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EDITOR'S NOTES

Volume 33, No. 2 of the *Canada-United States Law Journal* contains articles and speeches that occurred throughout a year of Canada-United States Law Institute programming. In this issue, our authors examine the importance of the Canada-U.S. relationship with China and the potential impact of that relationship on the traditional laws governing international trade. Our authors also examine the effects that China's trade and human rights policies have had on Canada and the U.S.; the energy, immigration, and trade issues between Mexico and the U.S.; and also how the Canadian and American governments are regulating new technologies. Moreover, Fmr. Ambassador Gotlieb has added his perspective as to the future of the Canada-United States relationship. I extend a sincere thank you to all our contributing authors for their insightful and exceptional scholarship.

The publication of this second issue of Volume 33 presented second- and third-year law students the chance to contribute to the editorial process of an extraordinary issue. This opportunity would not have been possible without the assistance of a number of individuals. Foremost, I would like to thank Dr. Henry T. King and Professors Richard Gordon and Chios Carmody. Their knowledge and skill have made both the *Journal* and the Institute a hallmark in the international legal field. I would also like to thank Dan Ujczko for his valuable advice and support. He has been an outstanding advisor, and I have appreciated his encouragement and guidance throughout the many meetings, calls, and e-mail communications. I would also like to thank Deborah Turner, who has been a terrific asset. She has lent her assistance and support at every turn. My Managing Editor, Kelly Schmidt, has also been invaluable. I sincerely thank her for her superb abilities and dedication. Lastly, I would like to enthusiastically thank the entire editorial staff. They are the core of the *Journal* and their enthusiasm and skills were extraordinary. I would also like to extend a special thanks to executive editors Monty R. Silley and Will Randall, and Associate Editors Michael Emancipator, LerVal M. Elva, and Jason Kral, for their hard work on this issue. The publication of this issue would not have been possible without the foregoing individuals, and I am grateful to them all.

Any questions regarding factual assertions should be directed to the attention of the authors. Your continued support and readership is greatly appreciated, and any comments you may have are welcome. Thank you.

Megan McCarthy
Editor-in-Chief



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2008

THE CANADA-U.S. RELATIONSHIP IN THE GLOBAL ENVIRONMENT

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December 8 2006**

Sponsored by Steptoe & Johnson, LLP and Kaye Scholer

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ENGAGING CHINA: UNDERSTANDING THE CHALLENGE
AND SEIZING THE OPPORTUNITIES

Hon. Sergio Marchi

ADDRESS TO THE SYMPOSIUM ON RESPONSES OF THE UNITED
STATES AND CANADA TO THE ECONOMIC CHALLENGES POSED
BY CHINA

WASHINGTON D.C.

December 8, 2006

Introduction

Good afternoon ladies and gentleman.

Thank you for your thoughtful invite. It is a pleasure to be here today and to share some thoughts on how the U.S. and Canada can best engage China.

The histories of the United States and Canada have been closely tied to one another. Our politics and economies have influenced each other greatly, and our peoples have been good neighbours and friends. Of course, while there have been disagreements along the way, the relationship has been strong and mutually beneficial.

For many years, Canadians have been proud to underline that Canada and the United States are each other's largest trade partners – and we felt slighted when Japan or Mexico were cited as the U.S.'s largest partner!¹ So when it was announced in 2005 that for at least one month, China had surpassed Canada as the United States' largest trade partner, it was an economic signal for Canadians.² It reflected a fundamental paradigm shift in the global

* Remarks occurred at an event entitled The Economic Challenges of China: US & Canadian Responses, held on December 8 2006, and sponsored by Steptoe & Johnson, LLP and Kaye Scholer.

¹ See *Canada-U.S. Trade Relationship*, U.S. Commercial Service, <http://www.buyusa.gov/canada/en/traderelationsusacanada.html> (last visited Feb. 9, 2008).

² See *China to be Biggest Trading Partner of US This Year: Former Trade*

economy, namely, that of an economically vibrant and influential China, which is forcing Canadians to rethink their position in the North American and global economies. And we are certainly not alone.

In 1972, Richard Nixon surprised the world with his visit to China. While Nixon and Kissinger were euphoric with the overall success of their trip, Nixon also noted the following words in his personal diary:

“Not only we, but all the people of the world, will have to make our very best effort if we are going to match the enormous ability, drive and discipline of the Chinese people.”³

Almost 25 years later, this observation is particularly true and captures very accurately, the core of the so-called “China Challenge.”

How do we, in North America, then respond to the challenge of a focused and ambitious China? How do our companies meet the challenge of the realities of a changing global economic order with China being a major engine? How do Canadian companies, which are export-oriented, incorporate a focus on the Pacific, when for so long, they have been so continentally focused? How can Canadian companies remain globally competitive and relevant?

These are all good questions, looking for equally good answers.

In addressing the Canadian challenge, in the context of our relationship with the United States, let me touch on four areas:

1. Some bilateral trends and developments.
2. How Canada has responded to date.
3. The need to change mindsets.
4. And finally, China, the opportunity.

I. Some Bilateral Trends and Developments

Canada-China trade has grown dramatically. Today, China is Canada’s second largest trade partner.⁴ However, a central concern is the growing

Representative, People’s Daily Online, (Apr. 25, 2005), http://english.people.com.cn/200504/25/eng20050425_182637.html [hereinafter *China to be Biggest Trading Partner*].

³ RICHARD M. NIXON, *THE MEMOIRS OF RICHARD NIXON* 572 (1978).

⁴ *In Depth: China Milestones in Chinese-Canadian Relations*, CBC News, Nov. 16, 2006, <http://www.cbc.ca/news/background/china/china-canada-relations.html>.

disparity. While Canadian exports to China have grown, Chinese imports have grown even faster.⁵ Between 2001-2005, our exports to China grew 65%.⁶ During the same time period, our imports grew an astonishing 115%.⁷

As well, Canada has traditionally been an exporter of resources and commodities, and it's no different with China – about 80% of our exports to China consist of resources.⁸ We have benefited significantly from their rapid industrialization, which has put upward pressure on commodity and energy prices.⁹ Our exports have reflected China's development needs and have also shifted, as China adds value to their production and manufacturing.¹⁰

Historically, Canada's major export to China was wheat.¹¹ But once China started producing its own crop, and also decreased their consumption of wheat, Canada's wheat exports fell sharply.¹² As a consequence in part, our exports of fertilizers, meat and seafood grew.¹³ Exports of industrial material such as nickel, iron, steel, copper, and aluminum also grew rapidly in the 1990s to feed China's manufacturing boom.¹⁴ Paper was once a major export of Canada to China – but as China established its own mills, paper exports have dropped, while pulp exports have grown.¹⁵

As you can note from some of these examples, developments in China's economy impact the kinds and volumes of Canadian exports. In some instances, Canada has moved down the value chain, while in others, we created and added value. However, when China acquires and develops its own fertilizer production, for instance, will Canada still be able to add value? Or will Canada move down the value chain and just supply the raw material? And with China's increasing exports to the U.S., Canadians are becoming aware that this comes at the expense of our own.

While our exports to China continue to be resource heavy, our imports have shifted dramatically in the last few years. In the 1990s, imports from

⁵ Francine Roy, *Canada's Trade and Investment with China*, CAN. ECON. OBSERVER, 3.1, 3.7 (2005) [hereinafter *Canada's Trade*].

⁶ *See id.*

⁷ *See id.*

⁸ *See* Dennis & Sandi Jones, *China: Opportunities from East to West*, Aug. 11, 2005, <http://exportsource.ca/gol/exportsource/site.nsf/en/es03259.html>.

⁹ *See* Steve Grunau, *Analytical Paper – Feeding the Dragon: Canadian Exporters and a Booming China* 5, STAT. CAN. 3, available at <http://dsp-psd.pwgsc.gc.ca/Collection/Statcan/11-621-M/11-621-MIE2006037.pdf> (last visited Mar. 25, 2008).

¹⁰ *See id.* at 3.

¹¹ *Canada's Trade*, *supra* note 5, at 3.4.

¹² *Id.* at 3.6.

¹³ *See generally* Francine Roy, *Insights on the Canadian Economy: Canada's Trade with China*, STAT. CAN. 4, available at <http://dsp-psd.pwgsc.gc.ca/Collection/Statcan/11-624-M/11-624-MIE2004007.pdf> (last visited Mar. 25, 2008).

¹⁴ *Id.*

¹⁵ *Id.*

China were largely made up of consumer goods, shoes, toys and textiles.¹⁶ However, in recent years, there has been a dramatic shift toward productivity-enhancing goods, that is, electronic products including laptop computers, telecommunications equipment, industrial machinery, measuring equipment, and automotive parts.¹⁷

China is now a major source of low-priced industrial equipment for North American firms.¹⁸ In the case of some of these products, the shifts have been quite dramatic. Moreover, Canada's imports from China have now surpassed those of Japan and Mexico, and more recently, U.S. imports have begun to level off as well.¹⁹

In short, we can expect these trends to continue, and as China's industry continues to move up the value chain, this presents Canadian industry with some real challenges in adapting to these new economic realities.

II. How Has Canada Responded to the China Challenge So Far?

(As mentioned) earlier this year, I became the President of the Canada China Business Council, a private membership association that works with Canadian firms in China. In the last number of years, the Council has emphasized the importance of understanding the impacts of China for Canadian companies in our own market, in China, and globally.

The central lesson is that no matter how big or small, every Canadian firm needs a China strategy. It may be active or passive, depending on the company's resources, but it is absolutely crucial to understand how China is changing the global economy and develop an effective response.

In a survey of Canadians conducted this year by the Asia Pacific Foundation of Canada, Canadians are most aware of the potential of China, with 42% of respondents saying China showed the most export potential, while 29% chose the U.S.²⁰ In fact, Canadians expressed a belief that the Chinese economy will surpass that of the U.S. in 20 years or so.²¹ That may or may not be the case, but that's the perception today.

Yet, another survey involving Canadian automotive parts makers is very revealing:

¹⁶ See *Some Familiar Patterns Developing In Trade Between China and British Columbia*, Bcstats.gov.ca 4 (2000), available at <http://www.bcstats.gov.bc.ca/pubs/exp/exp0008.pdf>.

¹⁷ See *Canada's Trade*, supra note 5, at 3.2.

¹⁸ See *id.*

¹⁹ *The Daily, Canada's Trade with China*, Statistics Canada, Jun. 8, 2004, <http://www.statcan.ca/Daily/English/040608/d040608a.htm>.

²⁰ The Asia Pacific Foundation & Globe and Mail, *Canadian Views on Asia: A Report to The Asia Pacific Foundation of Canada and the Globe and Mail*, 7 (2006).

²¹ *Id.* at 12.

- Asian facilities accounted for only 0.29% of their production,
- Asian suppliers represented only 5% of their inputs/supply needs, and
- Asian buyers accounted for only 1.6% of their customers.²²

While Canadians seem to be aware of the China challenge and opportunity, this second survey would indicate that we still have much work to do. In this sector, we need to accelerate this industry's integration into the Asian market; otherwise, we run the risk of losing significant ground.

Some Canadian economists have made a link between foreign investment and Canada's lagging trade performance vis-à-vis China. They have argued that the traditional concept of bilateral trade – measuring who benefits by looking at the trade balance – is not as relevant in today's global economy. This is because so much of the trade is now within companies. The new mantra is integrative trade. "Integrative" encompasses all the emerging elements of international business: exports, imports used in exports, FDI, use of foreign affiliates for sales, and globalized production and distribution.

The international economy has become a global workshop, where products are sourced from multiple points, assembled at the most convenient locations, and sold into the global marketplace. In this global workshop, for example, nearly half of all U.S. imports represent American companies buying from their own foreign affiliates.²³ And foreign affiliates of Canadian companies generate sales of about U.S. \$400 billion each year – roughly the same amount as Canadian exports.²⁴

Indeed, more than half of China's exports originate from multinational firms operating in China.²⁵ In an attempt to remain globally competitive, many foreign firms are investing in China so as to integrate China into their global supply chains.²⁶ They are also, of course, trying to gain access into their huge market. Yet Canada's investment in China is relatively low, which means that we will need to establish stronger integrated trade links with China.²⁷ In the long run, given the changing and competitive nature of the marketplace, exporting alone won't suffice.

²² Asia Pacific Foundation of Canada, *The East Asian Automobile Industry: Opportunity or Threat?*, CAN. IN ASIA 6 (2005).

²³ Stephen S. Poloz, Senior Vice-President and Chief Economist, *The New Global Trade Game: Will Canada be a Player, or Just a Spectator?* Jan. 20, 2005, (transcript available at http://www.edc.ca/english/docs/speeches/2005/mediaroom_7001.htm).

²⁴ *Id.*

²⁵ *Id.*

²⁶ *See id.*

²⁷ *See Canadian Ambassador Calls for Canada, China to Expand Investment Scale,*

At the same time, while China's accession into the WTO opened opportunities for foreign investment, it also gave Chinese firms a clear timeline to establish manufacturing centres and companies that could compete globally. And not just in labour intensive cheap consumer goods, but also in the value-added and hi-tech sectors. In other words, the WTO has also pushed Chinese firms towards global competitiveness, and we in North America need to recognize that these up-and-coming Chinese firms will be highly competitive both in China and around the world.

III. Third, We Need to Change Mindsets

Former Prime Minister Trudeau once compared being neighbours with the United States to sleeping next to an elephant.²⁸ No matter how friendly and even-tempered the elephant is, we are affected by every twitch and grunt. As our economies became so interconnected, Canadians have become very accustomed to sleeping next to the elephant.

As you well know, the elephant is our major trade partner, our major customer, and our major buyer. Despite an increasingly global economy, the main priority for Canadian companies remained on anticipating and adjusting to the elephant's every move. They have traditionally been focused on the U.S. market and U.S. customers. Despite the government's plea for diversification, 85% of our exports go to the U.S.²⁹ This is particularly true of central Canada, the heartland of our industrial and manufacturing output. And yet, it is perhaps in this region, that the most dramatic impacts of China's economic boom are being felt, especially by lower tier suppliers to U.S. customers, who are feeling the pressure to produce more cost effective product or risk losing their U.S. customer base.

One of the greatest differences between the Canadian and U.S. economies is the number of large international firms. With the internationalization pressures of the 1990s, many U.S. companies had the size and depth to go abroad, make mistakes, and correct them. By contrast, in Canada, few firms could afford early entry errors.

While Canada certainly has a number of large companies with the resources to compete globally, many of Canada's firms are smaller and lack sufficient resources to be in every market. Combined with a traditional focus

People's Daily Online, Feb. 18, 2006, http://english.people.com.cn/200602/18/eng20060218_243712.html.

²⁸ *Canada and the World: A History, The Trudeau Years*, Foreign Affairs and International Trade Canada, June 8, 2007, <http://www.international.gc.ca/department/history/canada9-en.asp>.

²⁹ *See The World Factbook – Canada*, Central Intelligence Agency, Feb. 12, 2008, <https://www.cia.gov/cia/publications/factbook/geos/ca.html>.

on the U.S. market, these companies have shown a preference “to ride the coattails” of U.S. customers into new markets, including China. They view themselves as suppliers of inputs within an integrated North American economy. And there is a confidence that the supplier-customer relationship that worked in North America could be duplicated elsewhere. However, while this strategy might work in the short term, it may not be viable for the long haul. We need to realize that Chinese suppliers are moving up the value chain very quickly, are becoming as innovative as the top western firms, and threaten to supplant Canada’s position in supplying the U.S. and others.³⁰

The rise of China is forcing Canadian companies to shift mindsets, to move from a continental outlook to a more global one, and to evaluate where to best position themselves in the global supply chain. In order to grow their business internationally, they will increasingly have to look at investing abroad. The ultimate goal is to maintain competitiveness.

In doing so, our private sector will need to address some fundamental issues. How has the rise of China affected their relationship with U.S. customers and their place in the supply chain? How has the rise of China affected the North American economy? What kind of value can Canadian companies continue to deliver to its U.S. customers and the global supply chain? What kind of adjustment will be required to be relevant in the U.S. and other markets important to Canadian firms?

With the news that China became the U.S.’s largest trade partner for at least one month in 2005, also came the projection that China may likely one day become the U.S.’s largest trade partner.³¹ This projection should force a cold analysis of where Canada stands in the global economy and what our country needs to do in an effort to remain competitive. I don’t want us to wake up one day to find that the elephant was an early riser and had moved on – perhaps over to the dragon’s pen. Sure, it may have been a bit intimidating sleeping next to the elephant all of these years, but it could be even more frightening to discover that the elephant might, one day, no longer be there.

IV. China: The Opportunity

As much as the changes have created new challenges, China has also brought new opportunities. Massive economic reforms and obligations under the WTO, for instance, have created new openings in China.³² Those that are

³⁰ *Economic Relationships Between the United States and China: Hearing Before the H. Comm. on Ways & Means, 109th Cong. (2005)* (statement of Douglas Holtz-Eakin, Director, Cong. Budget Office).

³¹ See generally *China to be Biggest Trading Partner*, *supra* note 2.

³² Susan Hamrock, Corey Whiting, Christopher Baha, & Heather Clark, *China’s Entry into*

able to understand these changes and adapt successfully will be well placed to take advantage of these ever changing circumstances. And these changes are irreversible. There is no going back.

