helpful in settling disputes relating to the free trade agreement which have arisen between American and Canadian individuals, corporations, or interest groups. It might be useful, therefore, to provide in the free trade agreement for their direct participation in the settlement of this kind of dispute.

The procedure that might be used for this purpose might be as follows:

A private person, an individual or a corporation, whose rights, interests, or duties might be seriously affected by a court proceeding or an administrative action relating to the application of the free trade agreement, would be entitled to ask for a *reference* of an issue of interpretation of that agreement by the court or administrative agency to the proposed joint Canada-United States tribunal for advice. In such a case, the pro-

[6] *See* European Economic Community Treaty, Mar. 25, 1957, art. CDXXVII, 298 U.N.T.S. 11. *See also* T. HARTLEY, THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW 247-82 (1981); S. STEIN, P. HAY & M. WAELBROECK, EUROPEAN COMMUNITY LAW AND INSTITUTIONS IN PERSPECTIVE 261-71 (1976).

ceedings before the court or the administrative agency would be suspended until the joint tribunal has transmitted its reply to the requesting institution. The national court or agency would then resume proceedings, and would apply the interpretation given by the joint tribunal to the facts of the case.

This procedure would contribute to uniform interpretation of the free trade agreement on both sides of the border, and would prevent the escalation of each private conflict into an inter-governmental dispute. It would avoid, at the same time, the difficulty that might be presented by a procedure relying on appeal to an international tribunal from a decision of a national court or agency. It is much easier for a national court or agency to apply an interpretation given by an international tribunal, than to suffer the indignity of having its decision reversed on appeal by an outside tribunal. National pride is thus protected, justice is provided, and governments are saved from protracted negotiations and an increase in animosities that might jeopardize the whole trade relationship.

This paper has only touched a few main points, and leaves many questions unanswered, including some which, I hope, will be discussed by other speakers. I have, in particular, in mind the relationship to the General Agreement on Tariffs and Trade,[7] changes to which are being negotiated at the same time. If the negotiations between Canada and the United States are successful, they can light the way for the other, even more complex, negotiations.

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[7] For a review of the GATT dispute settlement procedures R. HUDEC, *GATT Dispute Settlement After the Tokyo Round: An Unfinished Business*, 13 CORNELL INT'L L.J., 146-99 (1980); USITC, Review of the Effectiveness of Trade Dispute Settlement Under GATT and the Tokyo Round Agreements.

See generally K. DAM, THE GATT: LAW AND INTERNATIONAL ORGANIZATION (1987); R. Hudec, Paper presented on legal issues in US/EC Trade Policy: GATT Litigation, 1960-1985, at Conference on Europe/US Trade Relations at Centre for European Studies in Brussels (1986); J. JACKSON, WORLD TRADE AND THE LAW OF GATT (1969).