There is also no magic recipe to success. We at the Council advise our members to objectively assess their advantages and weaknesses, and the value they can bring to the global supply chain. Companies need to ask:

- Where do we fit in the global supply chain? Can we build parallel networks outside of North America? Can we build them in Europe and Asia?
- How can my company increase productivity, add value, and be innovative?
- What is my company's competitive advantage in the global marketplace, as distinct from Canada and North America?
- How is the global economy affecting my customers' decisions and what do we have to do to continue to service our customers?
- What does the rise of China mean for my industry and my company both in Canada and globally?

China is a tough market, which demands resources. It can also be unforgiving. That's why as a minimum, companies need a passive China strategy. They need to consider how China affects the Canadian market and what they can do to survive and be relevant.

Whatever it may be, the China challenge is an opportunity for firms who can develop innovative responses, leverage their strengths against potential weaknesses in Chinese firms, create solutions for China's development needs, and continue to deliver value.

There is also significant complementarity between Canada and China. China is a resource hungry nation – and Canada is well regarded and blessed as a resource country, with both resources to explore and the expertise to do it.³³ Chinese firms have taken some initial investments in Alberta's oil patch

the WTO: What it means for U.S. Industry, EXPORT AM. 23-25 (2002).

³³ See generally, Ann McLellan, Minister of Natural Res. Can. and Member of Parliament, Speech to the Canada-China Business Council (May 21, 1996) (transcript available at http://www.nrcan.gc.ca/media/archives/speeches/1996/199651_e.htm).

and it is no secret they are looking for more, as well as to secure sources of other commodities.³⁴

As well, major Canadian financial services and insurance companies have long and established histories in China – and have successfully penetrated the Chinese market.³⁵ In China, Canada has a strong reputation as a source of environmental technologies and alternative energy sources. In addition, we have had notable successes in construction products and services, transportation, infrastructure, and education.

The future should also be about Canadian and U.S. firms jointly embracing Chinese opportunities. For instance, one of the CCBC's (the Canada China Business Council) members based in Vancouver is working on a joint venture partnership with a firm from Indiana to sell clean natural gas and liquified natural gas bus engines to China.³⁶ The partnership has been quite successful in Beijing, with over 2,000 buses being powered by their engines.³⁷ Hopefully, this can be replicated in other sectors, and build upon the many close synergies that our companies have created over many years of bilateral trade and investment flows.

Finally, there are also opportunities for Canadian and Chinese companies to work in both directions. Nortel, for example, has secured numerous contracts in China building up its communications infrastructure – and at the same time, has tentatively agreed to work on a joint venture based in Canada with Huawei, one of China's leading global firms.³⁸

We clearly need to be candid about the challenges posted by China. But we also need to be positive and hopeful enough to recognize that the flip side of the challenge coin is opportunity.

Closing

In closing, I earlier made a reference to Mr. Trudeau's analogy of sleeping next to an elephant. Well, the rise of China has brought significant changes to our "global zoo." And China's economic energy and zeal will not

³⁴ Robert Collier, *China Moves Fast to Claim Oil Sands*, S. F. CHRON., May 22, 2005, <http://www.sfgate.com/cgi-bin/article.cgi?file=/c/a/2005/05/22/CHINA.TMP>.

³⁵ See Julia Chan, *China Seeks More Aggressive Canadian Investment in Financial Sector*, INS. BUS. REV., Jan. 22, 2007, http://www.insurance-business-review.com/article_news.asp?guid=9D55F3B3-D0AF-4FD0-A29C-CACEE1DCC8A9.

³⁶ See Press Release, Westport Innovations, Inc., Cummins Westport Receives First Order for Lng-Powered Bus Engines in China (Jul. 30, 2003) (available at http://www.westport.com/news/newsdetail.php?id=201&return_to=index.php).

³⁷ See *id.*

³⁸ Press Release, Nortel Networks, Inc., Nortel, Huawei to Establish Joint Venture to Address Broadband Access Market (Feb. 1, 2006) (available at http://www2.nortel.com/go/news_detail.jsp?cat_id=-9721&oid=100194384&locale=en-US).

be reversed any time soon. Nor will their impacts on the North American marketplace. Our challenge is to fully understand what the changes mean, and embrace the new economic opportunities that are being created.

Our history in Canada, including the U.S., is rich with examples of our nations' economic resilience and the ability of our private sector leadership to adapt to changing economic forces. I remain hopeful that this spirit of entrepreneurship will continue to shape our future as a country, at a time in our history when China takes its place within the economic elite of the world.

As well, politically, it is important for both of our countries to engage China as one of our foreign policy priorities. There can be no question that the China relationship will be one of the most important of the 21st Century. It is in our interest, and in the interest of the international community at large, not to ignore or isolate this vast country, which currently represents one-fifth of humanity. Global stability, together with the promotion of our values and interests, will best come from a constructive and active engagement.

Thank you.

CHINA – TRADE OR HUMAN RIGHTS: WHICH COMES FIRST?

THE CANADIAN MODEL

Amos N. Guiora[†] and Samuel S. Riotte^{††}

I. General Overview

The question of whether trade and human rights are naturally at odds has been the subject of numerous articles, commentary, political discussion and debate.¹ The issue was much discussed in 1974 when Senator Henry “Scoop” Jackson (D-Wash) and Congressman Charles Vanik (R-Ohio) introduced the so-called “Jackson-Vanik” Amendment, which denied normal trade relations to countries with non-market economies and emigration restrictions. More specifically, it addressed then Soviet Premier Leonid Brezhnev’s implementation of a tax that effectively prevented individuals studying in the USSR from emigrating, even if it prevented them from returning to their families.

The legislation’s significance was clear: the human rights policies of a potential trading partner may dictate the extent to which trade will occur. But such policies are not always affected through legislation. The recent “globalization” of the international community has resulted in more nations making policy statements intended to cajole other states into improving their human rights stance. Canada’s recent dealings with China highlight just such a policy.

On November 15, 2006, the Canadian Prime Minister, Right Honourable Stephen Harper, made comments regarding Canadian trade with China that became the subject of much discussion. Speaking to reporters about the two

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* Remarks occurred at an event entitled The Economic Challenges of China: US & Canadian Responses, held on December 8 2006, and sponsored by Steptoe & Johnson, LLP and Kaye Scholer.

¹ See Dinah Shelton, *Protecting Human Rights in a Globalized World*, 25 B.C. INT’L & COMP. L. REV. 273 (2002); Amy J. McMaster, *Human Rights at the Crossroads: When East Meets West*, 29 VT. L. REV. 109 (2004); Frank J. Garcia, *The Global Market and Human Rights: Trading Away the Human Rights Principle*, 25 BROOK. J. INT’L L. 51 (1999); see also Human Rights in China, Statement of the WTO-Human Rights Caucus (Dec. 14, 2005), <http://www.hrchina.org/public/contents/article?revision%5fid=26420&item%5fid=26396>.

countries' relationship while en-route to the Asia-Pacific Economic Co-Operation Conference in Hanoi, Harper said, "I think Canadians want us to promote our trade relations worldwide, and we do that, but I don't think Canadians want us to sell out important Canadian values – our belief in democracy, freedom, human rights...they don't want us to sell that out to the almighty dollar..."² The Prime Minister's comments drew an immediate response both supporting and attacking the policy. Comments critical of the stance focused on two points: that it would negatively affect Canadian business interests and that Canada was interfering in internal Chinese politics. Favorable comments perceived the Prime Minister's stance as principled – he refused to make financial interests paramount to the rights of individuals.

The Prime Minister's comments, however, were not a complete surprise. Canada has been involved in bilateral human rights discussions with China since 1997, and in 1990, Canada sponsored the first resolution addressing the status of human rights in China submitted to the United Nations Commission on Human Rights.³

China initially responded to Prime Minister Harper's comments by canceling proposed talks between the Prime Minister and China's president, Hu Jintao, as the Chinese felt that Canada had made "irresponsible remarks about internal affairs."⁴ Although the talks were later rescheduled, it was clear that the Chinese were not pleased with Prime Minister Harper's comments. Some observed that, "The Chinese have sent a very strong message to Canada – that they're not very happy with the way the Tory government has shown its support for the Dalai Lama and taken a stand on human rights in China."⁵

In the months that followed, the relationship between Canada and China cooled. Though both nations indicated a desire to engage in dialogue they expressed concerns over each other's conduct. In late January 2007, Canada initiated what many viewed as a "softer" approach to China in the hopes of reinvigorating their relationship.⁶ Commentators suggested that both parties

² Officials: Harper may discuss human rights at APEC, CTV.ca News (Nov. 16, 2006), http://www.ctv.ca/servlet/ArticleNews/story/CTVNews/20061116/apec_politics_061116?s_name=&no_ads [hereinafter Officials: Harper].

³ Bilateral Human Rights Dialogue with China, Rights and Democracy (Jan. 2001), <http://www.dd-rd.ca/site/publications/index.php?lang=en&subsection=catalogue&id=1290&page=3>.

⁴ Officials: Harper, *supra* note 2.

⁵ *Id.*

⁶ Michel Cormier, *Canada's new 'China strategy'*, CBC News (Jan. 24, 2007), <http://www.cbc.ca/news/reportsfromabroad/cormier/20070124.html>.

expressed an interest in engaging in economic relations described as “cold on the political side and warm economically.”⁷

The ensuing talks, however, seem to have achieved little. In early February, China made what Canadians perceived as economic threats intended to prevent Canada from pursuing its human rights agenda. Prime Minister Harper responded by “reminding” China that Canada is the one with the leverage; that is, Canada chooses whether to buy Chinese goods and, in addition, Canada possesses oil China desires.

In determining to affect domestic policy of a sovereign nation, an “activist” nation invites international and domestic criticism alike, the former with respect to intervening in the domestic affairs of another sovereign, the latter raising concerns regarding economic damage at home. Prime Minister Harper has staked a clear position – whether this will be established and lead to an economic backlash will be determined. Nevertheless, in direct contrast to nations who turn either a “blind eye” or adopt a policy best described as a “wink and a nod,” the Canadian Prime Minister has articulated an unequivocal position directly linking future trade between the two nations to China’s domestic human rights policy.

A. *The Status of Human Rights in China*

In examining the link between the two issues, it is important to both describe and explain China’s human rights policy and practices. After the Tiananmen Square massacre in 1989, human rights in China became a concern of many nations of the world. While conventional wisdom holds that human rights conditions improved dramatically in the aftermath of the massacre, recent reports suggest that recently they have taken a turn for the worse.⁸ Chinese legislation expected to reform hot-button issues, including property ownership laws, the death penalty, and procedural rights, have lost momentum or been shelved altogether.⁹ Although civil rights movements are found within China,¹⁰ they are small, largely underground, and their survival is constantly threatened by government suppression and “in-house” conflict regarding how best to effectuate the desired changes.¹¹ The government has

⁷ Theophilos Argitis, *Canada Seeks New Chinese Investments in Oil Fields*, China Institute (Jan. 16, 2007), <http://www.uofaweb.ualberta.ca/chinainstitute/news.cfm?story=55218>.

⁸ See HUMAN RIGHTS WATCH, *WORLD REPORT 2007: EVENTS OF 2006*, 258 (2007).

⁹ *Id.*

¹⁰ The most successful of these, known as the “Weiquan Movement,” consists of a loosely organized group of lawyers, academics, and journalists who pursue social justice through litigation. Chinese authorities have targeted these individuals and many have been arrested on charges including “inciting subversion” and “illegal business activities.”

¹¹ Joseph Kahn, *Legal rivals seek to widen freedoms in China*, INT’L HERALD TRIB., Feb.

stepped up its restraint of individuals it perceives to be critical of its domestic policies. Measures to implement restraint on individuals suspected of political activism include incommunicado detention, electronic and physical surveillance, and restriction on domestic and international travel.¹² Frequently the government's efforts to silence its critics occur without arrest, thereby avoiding the unwanted international spotlight arrests can bring. Nevertheless, when arrests do occur, they are frequently the result of vague or ill-defined crimes.¹³

China cites a recent constitutional amendment guaranteeing human rights and private property ownership as indicative of the improving status of human rights within the country.¹⁴ Furthermore, China is a signatory to numerous international human rights treaties. However, Human Rights Watch speaks for many when it suggests that China "remains a one-party state that does not hold national elections, has no independent judiciary, leads the world in executions, aggressively censors the Internet, bans independent trade unions, and represses minorities such as the Tibetans, Uighurs, and Mongolians."¹⁵ Finally, attempts by international governments and non-governmental organizations to approach the Chinese government regarding these issues are frequently rejected due to China's perspective on sovereignty in the context of international relations.

B. Sovereignty

The concept of sovereignty defies a single universal definition. At the most general level, sovereignty refers to a political institution's supreme authority over a territory.¹⁶ The history of international law reveals that the concepts of human rights and sovereignty were frequently at odds.¹⁷ Recently, however, a modern conception of sovereignty and human rights has developed which maintains that the two principles have coalesced. As one commentator argues, "The State that claims sovereignty deserves respect only as long as it protects the basic rights of its subjects. It is from their rights that it derives its own. When it violates them... the State's claim to full

24, 2007, <http://www.iht.com/articles/2007/02/24/africa/web-0225china.php?page=1>.

¹² HUMAN RIGHTS WATCH, *WORLD REPORT*, *supra* note 8, at 258.

¹³ *Id.*

¹⁴ Philip P. Pan, *Chinese Leaders Speak of Reform, But How Quickly?*, *WASH. POST*, Mar. 14, 2004, at A19.

¹⁵ HUMAN RIGHTS WATCH, *COUNTRY SUMMARY: CHINA*, 1 (2006).

¹⁶ Stanford Encyclopedia of Philosophy, *Sovereignty* (June 18, 2003), <http://plato.stanford.edu/entries/sovereignty/>.

¹⁷ Vesselin Popovski, *Sovereignty as Duty to Protect Human Rights*, *UN CHRON. ONLINE EDITION*, <http://www.un.org/Pubs/chronicle/2004/issue4/0404p16.html> (last visited Mar. 19, 2008).

sovereignty falls with it.”¹⁸ The effect adopting such a definition has on China’s claim of sovereignty is clear.

One of the issues this article seeks to address is whether one nation’s attempt to shape another nation’s domestic policy violates that state’s sovereignty. By directly correlating future Canadian-Chinese trade relations to China’s human rights policy, Prime Minister Harper has *seemingly* attempted to interfere in Chinese domestic affairs. After all, the targets of Canada’s policy (and “victims” of China’s human rights policy) are exclusively Chinese nationals, not entitled to Canadian rights, guarantees, or obligations.

While Prime Minister Harper’s statements regarding the human rights practices of China may be remarkable for their frankness, the Chinese have become accustomed to such criticism. China’s response to Harper, invoking sovereignty, is representative of responses to previous, similar overtures by other countries. China rejects modern conceptions of sovereignty and human rights.¹⁹ Although China has acceded to over seventeen UN-sponsored human rights conventions,²⁰ it fails to recognize that the rights they contain trump its sovereignty. According to one international law professor in China, “Each country has the right to choose its own human rights development model without interference from outside. To protect human rights is mainly to prevent foreign invasion or occupation, racial discrimination and international terrorist activities.”²¹ As a result of this perspective, past attempts to influence Chinese human rights have largely failed. China maintains that they meet the international requirements and additionally admonish those who attempt influence by maintaining that their overtures violate China’s sovereignty.

C. International Trade

Trade relationships are premised on a basic “give and take” between partners – sometimes equal, other times not. An examination of China’s

¹⁸ See Stanley Hoffman, *The Politics and Ethics of Military Intervention*, 27 SURVIVAL 29 (1995).

¹⁹ See *China’s View of Sovereignty Significantly Different*, China Policy Institute International Conference on “China in the International Order: Integrating Views from Outside-In and Inside-Out” The University of Nottingham (September 2006), available at http://www.nottingham.ac.uk/china-policy-institute/events/China_in_the_International_Order_Conference_Sep_2006.php.

²⁰ Relations Between China and The UN Human Rights Mechanism, Permanent Mission of the People’s Republic of China to the United Nations Office at Geneva and other International Organizations in Switzerland, <http://www.fmprc.gov.cn/ce/cegv/eng/rqrd/jblc/t85088.htm> (last visited Mar. 19, 2008).

²¹ *Are human rights higher than sovereignty?* PEOPLE’S DAILY ONLINE, Mar. 17, 2006, http://english.people.com.cn/200603/17/eng20060317_251529.html.

economy suggests the following: in order to maintain the phenomenal growth of the past three decades,²² China is heavily dependent on crude oil. While China's presence in the Middle East has existed for some time,²³ only recently has it had to engage in relationships with additional countries to meet its oil needs.²⁴ In 1992, China produced enough oil to completely satisfy its domestic needs. Fifteen years later, China is notorious for its ceaseless search for oil in every corner of the world and its willingness to work with any government to satisfy the need.²⁵ China's dependence on imported oil is absolute; to meet it China has agreements with numerous countries allowing China access to their oil.²⁶ In many cases these agreements are with regimes that promote sub-standard human rights laws in areas rife with security concerns, including Sudan, Nigeria, and Iran.²⁷ Additionally, in 2005, construction of an oil pipeline from the Caspian Shelf in Kazakhstan to western China began.²⁸ The pipeline ends in Xinjiang, an autonomous region in western China. Nearly half of the region's people are Uighur,²⁹ a Muslim population frequently accused of terrorism by the Chinese government.

While these are all of great importance to the Chinese, an additional significant source of oil for them is the Alberta oil patch in Alberta, Canada.³⁰ The patch's fossil fuels are in the form of oil sands, as opposed to

²² The average annual growth rate of China's GDP has reached nearly 10% over the last 25 years. Furthermore, based on China's official poverty line, the poverty rate in China dropped from 33% in 1978 to less than 3% in 2004. See JIKUN HUANG, JUN YANG, & SCOTT ROZELLE, CHINA'S RAPID ECONOMIC GROWTH AND ITS IMPLICATIONS FOR AGRICULTURE AND FOOD SECURITY IN CHINA AND THE REST OF THE WORLD, <http://www.fao.org/docrep/009/ag088e/AG088E03.htm> (last visited March 3, 2007).

²³ China and Saddam Hussein's Iraq sought the right to develop Iraq's oil patch together though UN sanctions against Iraq prevented realization of this goal. See Peter S. Goodman, *Big Shift in China's Oil Policy*, WASH. POST, July 13, 2005, at D01.

²⁴ *China Needs More Oil*, PEOPLE'S DAILY, July, 5, 2000, http://english.people.com.cn/english/200007/05/eng20000705_44761.html.

²⁵ William Mellor and Le-Min Lim, *China Drills Where Others Dare Not Seek Oil*, INT'L HERALD TRIB., Oct. 2, 2006, <http://www.iht.com/articles/2006/10/01/bloomberg/bxchioil.php>.

²⁶ These areas include central Asia, Latin America, South America, and Africa. See Robert Collier, *China on Global Hunt to Quench its Thirst for Oil*, SAN FRANCISCO CHRON., June 26, 2005, <http://www.sfgate.com/cgi-bin/article.cgi?file=/c/a/2005/06/26/MNG27DF8HQ1.DTL>.

²⁷ Matthew Forney, *China's Quest for Oil*, TIME, Oct. 18, 2004, <http://www.time.com/time/magazine/article/0,9171,501041025-725174,00.html>.

²⁸ *China Starts Work on Kazakhstan-China Oil Pipeline*, PEOPLE'S DAILY ONLINE, Mar. 25, 2005, http://english.people.com.cn/200503/25/eng20050325_178162.html.

²⁹ Xinjiang Uygur Autonomous Region, People's Daily, <http://english.peopledaily.com.cn/data/province/xinjiang.html> (last visited Mar. 19, 2008).

³⁰ See, Simon Romero, *China Emerging as a U.S. Rival for Canada's Oil*, N.Y. TIMES, Dec. 23, 2004, <http://www.nytimes.com/2004/12/23/business/worldbusiness/23canada.html?pagewanted=1&ei=5088&en=bec439e3e7482281&ex=1261458000&partner=rssnyt>.

traditional crude oil, and this makes extracting oil more expensive. But the recent surge in oil prices has made the deposit, projected to be the second largest source of oil in the world behind Saudi Arabia, a coveted source of energy. Many believe it is capable of satisfying much of the world's energy needs for the next century. Not only has China expressed interest and invested in the oil patch, it appears that one of the major oil sands developers will use Chinese technology to extract crude from the sands.³¹

Prime Minister Harper's position takes on enormous significance when understood in the larger context of China's oil requirements. Linking human rights violations to trade may potentially impact China's ability to procure this additional oil. However, Canada's strength is predicated on China's inability to develop sufficient oil sources elsewhere. As one prominent Canadian business leader commented, "if the Chinese find sufficient oil elsewhere, they'll drop us [Canada] immediately and take 'their ball' elsewhere."³² With China's numerous and expanding interests in the international oil market, the issue becomes whether Canada has the requisite leverage to influence human rights in China.

II. Analysis

Circumstances such as those outlined above bring to the forefront questions regarding a nation's right to influence – some would say interfere with – another nation's domestic policy. This issue requires analyzing the limits and extent of sovereignty and will be discussed in section A below. An analysis of whether Canada's policy is effective and the criteria for determining such effectiveness will be discussed in section B. Furthermore, as the discussion cannot and does not take place in a political vacuum, an examination of factors that determine a nation's domestic and foreign relations is inherent to the analysis; this will be the focus of section C. Finally, in examining the issue from an integrative perspective, one of the fundamental questions is what external factors affect the human rights-trade relationship; this issue will be the focus of section D. The conclusion will present recommendations regarding the articulation and implementation of a policy, based on law that enables – or seeks to enable – a sovereign to interfere in the domestic affairs of another sovereign.

³¹ See Andrew Leonard, *Canada's Oil Sands Industry: Made in China?*, http://www.salon.com/tech/htww/2006/12/07/china_oil_patch/index.html (last visited March 30, 2008).

³² Private conversation with one of the authors.

A. *Limits and Extent of Sovereignty*

The first issue to address is whether Canada's policy potentially infringes on China's sovereignty. The sovereignty analysis can best be summarized as follows: though Canada has not engaged in an "armed attack,"³³ the Prime Minister directly sought to both influence Chinese internal politics and tacitly threatened to deprive China of a much needed resource. While Harper's policy would seem to suggest interference in Chinese sovereignty, unlike armed interference, the Chinese are free to ignore Canada's policy. Since many propose that sovereignty is simply the ability to make a choice free of coercion,³⁴ and China is free to choose to trade with Canada, then Canada has not infringed on Chinese sovereignty.

But China responded to Harper's comments by arguing that Canada violated its sovereignty. Such a response is problematic for a number of reasons, the least of which is that Canada has taken no concrete steps regarding the effects China's human rights standards will have on its relationship with Canada. At this point there are no circumstances that make such statements coercive. Rather, Prime Minister Harper simply made a public statement he believed represents a common concern of Canadian citizens, namely a desire to protect human rights. At this point, no legislation has been passed that would limit Canadian involvement with China at any level. Absent any concrete act that mandates China alter its behavior, China's response seems premature and reactionary. It certainly cannot claim that Harper's opinion in and of itself violates its sovereignty. But the question remains: at what point could Harper's comments represent an infringement on China's sovereign right to conduct its internal affairs as it sees fit?

The question becomes more interesting in the event that Canada proposes and passes legislation that does curtail its relationship with China. For example, Canada may decide to pass legislation that makes the extent of its trade with China dependant on China improving its human rights practices. Presently, Canada maintains a substantial trade deficit with China; simply put, this means Canada spends more money on Chinese goods than China spends on Canadian goods. Thus, any Canadian law predicating its trade with China on Chinese human rights practices would, at a most basic level, limit the amount of Chinese goods entering Canada. While this would likely affect the daily lives of millions of Canadians, the question of whether this would have any measurable affect on China's economy is less clear.

China has indicated that its trade relationship with Canada leaves something to be desired. China recently implied that Canada is lagging

³³ U.N. Charter art. 51.

³⁴ See Jack Donnelly, *State Sovereignty and Human Rights*, <http://www.du.edu/~jdonnell/papers/hrsov%20v4a.htm> (last visited Mar. 19, 2008).

behind other nations with regard to its trade relationship with China, meaning that China may further limit or suspend trade with Canada unless Canada actively engages in behaviors demonstrating to China its desire to continue trading. While these statements are likely nothing more than a Chinese attempt to induce Canada to increase its trade with China, if they are true, it means that Canada need not threaten to reduce trade with China over its human rights standards, for maintaining the status quo in its relationship will have the same result. Statements such as Harper's may only speed the decline. Thus, it appears that China, too, makes efforts to shape the trade policies of other nations.

The effect such legislation would have on China's ability to invest in and secure rights to Canada's oil sands also merits discussion. Assuming that there is as much crude oil in Alberta as projected, it will surely become an integral source for satisfying numerous countries' energy needs. If Canada does pass legislation limiting China's access to Canadian oil without substantial change in China's human rights policies, China will have little choice but to submit to Canada's demands. Furthermore, China's recent decisions to invest in regions of the world that are frequently subject to political instability increases the possibility that present sources of Chinese oil may, in the future, no longer be available. Thus, it would appear that in the world of securing energy, Canada might have a large and irresistible carrot to dangle in front of China. Would Canada's demands in this context rise to the level of sovereignty violations?

B. Policy Effectiveness

In examining policy effectiveness, it is essential to initially define "effectiveness." Foreign relations often reflect a composition of a nation's perspective in the areas of geo-politics, philosophy, and real politic. Those relations manifest themselves through words and deeds alike, though non-action is as significant as action. Analyzing a nation's foreign policy also requires an appreciation for domestic realities and limits. Furthermore, it is important to discern the intended audience of a particular policy. Henry Kissinger, as described in Jim Mann's authoritative book on US-China relations, was a practitioner of the "feign" with respect to the US foreign affairs conducted during the Nixon years.³⁵ It should be added that the "bob and weave" and deceptions that were a Kissinger hallmark were intended for domestic and international audiences alike.

In direct contrast, Prime Minister Harper's words appear to represent a different school of thought, one predicated on "I mean what I say and I say

³⁵ See JIM MANN, *ABOUT FACE: A HISTORY OF AMERICA'S CURIOUS RELATIONSHIP WITH CHINA, FROM NIXON TO CLINTON*, (First Vintage Books, 1999).

what I mean.” In examining media reports and commentaries and speaking with individuals from different sectors,³⁶ the overwhelming impression is that Prime Minister Harper, unlike Kissinger, was not engaging in the feign. Rather, Harper was seeking to affect Chinese domestic policy so that they reflect his notion of human rights.

On the assumption that this analysis is correct, what criteria should be developed for determining the policy’s effectiveness? In developing a matrix, the following parameters are suggested:

- 1) What are the policy’s goals?
- 2) Who is the intended audience?
- 3) Is the desired change realistic?
- 4) What are the consequences if the policy fails?
- 5) If the policy has been previously articulated, did it succeed or fail and why?
- 6) What is the vehicle for influencing the suggested policy change?

Based on the above matrix, the following answers serve as a convenient road map in determining the effectiveness of Prime Minister Harper’s policy. The policy’s goal – on the presumption that Harper is to be taken at face value – is to directly affect change in China’s human rights policy with respect to Chinese nationals. But in order to be successful the goal must be more clearly articulated. Harper does not represent a new Canadian perspective; he is just the most recent to articulate it. And, as in the past, the main critique of his demand on China is that it lacks specificity.

There are at least four intended audiences: the Chinese government, the Chinese people, Canadian business leaders engaged in trade with China, and the nations of the world. In analyzing audience impact, the requisite follow-up question is whether the impact on all four should be considered equally or whether Harper’s message is intended for one audience more than the others. We suggest the latter and therefore propose the following order: the Chinese government, Canadian businesses, the nations of the world, and the Chinese people. With respect to the other identified audiences, particularly the nations of the world, their importance (from a policy effectiveness perspective) is

³⁶ Private conversations as preparation for the writing of this article.

unclear. If they adopt Canada's principled position, then Harper can subscribe to himself a modicum of success that will ultimately be tempered when one (or more) nation determines that its national self-interests are best served by engaging China in trade rather than attempting to reform Chinese domestic policy.

The critical issue is whether Canada's demands are realistic. The "X" factor in this equation is whether the Chinese government truly needs Canadian oil. That is, if the Chinese are satisfactorily and consistently able to procure foreign oil from elsewhere, then Canada's importance as a trading partner is significantly reduced. In that event, the Canadian policy will be "high on principle" while simultaneously "low on effectiveness."

C. Foreign Policy

Turning to the consequences if the policy fails, as indicated earlier, there is some indication that Canada's policy toward trade with China is already failing from the Chinese perspective. If that is true, one could argue that Harper's position, if it fails, is likely to only exacerbate an already struggling relationship. From the perspective of Canadian businesses, they may argue that a faltering relationship with China means Canada should do more to repair a weak relationship, something that Harper's position surely does not do.

From Machiavelli to Metternich, foreign relations have ultimately been a reflection of a nation's self-interest; world order reflects a balance of competing, sometimes converging, national interests. Whether principle is relevant to realpolitik is an open question; however, it would seem that economic interests outweigh matters of conscience *even if* individual nations strive to develop a principled foreign policy. That is why the question of intended audiences is so critical to this discussion.

The policy will have failed (from a Canadian perspective) if China procures oil elsewhere and will therefore be able to politely (at best) listen to Prime Minister Harper while duly ignoring his principled approach. The losers? From an economic perspective, the oil speculators in specific and the Canadian economy in general. The winners? China's *other* sources of oil. If international trade is to be viewed as a zero sum game, then a principled policy – or at least one that stakes a principled position – suggests an approach devoid of compromise, and one potentially best expressed as long on principle and short on practicality.

D. An Integrative Analysis: The Olympics – Will Circumstances Force the Issue?

There is also an additional factor to be taken into consideration when

analyzing Chinese human rights policy: the 2008 Olympics. Many have expressed concern that the process of preparing Beijing for the Olympics will necessitate a litany of human rights abuses including, but not limited to, home demolition, restrictions on travel, and insufficient wages for workers. Similarly, there are concerns that during the Olympics China's tight control on freedom of expression will result in further human rights abuses. These issues must be addressed from at least two different perspectives: Chinese attitudes regarding the rights of the individual and the state's obligation with respect to the individual and how human rights violations will "play" in the court of international opinion. To work our way backwards – if the Chinese government is perceived to have engaged in significant human rights violations either before or during the Olympics, international public opinion may force other nations to, at a minimum, address the egregious violations. How serious must violations be in order for states to "violate Chinese sovereignty" by interfering in internal Chinese matters is an open question, but one that may be based on the Canadian model.

As mentioned earlier, China is in the midst of constructing an oil pipeline in the westernmost region of the country to help address its oil needs. Because the oil pipeline runs through Xinjiang, concern has also been raised regarding the possibility of an al-Qaeda terrorist attack in the predominantly Muslim province. The suggested timing: either as a run-up to the Olympics or during the Games themselves.³⁷ With the world watching, would the Chinese respond to such a hypothetical attack with their "gloves off" and therefore, potentially, engage in egregious human rights violations? And if so, would Canada's proposed method of protecting the human rights of Chinese citizens be adopted if the international community chooses to get involved? What would be the costs?

III. Conclusion

According to scholars, China's political history and philosophy suggest that the regime not concern itself with domestic opposition to human rights violations because the individual is expected to be subservient to the needs of the state. In other words, if the state, in response to a terrorist attack on a vital resource (oil) violates the individual human rights of a particular population (Muslims), the general population will exercise restraint in its criticism of the state. While clearly reflective of "lessons learned" from its Maoist past (the Cultural Revolution is but one example of how the state or the Communist Party aggressively responds to internal dissension), it gives the state

³⁷ China: Exploiting the Uighur 'Terrorist Camp' Raid, Strategic Forecasting, Inc., Jan. 10, 2007, http://www.stratfor.com/products/premium/read_article.php?id=282716&selected=Analyses.

significant “wobble room” from within with respect to how it conducts domestic policy. While that may be the case, the question that stands before us is whether other nations will adopt the Canadian model, or will “lip service” be the preferred response in the name of “mutual business interests.”

If history is an indicator (Santayana’s “those who fail to learn from history are doomed to repeat it” may, yet again, prove prophetic), then the majority of the nations of the world will opt not to follow the Canadian example. History is replete with examples of the turning of a blind eye, rather than taking a principled stand. In this context, are we to view Canada’s stance as a violation of Chinese sovereignty or as a principled stand reflective of the “higher moral ground?” The answer would seem to lie with who is asking the question; from the Chinese perspective, the Canadian position would seem to violate Chinese sovereignty whereas the Canadians would, no doubt, argue that their principle supersedes sovereignty. The question becomes whether these opposing views may meet somewhere in the middle, as international trade, resources procurement, and the international stage center more on China.

THE CHINA FACTOR:
CANADA'S TRADE REMEDY RESPONSE TO CHINA'S
ECONOMIC CHALLENGE

Lawrence L. Herman[†]

I. Introduction

Growing concern is being voiced in the Canadian manufacturing sector over the huge and unrelenting increase in Chinese goods entering the market. This has produced allegations of unfair trading, and Canadian companies have increasingly resorted to invoking Canada's trade remedy laws as one response to this phenomenon. The results of these cases are mixed, however. While some complainants have succeeded, the overall results are less than decisive that Chinese-origin imports have been massively dumped or subsidized or have been injuring Canadian production.

Dumping complaints against Chinese imports under Canada's Special Import Measures Act¹ ("SIMA") have been around for many years. Until recently, Canada allowed the use of surrogate-country data for purposes of estimating Chinese dumping margins, given the policy of the Canada Border Services Agency ("CBSA" or "Agency") and its predecessors that China was a non-market economy country. This long-standing policy has been gradually changed over the last ten years, culminating in a key policy statement by the

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¹ Special Import Measures Act ("SIMA"), R.S.C., ch. S 15 (1985) (covers various anti-dumping liabilities, as well as countervailing and provisional duties). SIMA came into force in 1984, incorporating Canada's international obligations under the GATT and the former GATT Codes. It has been amended over the years to implement Canada's obligations under the 1987 Canada-US Free Trade Agreement, the 1994 North American Free Trade Agreement and the 1994 World Trade Organization Agreement. Details on the implementation of trade relief are contained in the Special Import Measures Regulations. *See, e.g.*, Special Import Measures Regulations SOR/1984-927 (Can.) (amending SIMA, R.S.C., ch. S 15, § 17 (1985)).

Agency in 2004 that, unless proven otherwise, it will consider China to be operating under free market principles.

With respect to subsidies, unlike the United States, Canadian law permits the application of countervailing duties on goods from China.² Canadian countervail cases against China, however, were non-existent until 2004. Since then, partially resulting from the change in CBSA policy regarding market-economy countries, there have been a number of investigations and two final determinations resulting in countervailing duties on Chinese imports. Because complete information from the Chinese government on its subsidy programs was not provided, however, the jury is still out on just how many, and to what extent, Chinese government programs are aiding manufacturing industries in that country.

With respect to safeguards (“emergency” relief), Canadian laws were changed in 2002 to implement China’s World Trade Organization (“WTO”) accession protocol and to permit targeted cases to be taken against Chinese products that are alleged to have caused market disruption.³ The Canadian experience in the single China safeguard case to date has not been positive. The government has signaled a reluctance to implement safeguard relief – for a variety of reasons – against consumer products coming from China.

II. Changes in Canadian Policy on China’s Market Economy Status

China had historically been considered a state-trading nation in dumping investigations by the CBSA and its predecessors, which have used surrogate-country information to estimate Chinese normal values. Typical of its approach was the investigation in *Carbon Steel Plate*⁴ in 1997, where the CBSA’s predecessor agency said this:

The Department has historically designated China as a state-controlled economy with the result that normal values for imports from China

² Subsidy-countervail complaints in Canada are also governed by SIMA, which makes no distinction between subsidies in a market economy country and subsidies in a state-controlled or non-market economy country. Under SIMA’s definition of “subsidy,” the necessary criteria depend not on the nature of the economic system but whether a financial or other contribution has been provided by the state and a benefit conferred on the recipient. *See* SIMA, *supra* note 1, § 2(1)(i)(a), (b).

³ Safeguard relief in Canada is governed by the Canadian International Trade Tribunal Act (“CITT Act”), R.S.C., ch. 47 (1985) (4th Supp.), which was amended to implement Canada’s rights and obligations under the WTO accession protocol with China.

⁴ Certain Hot-Rolled Carbon Steel Plate – Statement of Reasons for Final Determination, File No. 4258-102, AD/1139 (Can. Border Services Agency Sept. 25, 1997), *available at* <http://cbsa-asfc.gc.ca/sima-lmsi/i-e/e/ad1139/ad1139p-eng.html>.

have generally been determined on the basis of sales of like goods in a third or surrogate country.

At the time of initiation, the Department forwarded a Request for Information to the Chinese Government and exporters in an effort to determine whether the steel industry in China should still be considered to be state-controlled. In response, the Department received submissions from the Government as well as two exporters - Shanghai Pudong Iron & Steel (Group) Co. Ltd. and Angang Group International Corporation.

In reviewing these submissions, the Department identified additional information requirements and supplementary Requests for Information were issued.

The Government of China responded to the Department's supplementary Request for Information just prior to the preliminary determination. Based on a review of the submission, additional information and clarifications were required. Accordingly, shortly after the preliminary determination, another supplementary Request for Information was sent out.

No response was received from the Chinese Government or the two exporters regarding the Department's latest Requests for Information.

....

As responses to the Department's latest Requests for Information have not been received and on-site verification has yet to take place, the Deputy Minister cannot form an opinion as to whether the steel industry in China continues to be state-controlled under the provisions of the SIMA.

As with Russia, *the economy of China has historically been considered to be state-controlled. Accordingly, normal values for the subject goods of Chinese origin were also established by ministerial specification on the basis of the average normal value found for like goods in three surrogate countries.*⁵

The above-cited passage exemplifies a long-standing policy on the part of Canada's investigating agencies that had considered China to be a non-market economy unless otherwise demonstrated, meaning that the burden was on the exporters and Chinese government to make the case.⁶ This policy

⁵ *Id.* (emphasis added).

⁶ Other illustrative cases where the Agency and its predecessor relied on generally-available information to conclude that China was a non-market economy country and that the sector under investigation was not based on free market principles include: Certain Xanthates

obviously facilitated the task of Canadian complainants, who were faced with difficulties obtaining reliable Chinese domestic selling-price information or estimating Chinese production costs that bore any semblance of reality.

The Agency's policy began to shift in the early years of the present decade. An illustration of this is *Laminated Windshields*,⁷ a dumping case initiated in 2001. The Agency accepted the complainant's submissions on initiation that China was a non-market economy.⁸ It maintained this view at the Preliminary Determination, albeit with some cautionary observations.⁹ The full surprise was saved for the Final Determination where the Agency changed course and arrived at the following conclusion:

Based on the analysis of the responses received from the government, the four exporters and publicly available information as well as

– Statement of Reasons for Final Determination, File No. 4240-50, AD/1282 (Can. Border Services Agency Feb. 3, 2003), *available at* <http://www.cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1282/ad1282i-eng.html> [hereinafter *Xanthates - Final*]; Certain Hot-Rolled Carbon Steel Sheet – Statement of Reasons for Final Determination, File No. 4258-114/AD-1262 (Can. Border Services Agency July 18, 2001), *available at* <http://www.cbsa-asfc.gc.ca/sima-lmsi/errr/rr2001-006/rr2001-006s-eng.html>; Certain Corrosion-Resistant Steel Sheet Products – Statement of Reasons for Final Determination, File No. 4218-11/CV92, 4258-113/AD-1258 (Can. Border Services Agency June 4, 2001), *available at* <http://cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1258/ad1258i-eng.html>; Garlic, Fresh or Frozen – Statement of Reasons for Final Determination, File No. 4237-89, AD/1250 (Can. Border Services Agency Apr. 2, 2001), *available at* <http://www.cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1250/ad1250f-eng.html>.

⁷ Automotive Laminated Windshields – Statement of Reasons for Initiation of Investigation, File No. 4264-60, AD/1278 (Can. Border Services Agency Dec. 18, 2001) *available at* <http://cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1278/ad1278i-eng.html> [hereinafter *Laminated Windshields - Initiation*]; Automotive Laminated Windshields – Statement of Reasons for Preliminary Determination, File No. 4264-60, AD/1278 (Can. Border Services Agency May 2, 2002) *available at* <http://www.cbsa.gc.ca/sima-lmsi/i-e/ad1278/ad1278p-eng.html> [hereinafter *Laminated Windshields - Preliminary*]; and Automotive Laminated Windshields – Statement of Reasons for Final Determination, File No. 4264-60, AD/1278 (Can. Border Services Agency July 31, 2002), *available at* <http://customscanada.com/sima-lmsi/i-e/ad1278/ad1278i-eng.html> [hereinafter *Laminated Windshield - Final*]. *Laminated Windshields – Initiation*, *Laminated Windshields – Preliminary*, and *Laminated Windshield – Final* are hereinafter collectively referred to as *Laminated Windshields*.

⁸ See *Laminated Windshields – Initiation*, *supra* note 7.

⁹ See *Laminated Windshields – Preliminary*, *supra* note 7. The Agency stated, however, that its consideration of China as a non-market economy was still under consideration:

In view of the amount of information provided, the CCRA has not completed its analysis and cannot at this time, form an opinion as to whether section 20 of SIMA is applicable to exports from China. Verification visits to the government, exporters and vendors of the subject goods will be made at the earliest opportunity to obtain clarification deemed essential to enable the Commissioner to form an opinion on the matter. The examination of all the information collected so far in addition to the further clarifications will allow the Commissioner to form an opinion on whether sections 20, 15 to 19, or 29 of SIMA apply to the calculation of the normal value of ARG windshields. *Id.*

information retrieved during the verification visits, pursuant to subsection 20(1) of SIMA, the Commissioner is of the opinion that the government of China *does not have a monopoly or substantial monopoly over its export trade in the replacement windshield industry*. The Commissioner is also of the opinion that *the government of China does not substantially determine domestic prices and that there is no sufficient reason to believe that these prices would be different in a competitive market*. Consequently, the CCRA considers that China's replacement windshield industry operates under market conditions and that the provisions of section 20 do not apply.¹⁰

In another subsidy investigation in *Leather Safety Footwear*¹¹ in 2001, later in that same year, the CBSA reverted to surrogate-country data but only because of insufficient information from the Chinese Government to show that free market principles were in operation. The Agency made it clear, however, that with more complete information from the Chinese end, it would be prepared to hold that that country and the industry concerned to be operating on a free market basis:

The government of China provided a response to the CCRA's questionnaire regarding the economic conditions in the footwear sector. This submission was deemed to be incomplete and inconclusive with respect to whether economic reforms have progressed sufficiently such that the footwear sector is no longer operating in non-market economic conditions.

For the purpose of the preliminary determination of dumping, the CCRA maintained its position that the footwear industry in China is operating under non-market conditions....

In the absence of sufficient information from the government of China and the producers in the surrogate countries, normal values were estimated on the basis of the best available information, i.e. information supplied in the complaint.

The government of China has not responded to a supplementary RFI issued at the time of the preliminary determination of dumping. Therefore, the CCRA's position that footwear industry in China is operating under non-market conditions remains unchanged. As a

¹⁰ *Laminated Windshields – Final*, *supra* note 7 (emphasis added).

¹¹ *Leather Footwear with Metal Toe Caps Excluding Waterproof Footwear Subject to the Finding by the CITT in Inquiry No. NQ-2000-004 – Statement of Reasons for Final Determination*, File No. 4261-124, AD/1275 (Can. Border Services Agency Nov. 27, 2001), available at http://www.citt-tcce.gc.ca/dumping/preinq/determin/pi2b001_e.asp [hereinafter *Leather Safety Footwear – Final*].

result, the CCRA continued its attempts to obtain information from producers in a surrogate country. These requests have yielded no information to date.¹²

Later investigations following *Laminated Windshields* and *Leather Safety Footwear* continued the Agency's policy of holding that China was a non-market economy but with the caveat repeated that, if enough information was provided to the Agency by Chinese authorities and by the industries under investigation, it would be prepared to deem that particular sector to be a free market and disallow use of surrogate-country data.¹³

That policy change was formally promulgated by the CBSA in an important notice to stakeholders in June 2004.¹⁴ The notice said that substantial progress had been made in former Communist countries, including countries like China, toward market liberalization. The Agency therefore decided to abandon its existing policy of a blanket categorization of China as a non-market economy country in favour of a case-by-case examination of the sector under review.

A critical part of the new policy was the change in the nature of the evidence that the Agency would rely on in applying that policy. As noted previously, the Agency had traditionally proceeded on the assumption that any country, like China, operating under a Communist or state-controlled form of government was a non-market economy. The burden was on the exporters' government and on responding industries to disprove that fact. The new policy shifted the evidentiary burden to the complaining industry in Canada. As stated by the Agency:

Regardless of the country, sector or product under investigation, anti-dumping investigations and re-investigations (administrative reviews) are to be initiated *on the presumption that section 20 of the Act is not applicable to the sector under investigation unless there is evidence that suggests otherwise.*

....

¹² *Id.*

¹³ See *Xanthates - Final*, *supra* note 6; see also Carbon Steel Pipe Fittings – Statement of Reasons for Final Determination, File: 4258-119, AD-1291 (Can. Border Services Agency June, 27, 2003), available at <http://www.cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1291/ad1291i-eng.html>.

¹⁴ See Canadian Border Services Agency, Information on the Application of Section 20 of the Special Import Measures Act (“Non-market Economies”) (August 2007), available at <http://www.cbsa-asfc.gc.ca/sima-lmsi/section20-eng.html>.

If a complainant alleges that goods are exported to Canada from a country in which the conditions described under section 20 apply, the complainant must provide information to support the allegation.

The President will not initiate a section 20 inquiry if there is insufficient evidence that the conditions of section 20 may exist in the sector under investigation.

*If the complainant cannot provide sufficient evidence regarding the conditions of section 20, the evidence of dumping provided in the written complaint must be based on prices or costs of the goods in the country of export rather than prices and costs in a third country.*¹⁵

Section 20 of SIMA, it should be explained, deals with determinations of non-market economy status and the conditions under which surrogate-country normal value information is permitted. It reads in part:

- (1) Where goods sold to an importer in Canada are shipped directly to Canada
 - (a) from a *prescribed country* where, in the opinion of the Commissioner, domestic prices are substantially determined by the government of that country and there is sufficient reason to believe that they are not substantially the same as they would be if they were determined in a competitive market, or
 - (b) from *any other country* where, in the opinion of the Commissioner,
 - (i) the government of that country has a monopoly or substantial monopoly of its export trade, and
 - (ii) domestic prices are substantially determined by the government of that country and there is sufficient reason to believe that they are not substantially the same as they would be if they were determined in a competitive market,¹⁶

then the normal value of the goods may be determined by reference to either the selling prices at the same level of trade and under the same conditions in

¹⁵ *Id.* (emphases added).

¹⁶ (emphasis added).

a surrogate country or, under certain circumstances, by reference to the costs of production, etc., in that surrogate country.¹⁷

There is an important distinction between paragraph (a) and paragraph (b) of Section 20(1): under paragraph (b), the normal value of imported goods from a non-market country will be determined where, in the opinion of the CBSA (1) the government of that country has a monopoly or substantial monopoly of its export trade *and* (2) domestic prices are substantially determined by the government of that country and there is sufficient reason to believe that they are not substantially the same as they would be if they were determined in a competitive market. Under paragraph (a), however, for any “prescribed country” the conditions for finding non-market economy status are less stringent. China is the only country to so far have been “prescribed.”¹⁸ In order to find that a Chinese industry is operating in a non-market situation and thus to use surrogate-country data, the President of the CBSA has to be of the opinion only that domestic prices in China are *substantially determined* by that government (as opposed to there being a government monopoly). The other condition – that there must be “sufficient reason to believe” that such prices are not substantially the same as they would be in a competitive market – remains the same as for non-prescribed countries.

But while the conditions for finding non-market economy status are less stringent for China, the onus under the June 2004 CBSA policy still remains on the complaining industry to satisfy the Agency as to the existence of the necessary conditions. These provisions will be applied on a *sectoral basis* by the Agency.

The result is that determining non-market economy conditions for China in any given case will not only depend on the circumstances of the particular sector, it will require the complaining industry to present evidence in its complaint to justify the Section 20 designation for China on the basis of the above two Section 20 factors. Moreover, the fact that it found that the

¹⁷ *Id.*

¹⁸ As part of Canada’s implementation of the WTO accession protocol, China has been listed as a prescribed country under section 20(1)(a) of the CITT Act, the only country designated by order in council. See Special Import Measures Regulations SOR/96-255; see also Government of Canada, *Regulations Amending the Special Import Measures Regulations*, CANADA GAZETTE, October 9, 2002, at 1, available at <http://canadagazette.gc.ca/partII/2002/20021009/html/sor349-e.html>; but cf. An Act to Amend Certain Acts as a Result of the Accession of the People’s Republic of China to the Agreement Establishing the World Trade Organization [hereinafter *Act Amending China’s Accession to the WTO*], B. C-50, House of Commons of Can. (2002), available at http://www2.parl.gc.ca/content/hoc/Bills/371/Government/C-50/c-50_3/90177bE.html; Information on the Application of Section 20 of the Special Import Measures Act (“Non-market Economies”), *supra* note 14.

conditions under Section 20 exist in a particular sector in China will not necessarily have any relevance in respect of any other Chinese sector that is under investigation in a subsequent case.

In *Laminate Flooring*,¹⁹ a 2005 dumping and subsidy investigation under the CBSA's new policy, the Agency concluded that in that particular sector China was a free market, and dumping margins were therefore assessed in the normal case using estimated costs of production in China. The complainant disagreed with that approach. It made representations to the Agency to change it. These submissions were rejected:

Counsel for the complainant provided representations that the CBSA policy on section 20, issued in June 2004, is 'wrong in law and in policy and ought to be reversed.' Counsel quotes SIMA, and the *Protocol on the Accession of the People's Republic of China to the WTO* and states that the onus should be on Chinese exporters to clearly show that market economy conditions prevail in China rather than Canadian producers showing an absence of market conditions in China.

The CBSA addressed this subject in the SOR issued at the preliminary determination of this investigation. The CBSA did not find any information during its verification visits of the two largest Chinese exporters nor was any additional information provided to the CBSA that would suggest that the GPRC was substantially determining domestic prices of laminate flooring.²⁰

The result was a final dumping margin for China of the relatively modest average amount of just short of 8% (as a percentage of the export price) with 0% margins for one of the exporting companies.²¹ The Agency's method of calculating final dumping margins for China is currently the subject of a judicial review application to the Federal Court of Appeal brought by the complainant.²² The Agency's decision that Chinese producers were operating in an open market, however, is *not* one of the issues in the application.

¹⁹ Certain Laminate Flooring – Statement of Reasons for Final Determination, File No. 4214-4, AD/1332; 4218-19, CVD/104, ¶¶ 56-57 (Can. Border Services Agency June 1, 2005) <http://www.asfc-cbsa.gc.ca/sima-lmsi/i-e/ad1332/ad1332nf-eng.html> [hereinafter *Laminate Flooring – Final*]; see also Certain Laminate Flooring – Statement of Reasons for Preliminary Determination, File No. 4214-4, AD/1332; 4218-19, CVD/104, ¶ 123 (Can. Border Services Agency Mar. 3, 2005), available at <http://www.cbsa-asfc.gc.ca/sima/anti-dumping/ad1332p-e.html>.

²⁰ *Laminate Flooring - Final*, *supra* at note 18.

²¹ *Id.*, Appendix 2. In the same determination, the subsidy amount, discussed further below, was found to be very small for most of the Chinese-based producers and exporters, with the average subsidy equaling merely 3% as a percentage of the export price. *Id.*

²² See generally, *Uniboard Surfaces Inc. v. Kronotex Fussboden GmbH and Co.*, No. A-

The changes in Canadian policy regarding China have caused Canadian trade remedy laws to diverge substantially from those in the United States. Under U.S. policy, China is considered by the Commerce Department to be a non-market economy²³ and this policy seems unlikely to change, at least in the near term.²⁴

Since the 2004 policy change in Canada, there have been five dumping investigations involving Chinese-origin goods where the CBSA rejected use of surrogate-country data for normal value purposes – that is, the CBSA determined that, for those particular goods, Chinese producers operated under market economy conditions. Estimates of normal values followed the usual course of investigations where exports from market economy countries were involved.²⁵ In the most recent investigation in *Copper Pipe Fittings*,

285-05, [2006] CarswellNat 4337, (Federal Court of Appeals Dec. 7, 2006) (Westlaw).

²³ Under U.S. law, a non-market economy country (NME) is a country that does not operate on market principles “so that sales of merchandise in such country do not reflect the fair value of the merchandise.” Tariff Act of 1930, 19 U.S.C. §1677(18) (1996). China is one of twelve countries that the Department of Commerce has determined to be an NME. Given current political circumstances, it is uncertain when or whether that designation will change in the near future. For a useful review of U.S. law and policy on this issue, see *Challenges and Choices to Apply Countervailing Duties to China: Hearing on U.S.-China Trade Before the U.S.-China Economic and Security Review Commission*, 109th Cong. (2006), available at <http://www.gao.gov/new.items/d06608t.pdf> (statement of Loren Yager, Director of International Affairs and Trade, United States Government Accountability Office); and UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, U.S.-CHINA TRADE: ELIMINATING NONMARKET ECONOMY METHODOLOGY WOULD LOWER ANTIDUMPING DUTIES FOR SOME CHINESE COMPANIES, (2006), available at <http://www.gao.gov/new.items/d06231.pdf> (report to Congressional Committees).

²⁴ In a press release commenting on the dialogue between the U.S. and Chinese governments in the Joint Commission on Commerce and Trade (“JCCT”) on the possibility of altering China’s NME designation, the U.S. Secretary of Commerce, no doubt reflecting political pressures, stated that, “Until these reforms are made – and the statutory criteria are met – China will continue to be considered a non-market economy under U.S. anti-dumping law, and American companies alleging unfair trade practices are generally more likely to be successful.” Press Release, Donald L. Evans, Sec’y of Commerce, U.S. Dep’t of Commerce, America’s Economic Relationship with China (Apr. 28, 2004), available at http://www.commerce.gov/opa/press/Secretary_Evans/2004_Releases/April/28_Evans_China_stmt.htm.

²⁵ See *Certain Steel Fuel Tanks – Statement of Reasons for Final Determination*, File No. 4264-62, AD/1298, ¶¶ 47-53 (Can. Border Services Agency Aug. 18 2004), available at <http://cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1298/ad1298i-eng.html>; *Outdoor Barbeques – Statement of Reasons for Preliminary Determination*, File No. 4235-264, AD/1318; 4218-16, CVD/102, ¶ 45 (Can. Border Services Agency Sept. 10, 2004), available at <http://www.cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1318/ad1318i-eng.html> [hereinafter *Outdoor Barbeques - Preliminary*]; *Certain Carbon Steel and Stainless Steel Fasteners – Statement of Reasons for Final Determination*, File No. 4243-38, 4218-17, AD/1308, CVD/103, ¶ 44-55 (Can. Border Services Agency Dec. 24, 2004), available at <http://cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1308/ad1308i-eng.html> [hereinafter *Fasteners - Final*]; *Laminate Flooring - Final supra* note 18, at ¶ 144; *Certain Copper Pipe Fittings – Statement of Reasons for Preliminary*

which is continuing at this time, the Agency estimated dumping margins of 39% for three identified exporters, with an all-others rate of 116 percent.²⁶ The Agency is proceeding on the basis that the copper pipe fittings sector in China operates free of State involvement on a market economy basis.²⁷

III. Subsidies – Canadian Countervail Cases Achieve Mixed Results

As a practical matter, the change in Canadian policy regarding China's market economy status affected dumping investigations only. It had no bearing on Canada's approach to subsidy investigations. The absence of subsidy complaints regarding Chinese imports over the years was not because of impediments under Canadian law.²⁸ Rather, it was mainly the reluctance of Canadian industry to initiate these kinds of cases, given the many practical difficulties and large legal expenses in bringing such cases forward. The preference was to go pragmatically for more expeditious, less expensive and more likely – if not perfect – anti-dumping relief. This was preferable to the slow, cumbersome, costly – and not entirely certain – countervail relief.

*Outdoor Barbeques*²⁹ in 2004 was the first Canadian trade case involving subsidized imports from China. The complaint was filed on the basis that the

Investigation, File No. 4214-14, AD/1358, 4218-21, CVD/118, ¶¶ 93-98 (Can. Border Services Agency Nov. 3, 2006), available at <http://cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1358/ad1358np-eng.html> [hereinafter *Copper Pipe Fittings – Preliminary*].

²⁶ *Certain Copper Pipe Fittings – Preliminary*, supra note 24, ¶ 162 app. 2.

²⁷ See *id.* at ¶¶ 123-130, ¶ 162 app.4.

²⁸ There is nothing in SIMA or the stated policies of the CBSA that prevents or limits subsidized imports from NME countries being subjected to countervailing duties in Canada – provided the criteria under the WTO Subsidies and Countervailing Measures Agreement are met. See Dep't of Finance, Gov't of Canada, *Subsidies and Countervailing Measures Information Paper* (Nov. 17, 2004), available at http://www.fin.gc.ca/activty/pubs/Sub_e.html; see also Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 275 (1999), 1867 U.N.T.S. 14. [Not reproduced in I.L.M.], available at <http://docsonline.wto.org> (follow “Frequently Consulted”; then follow “Legal Texts and Agreements”; then follow “Agreement on Subsidies and Countervailing Measures”).

²⁹ *Outdoor Barbeques – Statement of Reasons for Initiation of Investigation*, File No: 4235-264/ AD-1318; 4218-16/CVD-102, ¶¶ 65-68, 77 (Can. Border Services Agency Apr. 28, 2004), available at <http://www.cbsa-asfc.gc.ca/sima-lmsi/> [hereinafter *Outdoor Barbeques - Initiation*]; *Outdoor Barbeques - Preliminary*, supra note 24; and *Outdoor Barbeques – Statement of Reasons for Termination of Investigation*, File No: 4235-264, AD 1318, 4218-16, CVD 102, ¶¶ 123-124, (Can. Border Services Agency Dec. 3, 2004), available at <http://www.asfc-cbsa.gc.ca/sima-lmsi/i-e/ad1318/ad1318tsor-eng.html> [hereinafter *Outdoor Barbeques - Termination*]. *Outdoor Barbeques - Initiation*, *Outdoor Barbeques – Preliminary*, and *Outdoor Barbeques - Termination* are hereinafter collectively referred to as *Outdoor Barbeques*.

Chinese barbeque industry operated in a free market without State controls, thereby avoiding the policy issue of whether non-market economy countries could be countervailed. In starting its investigation, the Agency accepted the complainant's evidence of a large array of Chinese subsidy programs at the national and sub-national level³⁰ and its ensuing preliminary subsidy determination, and on the basis of incomplete information from Chinese authorities, found that a large number of such programs conferred substantial benefits on Chinese producers³¹.

After obtaining full responses to information requests and verifying that information, however, the Agency radically adjusted its preliminary estimates and concluded that the amount of subsidy benefits flowing to Chinese barbeque makers was, in fact, inconsequential.³² Based on its investigation of eight identified subsidy programs, the Agency found either no benefit was in fact received or that the benefits were so insignificant that they failed to meet WTO thresholds:

When making a final determination of subsidizing under subsection 41(1) of SIMA, the President must be satisfied that the subject goods have been subsidized and that the amount of subsidy on the goods of a country is not insignificant. According to subsection 2(1) of SIMA, "insignificant" means an amount of subsidy that is less than 1% of the export price of the goods.

However, section 41.2 of SIMA directs the President to take into account the provisions of paragraphs 10 and 11 of Article 27 of the WTO Subsidies Agreement when conducting subsidy investigations. These provisions stipulate, in part, that any investigation involving a developing country must be terminated once it is determined that the total amount of subsidy for a developing country does not exceed 2% of the value of the goods.

The CBSA normally makes reference to Part I of the *DAC List of Aid Recipients*, maintained by the OECD, to determine eligibility for the differential amounts for developing countries in subsidy

³⁰ See *Outdoor Barbeques - Initiation*, *supra* note 28 ¶¶ 65-68, 77. Together with subsidies, the complaint also alleged dumping of Chinese barbeques as a cause of material injury. *Id.*

³¹ See *Outdoor Barbeques - Preliminary*, *supra* note 24, ¶¶ 73-74, 59-72, 99 app. 3.

³² See *Outdoor Barbeques - Termination*, *supra* note 28 ¶¶ 123-124. While information responses were deemed incomplete at the PD stage, subsequent filings were permitted by the Agency. See *id.*, ¶¶ 2-7. It received what it certified as complete responses from both the Chinese Government and four of the Chinese barbeque producers. See *id.*, ¶ 71. Following receipt of this information, the Agency undertook verifications that resulted in its *de minimis* determinations of both subsidy amounts as well as of dumping margins. See *id.*, ¶¶ 74-101, 55-60.

investigations. As China is a developing country according to this list, the 2% threshold for insignificance would apply. In this case, the amount of subsidy is below the 2% threshold, and as such requires the termination of the investigation.³³

Almost immediately after the *Outdoor Barbeques* case began, the *Fasteners* investigation was initiated by the Agency.³⁴ This time, contrary to the results in *Outdoor Barbeques*, the *Fasteners* investigation resulted in a determination of fairly sizeable subsidy amounts and, ultimately, a positive injury finding by the Canadian International Trade Tribunal.³⁵ Here is what the CBSA said at the start of the investigation:

In support of its allegations, the complainant has provided a number of documents detailing support offered by the government of China (GoC), primarily to exporting enterprises and those operating in special economic areas. The complainant was unable to provide specific information with regard to all potential subsidies granted by the GoC, as there is a lack of publicly available information.

This lack of available information is largely due to the fact that China has not provided a full notification to the World Trade Organization (WTO) Committee on Subsidies and Countervailing Measures, as required under Article 25 of the WTO Agreement on Subsidies and Countervailing Measures (Subsidies Agreement) and under Article XVI of the General Agreement on Tariffs and Trade 1994. The Chair's Report to Council for Trade in Goods in the Transitional Review of China, November 2003, notes that updated versions of this information have not been provided. Similarly, public reports from both the U.S. Trade Representative (USTR) and the U.S. Department of Commerce indicate that information regarding potential subsidies in China has not been provided and is difficult to obtain.

....

³³ *Id.*, ¶¶ 104-106.

³⁴ See Certain Carbon Steel and Stainless Steel Fasteners – Notice of Initiation of Investigation, (Can. Border Services Agency Apr. 28, 2004), available at <http://www.asfc-cbsa.gc.ca/sima-lmsi/i-e/ad1308/ad1308ni-eng.html>; Certain Carbon Steel and Stainless Steel Fasteners – Statement of Reasons for Initiation of Investigation, File No. 4243-38, AD/1308; 4218-17, CVD/103, (Can. Border Services Agency May 13, 2004), available at <http://www.asfc-cbsa.gc.ca/sima-lmsi/i-e/ad1308/ad1308i-eng.html> [hereinafter *Fasteners - Initiation*].

³⁵ See *Fasteners – Findings and Reasons*, Inquiry No. NQ-2004-005, ¶ 230, (Can. Int'l Trade Tribunal Jan. 21, 2005), available at http://www.citt-tcce.gc.ca/dumping/inquirie/findings/nq2e005_e.asp [hereinafter *Fasteners – Findings & Reasons*]; see also *id.*, ¶ 16.

In reviewing the information found in the reports and articles that were provided by the complainant, the CBSA has developed the following list of programs and incentives that may be provided to manufacturers of fasteners in China . . .

There is sufficient reason to believe that the programs and incentives listed above may constitute actionable subsidies provided by the GoC. *Based on the information available to the CBSA regarding the programs named above, it is reasonable to conclude that the named subsidy programs are available to the exporters of fasteners in China.* In examining these programs, the CBSA will request information from the government of China and from exporters of the subject goods to determine whether these programs confer countervailable benefits on the subject goods.³⁶

In the ensuing preliminary determination phase of the investigation, the Agency failed to get complete responses to information requests (“RFIs”) from either the Government of China or the Chinese fasteners industry. It therefore used estimates based on best available information³⁷ and found that State benefits were provided under the following eight programs: (1) Special Economic Area (“SEA”) incentives; (2) grants for export performance and employing common workers; (3) preferential loans; (4) loan guarantees; (5) income tax credits, refunds, and exemptions including (a) reduced corporate

³⁶ *Fasteners - Initiation*, *supra* note 33, ¶¶ 52-57 (footnotes omitted) (emphasis added).

³⁷ The agency reasoned as follows:

[109] The Government of China's response to all questions asked within the original RFI and the various supplemental RFIs was expected to be a comprehensive response encompassing all parties covered by the above definition of ‘Government of China’, and not to be restricted solely to the national level of government. The failure to provide this information renders incomplete any response that the Government of China has made with regards to actionable subsidies that it may or may not have made available to exporters of subject goods during the POI.

[110] The CBSA has requested that the Government of China provide a revised response to its original and supplemental RFIs reflecting information obtained through its own records rather than from enquiries of exporters, in order to corroborate exporters' submissions and to provide additional information regarding the potential subsidies available in the People's Republic of China. The CBSA also stressed the definition of the "Government of China" applicable for this investigation, and requested that responses to its questions be a comprehensive response from the entire Government of China.

[111] The information submitted by the Government of China in response to the original and supplemental questionnaires has been deemed to be incomplete and unusable for purposes of making a preliminary determination.

Certain Carbon Steel and Stainless Steel Fasteners – Statement of Reasons for Preliminary Determination, File No. 4243-38, AS/1308; 4218-17, CVD/103 (Can. Border Services Agency Sept. 24, 2004), *available at* <http://www.asfc-cbsa.gc.ca/sima-lmsi/i-e/ad1308/ad1308p-eng.html>.

tax rate for export-oriented enterprises, (b) exemption/reduction of corporate income tax during designated start-up periods, (c) income tax refund of amounts further invested in SEAs, and (d) exemption/reduction in local income tax for SEA enterprises; (6) relief from duties and taxes on inputs; (7) reductions in land use fees; and (8) purchase of goods from State-owned enterprises.³⁸

For the final determination, the Chinese government's responses to RFIs, as well as those of the majority of producers that were investigated, were still not complete. Among other deficiencies,

[T]he Sixth Supplemental RFI requested information from the GOC relating to levels of government below the national level, in order to determine whether any provincial, municipal, county, or other levels of government had made a financial contribution that might be considered an actionable subsidy to one or more of the sampled exporters. While a limited amount of information was submitted, other documents requested from the GOC regarding local governments were not provided.³⁹

The Agency therefore continued to determine subsidies and subsidy amounts based on available information. For the final determination, it concluded that Chinese carbon steel and stainless steel fastener producers received benefits amounting to approximately 32% of the export price.⁴⁰ In the ensuing inquiry, the Canadian International Trade Tribunal found that injury was caused by the dumping and subsidizing of carbon steel screws from China (but not by dumping or subsidizing of nuts and bolts).⁴¹ The essence of the Tribunal's finding on screws was that dumped and subsidized imports had a price-depressing impact on the Canadian industry, leading to a range of deteriorating financial indicators:

The Tribunal is of the view that the increasing presence of imports of carbon steel screws from the subject countries had widespread

³⁸ *Id.*, ¶ 69.

³⁹ *Fasteners – Final*, *supra* note 24, ¶ 81.

⁴⁰ *Id.*, ¶ 94. It should be noted that the investigation also concerned allegedly subsidized exports from Chinese Taipei as well as China. The Agency found that the subsidy amounts for goods from Chinese Taipei were insignificant and terminated the countervail investigation respecting the latter. *See also id.*, ¶¶ 97-99.

⁴¹ *Fasteners – Findings & Reasons*, *supra* note 34, ¶¶ 127, 230. In conducting its inquiry, the Tribunal decided to subdivide the goods into carbon steel screws, stainless steel screws, carbon steel nuts and bolts and stainless steel nuts and bolts. *Id.*, ¶ 75. It found that dumped carbon steel screws from China and Chinese Taipei and subsidized carbon steel screws from China had caused injury to Canadian production. *See id.*, ¶¶ 107-127.

negative impacts on the domestic industry. In fact, the Tribunal notes that the parties opposing the complaint were not denying so much that the domestic industry had suffered injury as they were arguing that the cause of that injury rested with factors other than the presence of the subject carbon steel screws in the market. While noting these other factors, some of which are dealt with below, the Tribunal is nevertheless of the view that the dumped and subsidized carbon steel screws were a very significant cause of injury to the domestic industry.⁴²

This was the first Canadian countervail case against China to proceed through to a positive injury finding. However, this positive result (from the complaining industry's viewpoint) has to be tempered by the modest average subsidy amounts of 32%. While in some respects this is a significant amount, as a practical matter, this level of CV duties, even when combined with AD duties, provided the Canadian fastener producers with only modest import relief. Another factor in assessing the impact of the subsidy findings in *Fasteners* is that the 32% subsidy amount was estimated by the Agency using best available information. Even applying this discretionary method, the total subsidy amount was not astonishingly high.

Fasteners has been followed by the *Laminate Flooring – Final* case, as noted, in which the CBSA also found a large number of actionable Chinese subsidy programs, some of which were the same or similar to the subsidy programs identified in *Fasteners*.⁴³ However, the total amounts of subsidies calculated by the Agency in this case were substantially less than in *Fasteners*, averaging a mere 3% of the export price.⁴⁴

In the ongoing *Copper Pipe Fittings* case, the preliminary subsidy estimates for China are 64% as a percentage of the export price.⁴⁵ While this amount is significant, it is based on unverified information and is much less than the complaining industry would have expected at this preliminary stage.

From the point of view of the Canadian complainants, the meager results in *Outdoor Barbeques*, *Fasteners*, and *Laminate Flooring* begs the question as to the value of pursuing countervail relief against Chinese products,

⁴² *Id.*, ¶ 122.

⁴³ See *Laminate Flooring – Final*, *supra* note 18, ¶ 91; see also *id.*, ¶ 145 app. 3. The programs found by the Agency to have conferred countervailable benefits included a range of preferential income tax programs for Foreign Invested Enterprises (“FIEs”), for enterprises located in Special Economic Zones (“SEZs”) and Coastal Economic Open Zones and for enterprises operating in the forestry industry; exemptions on tariffs and VAT for imported equipment; loan interest assistance grants and other grants to companies operating in specific areas, etc. *Id.*

⁴⁴ *Id.*, ¶ 98.

⁴⁵ *Copper Pipe Fittings – Preliminary*, *supra* note 24, ¶ 128.

particularly in the consumer products area. Even accepting that the result in *Fasteners* was somewhat more beneficial to the industry than in *Laminate Flooring*, the results leave real doubts as to the extent to which Chinese export industries are, or can be shown to be, the recipients of large subsidy benefits.

IV. Safeguard Relief Involving Goods from China

Canadian legislation was amended in 2002 to implement the Protocol on China's accession to the World Trade Organization ("*WTO Agreement*"),⁴⁶ which permits members to apply safeguard relief to aid industries in coping with an influx of Chinese products. Pursuant to new Section 30.22(1) of the Canadian International Trade Tribunal Act ("*CITT Act*"),⁴⁷ a Canadian industry can submit a safeguard complaint to the Tribunal – as opposed to the CBSA as in the case of subsidies and dumping – requesting the Tribunal to initiate an inquiry into whether the importation of goods from China has been causing or is threatening to cause *market disruption* to domestic producers.⁴⁸ If the Tribunal concludes that market disruption exists or is likely to occur in the future and is likely to be a "significant cause" of material injury, it can recommend to the Federal government the forms of relief to be accorded the industry to remedy that injury.⁴⁹

⁴⁶ See *Act Amending China's Accession to the WTO*, *supra* note 15. Bill C-50 was introduced in the Canadian Parliament in 2002 to amend existing federal legislation in order to implement the rights contained in the WTO's agreement with China. China's accession to the WTO was preceded by a series of bilateral agreements with China's trading partners, leading to full agreement by a Working Party and subsequently by the WTO General Council to admit China as a WTO member, as set out in the *Protocol on the Accession of the People's Republic of China to the World Trade Organization*. See World Trade Organization, *Accession of the People's Republic of China Decision of 10 Nov. 2001*, WT/L/432/NOV/23, (2001), available at <http://docsonline.wto.org/DDFDocuments/t/WT/L/432.doc> or http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm. The provisions in the Protocol set out the rights that Canada – and all other WTO members – obtained through the accession negotiations with China.

⁴⁷ CITT Act, *supra* note 3, § 30.22(1) (as amended by S.C. 2002, ch. 19, § 4).

⁴⁸ See Interim Guideline: Safeguard Inquiries- Imports From China, (Can. Int'l Trade Tribunal Mar. 31, 2003), available at http://www.citt-tcce.gc.ca/publicat/china_e.asp (explaining the market disruption inquiries). A full explanation of the Canadian safeguard regime where imports from China are concerned is found on the CITT website: http://www.citt.gc.ca/safeguar/guide/index_e.asp.

⁴⁹ In accordance with the WTO Protocol, Canadian law also allows Canadian producers to request a trade diversion inquiry to determine whether any action of another WTO member respecting Chinese goods is causing or threatening to cause "significant diversion of trade" into Canada. To date, no such inquiries have been initiated. See CITT Act, *supra* note 3, §§ 30.21 - 30.26 (explaining the Tribunal's procedures and standards of inquiry into market disruption and trade diversion).

The U.S. has a similar China safeguard system. Much of the Canadian process parallels that of the United States.⁵⁰ As in the U.S., Chinese market disruption safeguard relief is distinct from global safeguard relief, where the injurious effects of imports are assessed globally – i.e., from all sources. The relief for goods from China, as is clear, is exceptional and is targeted on goods of that country exclusively.

To start a case, a Canadian producer must first submit a properly documented complaint (in itself a complex and expensive process) to the Tribunal, not the CBSA as in the case of AD/CV complaints. Once the Tribunal determines to conduct an inquiry, it is necessary for a companion order of the Canadian Cabinet (an Order in Council) to direct the Tribunal to recommend, in the event that it determines that the goods are being imported in such increased quantities or under such conditions that they cause or threaten to cause market disruption to the domestic producers, the most appropriate remedy. Relief can only last for a period not exceeding three years, in accordance with Chinese accession agreements under the *WTO Agreement*.

The form of relief that the Tribunal can recommend varies – it can be surtaxes, quotas, or tariff rate quotas, or any combination of these. As in the United States, there is no legal obligation for the Federal government to act on those recommendations. The government can decide to modify any such recommendation or refuse to act entirely and provide any relief whatsoever.⁵¹

Like the U.S. system, the Canadian safeguard system is Byzantine, cumbersome, and complex. It is frustrating for domestic industries and responding parties alike. The conclusion after the recent experience is that the process entails significant hurdles and large legal expenses, likely to be a disincentive to future complainants.

The result of the single market disruption inquiry to date in *Barbeques*⁵² illustrates the point. *Barbeques* was started by a complaint filed by the

⁵⁰ China safeguard investigations come under Section 421 of the U.S. Trade Act of 1974, 19 U.S.C. 2251 (2007). As with the Canadian system, the United States International Trade Commission (“ITC”) determines whether a product from China is being imported into the United States in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products. If the ITC makes an affirmative determination, it proposes a remedy. The ITC sends its report to the President and the U.S. Trade Representative. The President makes the final remedy decision.

⁵¹ See generally CITT Act, *supra* note 3, § 30.22(8) (1985) (“The Tribunal shall prepare a report on the inquiry not later than ninety days after the inquiry is commenced and shall submit a copy of it to the Governor in Council, the Minister, the complainant and any other person who made representations to the Tribunal during the inquiry.”). There is no further obligation on the part of the Federal government to act.

⁵² *Barbeques Originating in the People’s Republic of China – Findings and Reasons*, Inquiry No. CS-2005-001, (Can. Int’l Trade Tribunal Oct. 11, 2005), *available at*

Canadian barbeque producers⁵³ following the surprise termination of the AD/CV investigation, noted above. After some delay, the complaint was eventually certified as properly documented and a market disruption safeguard inquiry was initiated by the Tribunal. After detailed written submissions and a lengthy oral hearing phase, the Tribunal found that imported barbeques from China were a significant cause of serious injury to Canadian production⁵⁴ and it recommended a system of relief based on tariff rate quotas.⁵⁵ The Tribunal engaged in a three-step process, as required by statute. First, it determined that the domestic industry had suffered serious injury during the period under review. Second, it found that imports of barbeques from China were a significant cause of that injury:

Having assessed, pursuant to subsection 5.1 of the *Regulations*, the actual volume of imports, the effect of such imports on prices and their impact on domestic producers, and having considered other potential causes of injury, the Tribunal finds that imports of barbeques from China are indeed a significant cause of the material injury experienced by domestic producers because they are an important cause of that injury (i.e. a cause "...that need not be as important as, or more important than, any other cause.").⁵⁶

Having made these two findings, the Tribunal then considered the nature and form of relief to recommend to the Federal government. It recommended a surtax set at 15% for a period of three years, applied on an *ad valorem* basis, FOB Chinese port of shipment as a means of raising the market price to a level that insured the Canadian industry could satisfactorily compete.⁵⁷

http://www.citt-tcce.gc.ca/safeguar/marinq/finalrep/cs2f001_e.asp [hereinafter *Barbeques – Findings & Reasons*].

⁵³ *Commissions: Canadian International Trade Tribunal Decision to Commence a Safeguard Inquiry in Respect of China Certain Outdoor Barbeques*, CAN. GAZETTE, July 23, 2005, available at <http://canadagazette.gc.ca/part1/2005/20050723/html/commis-e.html>.

⁵⁴ *Barbeques - Findings & Reasons*, *supra* note 51, ¶ 139.

⁵⁵ *Id.*, ¶ 151-164.

⁵⁶ *Id.*, ¶ 136.

⁵⁷ *See id.*, ¶ 164. The Tribunal reasoned as follows:

[T]he methodology used by the Tribunal in making the calculation involves deriving the first-cost advantage for Chinese producers by multiplying the domestic producers' reported average unit cost of manufacturing by the 40 percent differential noted above. The number so derived is then reduced by the average unit cost of importation. The difference between the two numbers is the estimated Chinese net-cost advantage after accounting for the cost of importation into Canada. The calculation shows that when imports of barbeques from China had fully penetrated the Canadian market at all retail segments by 2004, they were below domestic costs by about 15 to 20 percent, expressed as a percentage of Chinese FOB values at port of shipment.

The Tribunal notes that the actual Chinese net-cost advantage in Canada, at any given time, is

After many months of sitting on these recommendations,⁵⁸ the Federal government announced that it would not provide any relief, recommended or otherwise. As announced by the Canadian Minister of Finance,

After considering all of the information, it was determined that temporary protective tariffs simply wouldn't provide a competitive long-term solution in these two cases [barbeques and bicycles].... We want to grow and strengthen our economy, and imposing these surtaxes would have increased costs for both Canadian retailers and consumers.

The Government of Canada recognizes that many Canadian manufacturers are adjusting to fast-changing global realities.... We will continue to work closely with the private sector to develop trade strategies that will maximize the benefits of Canada's role in global supply chains.⁵⁹

The foregoing is the case where the Canadian complainants proceeded through the maze of procedural and other requirements, engaged in the necessary meetings and other activities to convince political decision-makers as to the merits of the Tribunal's recommendation, expended large sums on legal and consulting fees and, in the end, came up empty-handed. In another situation, Canadian complainants sought to convince the Tribunal to initiate a

subject to the fluctuation of factors such as the cost of ocean and inland freight and exchange rate movements. As freight rates rise, as they have in recent periods, the Chinese net-cost advantage is reduced. As the Canadian dollar appreciates, as it has in recent periods, the Chinese net-cost advantage increases. According to the evidence, rising freight rates have been an important factor in recent quarters. Having regard to all the foregoing considerations, the Tribunal is of the view that a surtax of 15 percent is the appropriate remedy, applied on an *ad valorem* basis, FOB Chinese port of shipment. *Id.*, ¶¶ 160-161.

⁵⁸ Including recommendations by the Tribunal in a companion global safeguard inquiry concerning bicycles and bicycle frames, which the Canadian International Trade Tribunal initiated on February 10, 2005 following a complaint from some Canadian producers. On September 1, 2005, the Canadian International Trade Tribunal submitted its report to the Government, concluding that imports of bicycle frames were not injuring the domestic industry, but that imports of bicycles were causing injury to the domestic industry. The Canadian International Trade Tribunal recommended the imposition of a declining surtax (thirty percent in the first year, twenty-five percent in the second year and twenty percent in the third year) to be applied on bicycles valued at \$225 or less at the time of importation. *Bicycles and Finished Painted Bicycle Frames – Final Report on Safeguard Inquiry*, Inquiry No. GS-2004-001/GS-2004-002, at VI, (Can. Int'l Trade Tribunal, Sept. 1, 2005), available at http://www.citt-tcce.gc.ca/safeguar/global/finalrep/g2e001_e.asp.

⁵⁹ Press Release, Dep't of Fin. Can., Government of Canada Rejects Trade Restriction on Imported Bicycles and Barbeques (May 29, 2006), available at <http://www.fin.gc.ca/news06/06-019e.html>. As noted in the press release, the government likewise declined to act on recommendations made by the Tribunal in the global safeguard action in *Bicycles and Finished Painted Bicycle Frames* cited in note 51, *supra*.

market disruption inquiry and, after many months of effort, failed to convince the Tribunal to even begin its investigation.⁶⁰

These cases are illustrative of substantive and procedural difficulties in Canadian trade law in obtaining safeguard relief against imported products from China. The practical results of these recent efforts have effectively been zero for the complainants. The impact has been to dampen enthusiasm among the manufacturing sector for dealing with trade competition from China in this traditional, WTO-sanctioned way.

V. Other Issues – Investment Restrictions Affecting Chinese Capital

While somewhat outside the scope of a trade remedy analysis, there has been concern expressed by the Federal government (both the former Liberal government and the present Conservative government) over large-scale Chinese State-owned enterprise investments in and takeovers of Canadian companies. The concern has been expressed in terms of protecting Canadian national security where Chinese State-owned enterprises are concerned, on the basis that such Chinese enterprises operate under the direction, directly or indirectly, of the Chinese government.⁶¹ Apart from the political dimension relating to human rights in China, the concern is over the direction such ownership might take and the impact on the Canadian economy.

Suggestions are being seriously pursued to amend the Investment Canada Act⁶² to permit the Canadian government to disallow a takeover of a Canadian company on certain, well-defined national security grounds.

⁶⁰ See Residential Furniture Originating in China – Market Disruption Inquiry, Inquiry No. CS-2005-003 (Can. Int'l Trade Tribunal Mar. 15, 2006), available at http://www.citt.gc.ca/safeguar/marinq/complaint/cs2f003_e.asp (complaint not properly documented). Here, the Tribunal refused to commence its investigation on the grounds, *inter alia*, that the complainant failed to properly subdivide the goods. On March 15, 2006, the Tribunal issued a letter explaining why it was turning down the complaint:

[T]he Tribunal is of the opinion that these categories appear to be too broad to meet the requirements of like or directly competitive goods. The Tribunal must look at all of the eight potential classes of like or directly competitive goods (or whatever other classes of goods the complainant may propose) in determining whether your complaint fulfills the requirements of subsection 30.22(2) of the Canadian Int'l Trade Tribunal Act. In a future complaint, you may wish to select only a certain number of groups or classes on which to base the complaint and for which the required information would need to be submitted. *Id.*

⁶¹ Steven Chase & Brian Laghi, *Ottawa Red Flags Foreign Buyouts; Fearing China's Growing Power, Tories to Stop Deals that Hurt National Interests*, THE GLOBE AND MAIL, Nov. 25, 2006, at A1; Shawn McCarthy, *Flaherty Defends Plan to Screen Foreign Takeovers; 'It is important that we protect Canada;' Critics Say Chance will Drive Off Chinese*, THE GLOBE AND MAIL, Nov. 28, 2006, at B4.

⁶² Investment Canada Act, R.S.C. ch. 28, §1 (1985).

VI. Conclusions

It is difficult to conclude whether and to what extent Canada's system of trade remedies constitutes a useful response to the influx of Chinese products into the Canadian marketplace. While anti-dumping relief has been historically used by Canadian industry to deal with allegedly unfairly priced imports from that country, some recent cases have revealed either the absence of dumping or relatively low margins. These results have been of questionable value to the domestic industry.

Pressure has been applied by several sectors of Canadian industry to try to rollback the change in policy of the CBSA respecting whether the Chinese economy operates under free-market principles. Formerly, the onus was on the Chinese side to demonstrate that an open market was in operation. The recent change by the CBSA puts the onus on the Canadian complainant to prove that free market principles do not operate. There is little likelihood that the new CBSA policy will be rolled back.

With respect to subsidies, the Canadian record has been mixed. While Canada has investigated alleged Chinese subsidies in a number of recent cases and has found subsidies to be countervailable, either these conclusions have been based on best available information or, where verified, the subsidy amounts have proven to be modest. In the event that more complete information comes forward from the Chinese government and the targeted industry, the very existence of these alleged subsidies might be called into question.

In the recent *Outdoor Barbeques* case, for example, the CBSA found on verification visits that no subsidies to that particular industry existed. In *Fasteners* and the ongoing *Copper Pipe Fittings* case, the estimated subsidy amounts, while noteworthy, are still relatively modest, even when best information has been used. The conclusion, therefore, is that the existence of large subsidies in China cannot be assumed but will require examination on an industry-by-industry basis.

Safeguard relief for Canadian companies experiencing competition from Chinese imports has not been successful in the single market disruption inquiry to date as a result of a policy decision taken by the government to not grant relief. In other cases, the complainants could not even surmount the hurdle of getting a safeguard investigation underway. Given the complexities and large expense of pursuing safeguard relief, it is doubtful whether Canadian industry will have much of an appetite to initiate new complaints.

Finally, with respect to investment in large Canadian enterprises by Chinese State-owned companies, there is serious concern at the level of the Federal government in Canada. Efforts are underway to find ways to amend Canadian laws, consistent with Canada's international obligations, to disallow such investments where there is a risk to Canada's national security

interests. This particular area is likely to be a source of tension between Ottawa and Beijing in the years ahead.

NAFTA AND THE NEW MEXICAN PRESIDENCY*

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CLEVELAND, OH

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I. Three Pressing Problems

When Felipe Calderón looks at Mexico from the window of his presidential office, he sees three pressing problems he must solve.

The immediate problem is the disputed legitimacy of his election. The electoral tribunal declared him winner,¹ but the opposition claimed fraud; they blocked Mexico City's main avenue with protests, met massively in the central square, and proclaimed Andrés Manuel López Obrador as the duly elected President. Their fury was so great that Calderón could be sworn into office only by entering the Chamber of Deputies through a back door and slipping out again after a four-minute ceremony interrupted by catcalls from the opposition. To be an effective president of Mexico, Calderón must earn the support of more Mexicans.

Even if Calderón earns that support, a continuing problem is the party make-up of Mexico's newly elected national Congress. In each house,

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¹ As certified, the votes were 35.9% for Felipe Calderón, 35.3% for Andrés Manuel López Obrador, and 22.2% for Roberto Madrazo. *A Survey of Mexico*, ECONOMIST, Nov. 18, 2006, at 4 [hereinafter *Survey*].

Calderón's party has only a plurality, less than López Obrador's party plus a significant third.² Unless Calderón can gather other-party votes for major projects, his legislative initiatives will be doomed from the start.

Beyond those problems of public and Congressional support looms the third problem, Mexico itself. Mexico is the world's most populous Spanish-speaking country,³ with more than 107 million people,⁴ and Mexico is well-endowed with natural resources, but for most of those people Mexico's resources have produced only marginal and unevenly distributed gain. The richest 10% of Mexicans own 45% of all wealth; the poorest 10% have only 1.6%.⁵ Half of the population lives in poverty, surviving on less than four dollars a day.⁶ Twelve million Mexican families scrounge at makeshift jobs in the "informal economy."⁷

That economic disparity breeds waves of resentment against the governing class. Recent surges were the Zapatista insurrection in Chiapas, the civic rebellion in Oaxaca, and the anti-Calderón demonstrations in Mexico City. The disparity also breeds crime and corruption, which discredit government itself. To be an effective president, Calderón must move Mexico into greater and more equally shared prosperity.

II. Three Key Issues

When President Calderón looks at Mexico, those are the problems he sees. But Mexican presidents must look at more than Mexico. An earlier Mexican president said it famously: "*Pobre México, tan lejos de Dios y tan cerca de los Estados Unidos.*" "Poor Mexico, so far from God and so near to the United States."⁸ Calderón must look north; he must deal with issues that involve Mexico and the United States.

When President Calderón looks north, he sees three key issues. By provision or omission, the North American Free Trade Agreement (NAFTA) brackets each of those issues.

² *Id.* at 5. Chamber of Deputies: Partido Acción Nacional (PAN), 206; coalition of Partido de la Revolución Democrática (PRD), 159; Partido Revolucionario Institucional (PRI), 122; others 13. Senate: PAN, 52; PRI, 39; PRD, 36; other, 1.

³ *Id.* at 3.

⁴ Recently estimated at 107.5 million. George Grayson, *In Mexico, whoever wins faces the same problems*, FIN. TIMES, Jul. 5, 2006, at 13.

⁵ *Losing Presidential Candidate Lopez Obrador May be Squandering His Chance to Empower Mexico's Poor*, HOUS. CHRON., Nov. 22, 2006, at B8.

⁶ *Id.*

⁷ Richard Lapper, *Special Report: Mexico and Infrastructure*, FIN. TIMES, Jun. 21, 2006, at 2.

⁸ THE OXFORD DICTIONARY OF QUOTATIONS (5th ed. 1999) (quoting President Porfirio Díaz).

A. Immigration

The first key issue is immigration. By one estimate there are 11 million illegal aliens in the United States, of which some 6.3 million are Mexicans.⁹ Of the 1 million people who enter illegally through the Mexican border each year, half are Mexicans and the rest are mainly from Central and South America.¹⁰ About 9% of Mexico's citizens live in the United States, and about half of Mexican-born U.S. residents are illegal aliens.¹¹

The last concerted U.S. response to that problem was a 1986 law that legalized nearly 3 million illegals and increased penalties against employers who hire illegals. Until recently the enforcement of those employer penalties has been lax. As the problem deepened, the U.S. Congress dithered. Finally, in December 2005, the House passed a bill to criminalize all illegals. In May 2006, the Senate countered with a bill to legalize most current illegals and to establish a guest worker and citizenship track for others. Reconciling those seemingly irreconcilable bills is a priority task of the new U.S. Congress of 2007.¹²

Understandably, Mexico favors amnesty and guest worker access. In meetings with President Bush, Calderón's predecessor urged those solutions. In campaign speeches and post-election statements, Calderón has continued that advocacy. But the U.S. Congress must decide, and the friendship of future Mexico-U.S. relations hangs on the tone and substance of that decision. If Mexico sees U.S. immigration policy as a disdainful rejection of Mexicans, President Calderón will be politically obliged to distance himself from the United States, with resulting harm to both sides.

On that immigration issue, NAFTA is almost silent. Regarding the movement of persons between NAFTA countries, NAFTA requires only temporary access for specified categories of "business persons;"¹³ it speaks not a word on the more sensitive subjects of guest workers and illegal aliens.

B. Energy

The second key issue involving Mexico and the United States is energy. It has two dimensions, transnational and national. Its transnational dimension –

⁹ *Survey*, *supra* note 1, at 15.

¹⁰ *Id.* at 16.

¹¹ GARY CLYDE HUFBAUER & JEFFREY J. SCHOTT, *NAFTA REVISITED: ACHIEVEMENTS AND CHALLENGES* 453 (Institute for International Economics, 2005).

¹² For a comparison of the bills, see Jim Rutenberg, *Border Fight Divides Party*, N.Y. TIMES, May 26, 2006, at A1.

¹³ North American Free Trade Agreement, U.S.-Can.-Mex, ch. 16, arts 1601-1603, Oct. 7, 1992, 32 I.L.M. 289 [hereinafter NAFTA].

the right to restrict the movement of energy products across the Mexico-U.S. border – is a milestone of the past. Its national dimension – the future of Mexico’s energy industry – is an on-going debate among Mexicans themselves.

1. Transnational

The transnational dimension of the energy issue has roots in the Canada-U.S. Free Trade Agreement of 1989. When that agreement was negotiated the United States was already a substantial net importer of energy products from Canada, but Canada and the United States were also parties to the General Agreement on Tariffs and Trade (GATT), and the GATT authorizes an exporting GATT country to *restrict* exports for many reasons – for example, to keep home prices down,¹⁴ to relieve “critical shortages” of “essential” products,¹⁵ to conserve “exhaustible natural resources,”¹⁶ and to distribute products that are in “local short supply.”¹⁷

Those GATT export restriction rights worried the U.S. negotiators. What will happen to U.S. energy needs, they wondered, if Canada invokes its GATT rights and shuts off the tap? The U.S. negotiators proposed reciprocal waivers, and the Canadians agreed, so the Canada-U.S. Free Trade Agreement provided that neither country would use its GATT export restriction rights to fix export prices higher than domestic prices, to disrupt “normal proportions” or “normal channels of supply,” or to reduce exports disproportionately to recent patterns.

That settled the transnational energy issue between Canada and the United States, but the issue erupted again when the Canada-U.S. Agreement was expanded to become NAFTA. Those negotiations introduced a new team of negotiators who gave in, but only to Mexico. So NAFTA creates an odd disparity of energy export rights among the three NAFTA countries. Between Canada and the United States, their old two-way waivers remain,¹⁸ but between each of them and Mexico, Mexico waives nothing.¹⁹ So Mexico retains its GATT rights to shut off the tap.

A later Prime Minister of Canada objected to Canada’s waiver and published a declaration against it,²⁰ but in the unamended language of NAFTA, that odd disparity remains to this day.

¹⁴ General Agreement on Tariffs and Trade, § III art. XX(i), Jan. 1 1948, T.I.A.S. No. 1700, 55 U.N.T.S. 194.

¹⁵ *Id.* at art. XI(2)(a).

¹⁶ *Id.* at art. XX(g).

¹⁷ *Id.* at art. XX(j).

¹⁸ NAFTA, *supra* note 13, at ch. 3, art. 315.

¹⁹ *Id.* at annex 315.

²⁰ *Declaration of Prime Minister Jean Chrétien*, CAN. GAZETTE, Pt. 1, Vol. 128, No. 1,

2. National

The national dimension of the energy issue is not a wrangle of trade negotiators. It is a fundamental disagreement among Mexicans themselves about how the energy resources of Mexico should be developed. In its significance for the United States and NAFTA, that issue is not merely a milestone of the past. It is a volcano of the present that may explode destructively, may be channeled productively, or may quietly simmer into irrelevance.

A flashback through history explains the prominence of the national energy issue in the Mexican mind:²¹

- Foreign investment in Mexican energy began under a mining law of 1884 and a petroleum law of 1901, both of which allowed private ownership.
- In 1910 came the Revolution. Its new Constitution of 1917 declared subsurface minerals to be the inalienable property of the Mexican nation, but after much contention, investors were allowed to keep concessions previously granted.
- The result was a thriving Mexican oil industry. By 1921 Mexico was producing one-fourth of the world's oil.
- Then the fateful blow. In 1938 President Cárdenas expropriated private oil companies and created Pemex, the state oil and gas monopoly. A 1958 statute confirmed that Pemex could pay private contractors only in money, not in reserves or percentages of production.
- In 1960 President López Mateos nationalized the private electricity industry by contractual buy-out, and, to operate that industry, created another state monopoly.

To many Mexicans, that history reads like an anthem of liberation from imperialistic foreign capitalism. They celebrate the oil expropriation with a beautiful Mexico City monument and an annual national holiday. Their battle

Jan. 1, 1994.

²¹ Ewell E. Murphy, Jr., *The Prospect for Further Energy Privatization in Mexico*, 36 TEX. INT'L L.J. 75, 77-78 (2001) (discussing the general history of Mexico's national energy issue).

cry is the slogan of the expropriation: “*El petróleo es nuestro.*” “The oil is ours.” Because of that history and those feelings, at Mexico’s insistence NAFTA explicitly preserves Mexico’s right to exclude foreign energy investment and to maintain Mexico’s state energy monopolies.²²

Nonetheless, there is another side to Mexico’s national energy debate, and that side argues that Mexico’s energy future needs private investment. Commencing in the 1990s, every Mexican president has tried to persuade the Mexican Congress to reduce the scope of the state monopolies.²³ Thus, President Salinas limited the electricity monopoly to “public service,” and President Zedillo carved out private sectors of transportation and distribution of natural gas. President Fox unsuccessfully lobbied for private generation and sale of electricity generally.²⁴ So far, President Calderón has spoken cautiously. He said he will welcome foreign investment in permitted energy areas,²⁵ but will be “very respectful of national legislation ... which doesn’t permit foreign investment in petroleum extraction.”²⁶

So at this point in history, as the world is clamoring for energy supplies and the price of oil zig-zags at record heights, Mexico’s energy industry is shrinking. The figures are almost unbelievable. Mexico is actually a significant *net importer* of natural gas and refined oil from the United States,²⁷ importing 23% of all the natural gas and 30% of all the gasoline that Mexico consumes.²⁸ Last year Mexico imported \$7.8 billion worth of petrochemicals.²⁹ The picture is even worse than that. Sixty percent of Mexico’s oil comes from a single offshore field of rapidly declining production.³⁰ In the words of a recent study, Mexico may become “a net energy importer by the end of the decade.”³¹

Why doesn’t Pemex come to Mexico’s rescue, finding and developing more oil and gas, building more refineries and petrochemical plants, and becoming a world-class energy operator both in Mexico and abroad? Pemex has enough people to do it – with about 140,000 of them,³² it is the largest

²² See NAFTA, *supra* note 13, at ch. 11 art. 1108. See also NAFTA, *supra* note 13, at annex III-Mexico, sec. A.

²³ See Murphy, *supra* note 21, at 77.

²⁴ *Mexico Workers Object to Power Sector Bill*, N.Y. TIMES, Aug. 26, 2002, at C4.

²⁵ See generally Marion Lloyd, *Changing of the Guard in Mexico*, HOUS. CHRON., Dec. 2, 2006 at A30.

²⁶ Dudley Althaus, *Energy*, HOUS. CHRON., Oct. 1, 2006, at D1.

²⁷ HUFBAUER & SCHOTT, *supra* note 11, at 419.

²⁸ *Survey*, *supra* note 1, at 12.

²⁹ *World Business Briefing Americas: Pemex to Increase Spending*, N.Y. TIMES, Mar. 2, 2006, at C10.

³⁰ Althaus, *supra* note 26.

³¹ HUFBAUER & SCHOTT, *supra* note 11, at 23.

³² *Id.* at 404.

corporate employer in Mexico.³³ It has enough constitutional authority and certainly enough revenues.

There's the rub. The Mexican government uses Pemex as a cash cow. Every year, the Mexican government appropriates about 60% of Pemex's gross revenues,³⁴ frequently leaving Pemex at a net annual loss.³⁵ Those appropriated Pemex revenues constitute more than one-third of all the revenues of the Mexican government.³⁶ For Mexican taxpayers, that is a blessing; it keeps their taxes down to less than 12% of GDP, a good two points below the Latin American average and less than a third of the average of OECD countries.³⁷ But for the energy future of Mexico, that annual appropriation of Pemex revenues is a curse.

And, for the joined economy of the NAFTA countries, it is an opportunity lamentably lost. Our energy world is a trauma of radical change. Old production is dwindling; new exploration prospects are hard to find; state-owned oil companies are jousting and ousting private companies in the global arena; oil-importing countries are burdened by cartel prices; and above the turmoil sounds the prediction that oil and gas energy will become a power of the past, that alternatives, renewables, and nuclear are the future.

Acting together, the three NAFTA countries could deal shrewdly and profitably with the world's traumatic energy change. More than any other neighboring group, in the aggregate these three countries can muster the money, the markets, the technologies, the operational and entrepreneurial skills, and much of the energy-producing potential of a winning coalition. The challenge is creating that coalition in a way that all three countries politically accept.

Without more popular and Congressional support, President Calderón may not be able to cause Mexico to grasp its energy opportunity. In the words of one analysis, "Basically, Mexico has three choices: find tax revenues elsewhere and allow Pemex to reinvest its financial surplus in exploration and development; invite private energy producers into Mexico to drill for oil and gas; or slide into the ranks of energy-importing countries."³⁸ Of those three choices, Mexico's sad destiny may be choice number three.

If Mexico chooses that destiny, it will be sad for the United States as well. Currently 80% of Mexico's crude oil production is exported to the United

³³ Elisabeth Malkin, *Mexican Oil Chief Sees Expansion*, N.Y. TIMES, Mar. 2, 2005, at C8.

³⁴ HUFBAUER & SCHOTT, *supra* note 11, at 404-05.

³⁵ *Around the World: Mexico City*, HOUS. CHRON., Nov. 1, 2005, at D10; James C. McKinley & Elisabeth Malkin, *Accidents Reveal Troubles at Mexico's Oil Monopoly*, N.Y. TIMES, May 15, 2005, at A17; & David Luhnnow, *Over a Barrel: As Mexico's Oil Giant Struggles, its Laws Block Foreign Help*, WALL ST. J., Jun. 15, 2005, at A1.

³⁶ *Survey*, *supra* note 1, at 10.

³⁷ *See id.*

³⁸ HUFBAUER & SCHOTT, *supra* note 11, at 60.

States.³⁹ That amounts to one-sixth of all U.S. crude oil imports,⁴⁰ making Mexico “the United States’ second largest source of foreign oil.”⁴¹ To the extent that Mexico loses the ability to export crude oil to the United States, the United States will become more dependent on less friendly, and less reliable, sources.

C. NAFTA’s Final Opening

The third key issue involving Mexico and the United States is whether NAFTA should be amended to delay, for some goods, NAFTA’s final trade opening.

When countries agree to trade freely with each other, they don’t say, “Okay, we’ll open up tomorrow morning at 9 o’clock.” It’s much more complicated than that. They open up gradually, one group of exports at a time, following lists called “staging categories.” Final trade opening takes a long time, and those “staging categories” are carefully crafted to leave the most problematic goods for the very end.

When Canada and the United States made their 1989 free trade agreement, they set their final trade opening for January 1, 1998. They accomplished that right on target, problematic goods and all. NAFTA’s final trade opening is set for January 1, 2008, but, for Mexico, zero-tariff access for some last-stage U.S. agricultural goods is *very* problematic.

The underlying economic fact is that NAFTA is an attempt to create an integrated North American economy among highly industrialized Canada and the United States, on the one hand, and slowly industrializing Mexico, on the other. That puts great stress on Mexican agriculture. As one writer explained, “Mexican farmers simply can’t compete with capital-intensive United States agribusiness, which continues to enjoy generous government subsidies.... In 1993, more than ten million Mexicans made their living off the land. Today, even as Mexico’s population has grown, that number has plummeted to about seven million.”⁴²

Those millions of disemployed Mexican farmers are moving to Mexican cities looking for jobs, and with each NAFTA “staging category” their looking gets harder. For some U.S. agricultural goods, a complete opening on January 1, 2008 may be more than Mexico can politically endure.

³⁹ Dudley Althaus, *Mexican President-Elect Must Ride Oil’s Fortunes*, HOUS. CHRON., Oct. 1, 2006, at D1.

⁴⁰ *Id.*

⁴¹ Luis Rubio & Jeffrey Davidow, *Mexico’s Disputed Election*, FOREIGN AFF., Sept./Oct. 2006, at 80.

⁴² Greg Grandin, *How to be a Good Neighbor*, N.Y. TIMES, Jul. 8, 2006.

In his campaign against Calderón, López Obrador promised that, if elected President, López Obrador would renegotiate NAFTA's free trade opening for U.S. corn and beans. The U.S. Undersecretary of Agriculture primly replied, "We have no interest in renegotiating any parts of the agreement."⁴³ That frames the issue President Calderón must now address. Pressure is mounting and the clock is ticking. That key issue must be resolved before January 1, 2008.

III. The Future of NAFTA

Do those immigration and trade-opening issues threaten the future of NAFTA? Is it possible that a harsh U.S. anti-alien law or a rigid U.S. refusal to postpone parts of NAFTA's final trade opening would so infuriate Mexicans that Mexico would withdraw from NAFTA? If Mexico withdrew, would that end NAFTA?

The answers are no. NAFTA allows a member country to leave NAFTA easily. All it takes is six-month written notice.⁴⁴ But even if Mexico left, between Canada and the United States NAFTA would remain intact; in NAFTA's words, "the Agreement shall remain in force for the remaining Parties."⁴⁵ The landing would be even softer than that. When NAFTA was formed, Canada and the United States did not abolish their two-way agreement; they merely "suspended" it, with the stipulation that it would revive if either of them left NAFTA or NAFTA otherwise failed.⁴⁶

But such pessimistic ponderings are unnecessary. However provoked, Mexico will not leave NAFTA. Too much of Mexico's trade stability, investment appeal, and creditworthiness depend on a continuing NAFTA relationship. We could imagine an enraged President López Obrador sending a six-month withdrawal notice in a tantrum, but we cannot imagine that of lawyerly, orderly President Calderón or even his party-split Congress. Immigration and final trade opening are not life-and-death issues for NAFTA, but they are issues that can cause Mexico and the United States to interact within NAFTA as antagonists or as friends.

IV. A Difficult Relationship

Those are the three key issues between Mexico and the United States today. Resolving those issues will require strength, patience, and wisdom

⁴³ *Id.*

⁴⁴ NAFTA, *supra* note, 13 at ch. 22, art. 2205.

⁴⁵ *Id.*

⁴⁶ See RALPH H. FOLSOM, NAFTA AND FREE TRADE IN THE AMERICAS 19 (Thomson/West, 2004).

from both sides. On immigration, the main effort must come from the United States; resolving NAFTA's final trade opening requires cooperation from both sides; creating coordinated energy muscle is largely up to Mexico. But underlying all three issues are President Calderón's three pressing problems: gaining popular and Congressional support and moving Mexico toward more equally shared prosperity. Those are problems that President Calderón must solve.

Mexican author Carlos Fuentes described the situation very clearly. "This relationship with the United States," he wrote, "promises to be one of the most difficult in our history because it now depends more on what we do in Mexico than what the gringos do in the United States."⁴⁷

⁴⁷ Carlos Fuentes, *A New Era for Mexico*, NEW PERSPECTIVES QUARTERLY, Winter 2007, http://www.digitalnpq.org/archive/2007_winter/15_fuentes.html.

THE ROLE OF LAW IN THE CONDUCT OF CANADA – U.S.
RELATIONS

Fmr. Ambassador Allan Gottlieb[†]

CANADA-UNITED STATES LAW INSTITUTE

DISTINGUISHED LECTURE

LONDON, ON

OCTOBER 4, 2007

I am honoured to be invited to speak to you as the inaugural lecturer at the Canada-U.S. Law Institute distinguished speaker forum. The subject of my talk today is the role of law in the conduct of our relations with the United States.

Thanks to its size and intensity, no relationship between any two sovereign countries is more complex than that between Canada and the United States. For this reason, the University of Western Ontario and Case Western Reserve University showed great prescience and leadership in establishing the Canada-U.S. Law Institute. I congratulate you on your contributions, over the years, to a better understanding of so many of the difficult legal issues that continually arise between our two societies.

I have had the honour to know many of the distinguished Canadian and American scholars and statesmen who have participated in your work over several decades. The partnership and spirit of close collaboration you have created between two important North American institutions serves as an exemplar of how to address our common issues. Professionalism, scholarly discussions, joint undertakings and studies, non-partisanship, bi-national collaboration – these are the key ingredients of a model approach to dealing with our trans-national issues.

[†] Former Canadian Ambassador to the United States and Undersecretary of State for External Affairs. Senior Advisor to Bennett Jones LLP.

Beyond knowing many of your distinguished participants from both sides of the border over the years, I have another personal connection to your institute. I note from your recent annual report that the William H. Donner Foundation was an early financial supporter of your conferences.¹ I have the honour to serve as chairman of the Donner Canadian Foundation,² a sister institution of the U.S. body, both of which were established over a half-century ago by the U.S. steel magnate William H. Donner.³ I am delighted that the U.S. foundation has supported your endeavours.

I myself have been associated with Canadian-U.S. issues for many years – to be exact, for a half-century. It was fifty years ago precisely that I joined the Department of External Affairs⁴ – as it was then known – and shortly thereafter, I was assigned to the legal division, a tiny band consisting of a handful of warm bodies, which, however, was twice the size of the U.S. division, consisting of only two warm bodies.⁵ Those were the days.

I subsequently moved in and out of the legal stream, serving later as the head of the Legal Bureau, legal adviser, Undersecretary, and finally Ambassador to Washington.⁶ In all these tasks, Canada-U.S. relations remained at the forefront of my responsibilities.

Early on, I formed some very distinct views on how best to conduct our relations with the United States. For a quarter of a century, I was very sceptical about the utility of law and bilateral institutions and mechanisms in conducting relations between us.

But as you will note, I came to a very different view after having served in Washington. The sceptic about the role of law turned into a convert. And the reason why is the theme of my lecture today.

To understand my personal odyssey, I want to take you back to the early years of the post-war era. These critical decades were, of course, the years of

* Remarks occurred at an event entitled Canada-United States Law Institute Distinguished Lecture, held on October 4, 2007.

¹ About the Institute: History, Canada-United States Law Institute, <http://cusli.org/about/history.html> (last visited Apr. 7, 2008).

² See The Trilateral Commission: Allan E. Gotlieb, <http://www.trilateral.org/membership/bios/ag.htm> (last visited Apr. 7, 2008).

³ See The William H. Donner Foundation, Inc: About William H. Donner, <http://003bd1d.netsolhost.com/aboutwilliam.html> (last visited Apr. 7, 2008).

⁴ See About the Department, Mr. Allan Gotlieb, Foreign Affairs and International Trade Canada, <http://www.dfait-maeci.gc.ca/department/skelton/gotlieb-bio-en.asp> (last visited Apr. 7, 2008) [hereinafter Foreign Affairs]; see also Gotlieb, Allan Ezra, *The Canadian Encyclopedia*, <http://www.thecanadianencyclopedia.com/index.cfm?PgNm=TCE&Params=A1ARTA0003330> (last visited Apr. 7, 2008).

⁵ See *Diplomacy: Speaking for Canada*, CAN. WORLD VIEW, Issue 24, Winter 2005, available at <http://www.dfait-maeci.gc.ca/canada-magazine/issue24/04-title-en.asp>.

⁶ See Foreign Affairs, *supra* note 4.

explosive growth in the relationship and its expansion into the largest two-way economic relationship in the world.⁷

In the fledgling Department of External Affairs, during the years of the Second World War and thereafter, there was no great love of international law and international lawyers.⁸ One might speculate about the reasons but I believe they were the legacy of the failure of the League of Nations and international law in the interwar era.⁹

The Covenant of the League was rightly seen as a document dominated by legalistic norms and prescriptions.¹⁰ Peace was to be achieved, according to the Covenant, “by the firm establishment of the understandings of international law.”¹¹ Even more dramatically, great powers, through the instrument of the Kellogg-Briand peace pacts, abolished war forever.¹²

It soon became evident that this reliance on law created complacency and cloaked the reality that war was becoming inevitable. It came to be seen that the international rules, indiscriminately violated, were futile – at best pious norms and at worst deceptions passed off on a pacifist public unwilling to arm in their own defence.

At the heart of the Covenant was the famous Article 10, which guaranteed the territorial integrity of all its members against “external aggression.”¹³ But the drafters of the U.N. Charter deliberately avoided making U.N. enforcement action conditional on any violation of international law. In a historic shift, mandatory enforcement action required only the determination by the Security Council of the existence of a “threat to the peace” or “breach of the peace.”¹⁴

The practitioners of diplomacy in the Canadian Foreign Service were well attuned to the political approach enshrined in the Charter.

As a participant in the Department’s puny legal division, a decade after the Charter took effect, I can testify to how marginal legal considerations were in the Canadian approach to maintaining peace and security. The

⁷ See Allan Gotlieb, *Bring Back the Special Relationship*, THE NAT’L POST, Aug. 17, 2007, [available at http://network.nationalpost.com/np/blogs/fullcomment/archive/2007/08/17/allan-gotlieb-bring-back-the-special-relationship.aspx](http://network.nationalpost.com/np/blogs/fullcomment/archive/2007/08/17/allan-gotlieb-bring-back-the-special-relationship.aspx).

⁸ See generally EDGAR MCINNIS, CANADA 496 (Ayer Publishing 1971) (discussing Canada’s cautious policy following the war).

⁹ See generally *id.* (noting the failure of the League’s collective system).

¹⁰ See generally JOHN O’BRIEN, INTERNATIONAL LAW 739 (Routledge Cavendish 2001) (noting the complicated and legalistic provisions in the Covenant).

¹¹ See LASSA OPPENHEIM & RONALD ROXBURGH, INTERNATIONAL LAW: A TREATISE 281 (The Lawbook Exchange, Ltd. 3d ed. 2005).

¹² See O’BRIEN *supra* note 10, at 739.

¹³ See OPPENHEIM & ROXBURGH *supra* note 11, at 268.

¹⁴ See F.H. HINSLEY, POWER AND THE PURSUIT OF PEACE: THEORY AND PRACTICE IN THE HISTORY FOR RELATIONS BETWEEN STATES 337 (Cambridge University Press, new ed. 1967).

practitioners of diplomacy in Canada's golden age were skilled conciliators and architects of compromises and brokered solutions. They were not writers of new rules for the very good reason that they had lived through that era during which more rules were proclaimed and broken than perhaps at any other time in history.

The culture of favouring diplomacy, not law, was nowhere better reflected in how we collectively dealt with problems arising out of our sharing a continent with the United States.

With the exception of the International Joint Commission,¹⁵ International Joint Commission, the P.J.B.D.¹⁶ and NORAD,¹⁷ and a short-lived attempt at establishing joint cabinet committees between our two governments,¹⁸ the world's closest and deepest two-way relationship was governed by ad hoc methods. "Ad hocery" was the hallmark of the era.

The merits of this approach had no more committed advocate than myself.

The attitude in favour of pragmatism and diplomacy was articulated in the first address I gave in the United States just before I took up duties as ambassador in the fall of 1981. Talking to the biennial meeting of The Association of Canadian Studies in the United States ("ACSUS") in East Lansing Michigan, I devoted the whole of my remarks to explaining how this massive relationship of ours was managed – and indeed was best managed – without the support of bilateral institutions, bilateral machinery, and a grander legal framework.

I speculated that Canadians were somewhat "suspicious of bilateral institutions because of the different weights and sizes of the two countries." But, I pointed out the U.S. itself has never been a "demander" of Canada in terms of creating new bilateral institutions. Both sides would, I said, find unhelpful a "creeping institutionalization" whose net effect would be to encumber the process of conducting bilateral relations."

¹⁵ See International Joint Commission: Who We Are, http://www.ijc.org/en/background/biogr_commiss.htm (last visited Apr. 7, 2008) (defining its purpose as preventing and resolving disputes between the United States and Canada).

¹⁶ See National Defence and the Canadian Forces: Backgrounder The Permanent Joint Board on Defence, http://www.forces.gc.ca/site/Newsroom/view_news_e.asp?id=298 (last visited Apr. 7, 2008); see also JOHN HERD THOMPSON & STEPHEN J. RANDALL, CANADA AND THE UNITED STATES: AMBIVALENT ALLIES 152 (University of Georgia Press, 3d ed. 2002) (noting the PJBD was the military version of the International Joint Commission).

¹⁷ See National Defence and the Canadian Forces: Backgrounder NORAD, http://www.forces.gc.ca/site/Newsroom/view_news_e.asp?id=1922 (last visited Apr. 7, 2008); see also THOMPSON, *supra* note 16 (describing NORAD, North American Air Defense Agreement, as a defense production sharing agreement).

¹⁸ See generally DIMITRY ANASTAKIS, AUTO PACT: CREATING A BORDERLESS NORTH AMERICAN AUTO INDUSTRY 1960-1971 158 (University of Toronto Press, 2005) (noting U.S. and Canadian officials met for annual joint cabinet committee meeting on trade and economic affairs).

In conclusion, I called for a premium to be continued to be placed on flexibility, a pragmatic approach to the use (or non-use) of institutions, and a heavy reliance on traditional diplomatic, and conciliatory methods.

If a defining characteristic of our relationship during the decades after World War II was the absence of dispute mechanisms and special machinery, how does one account for the remarkably smooth functioning of the relationship in those years?

The answer, I think, is that this was the era of the special relationship between our two countries.

Because of closely shared values, both of us looked at the world in a very similar fashion and worked together to resist threats to peace, security and freedom. Canada made enormously heavy defence expenditures in those days – as high as 40% of the federal budget in the mid 1950s¹⁹ – and was an architect of NATO,²⁰ and close western collaborator in the fight against Soviet expansion.²¹

In the Cold War, Canada's northern 'real estate' was seen as especially significant from a geopolitical standpoint,²² given our ownership of the landmass separating the two super powers.

Hence, U.S. strategic interests could be understood as virtually dictating special consideration for Canada. Even more significantly, there was a sense of trust and friendship. For example, when the U.S. considered nominees for the post of first Secretary General of the U.N., two Canadian civil servants topped the list: Lester Pearson and Norman Robertson.²³

¹⁹ See THOMPSON, *supra* note 16.

²⁰ See generally YONATAN RESHEF & SANDRA RASTIN, UNIONS IN THE TIME OF REVOLUTION: GOVERNMENT RESTRUCTURING IN ALBERTA & ONTARIO 170 (University of Toronto Press, 2003) (noting Canada is an architect of the Western alliance).

²¹ See generally ROBERT BOTHWELL, IAN M. DRUMMOND & JOHN ENGLISH, CANADA SINCE 1945: POWER, POLITICS, AND PROVINCIALISM 88 (University of Toronto Press, Rev. ed. 1989) (discussing Canada's approach to confronting "the problem of Soviet expansion").

²² See e.g., David Neufeld, *Commemorating the Cold War in Canada: Considering the DEW Line*, 20 THE PUB. HISTORIAN 9, 13 (Winter 1998) (explaining Canada's role in the Cold War by erecting the Distant Early Warning (DEW) Line, which was a "part of a continent-wide system lending credibility to the retaliatory nuclear threat used by the United States and NATO to contain feared Soviet Aggression"); see also Ann Denholm Crosby, *A Middle-Power Military Alliance: Canada and NORAD*, 34 J. OF PEACE RESEARCH 37, 38 (1997) (discussing the Canadian military role in the North American Aerospace Defence Agreement (NORAD), where "[m]ainstream analyses of Canadian defence policy is determined by the historical, geostrategic, economic, and political factors that predict its alliance arrangements, and by those alliances themselves. This means in the context of the air/aerospace defence of the continent during the Cold War when a Soviet attack on the USA would have been through or over Canadian airspace, Canadian governments were unable to adopt defence postures that might run counter to the interests of the USA.").

²³ James Barros, *Pearson or Lie: The Politics of the Secretary-General's Selection, 1946*, 10 CAN. J. OF POL. SCI. 65, 67 (Mar. 1977) (discussing Edward R. Stettinius' opinion, the

The record shows that the U.S., on a number of occasions, was willing to subordinate its economic interests (as they perceived them) to the larger purpose of maintaining good relations with Canada. It seems at times that it was the policy of the United States not “to treat Canada like any other foreign government.”

For example, Canadian oil imports into the U.S. were granted an overland exemption from restrictions on foreign imports of oil into the United States.²⁴

In this same period, when President Kennedy imposed an interest equalization tax on investment abroad, the special relationship meant that when Canada protested, once again we got an exemption.²⁵ The U.S. on some occasions refrained from applying its pernicious extraterritorial laws on trading with the enemy to our trade with China in trucks and machinery.²⁶

When serious countervailing issues arose as a result of duty remission schemes for the manufacture of automobiles in Canada, it was the U.S. that proposed to Canada that we consider an automotive agreement for tariff-free trade between our two countries in the automotive sector.²⁷ It then used its power and influence to help obtain GATT approval.²⁸ Thus, in 1965, the auto pact was born.²⁹

American representative in the United Nations Preparatory Commission, in discussing the selection of Secretary-General: “The first choice of the American government...should be the Canadian Undersecretary of State for External Affairs, Norman A. Robertson. There were, however, other persons who might have been considered: Lester B Pearson. . .”).

²⁴ Thomas W. Zeiler, *Kennedy, Oil Imports, and the Fair Trade Doctrine*, 64 THE BUS. HIST. REV. 286, 289 (Summer 1990) (“The program limited imports to 9 percent of estimated domestic demand but exempted Canada and Mexico from quotas in order to maintain their safely imported, overland supplies.”).

²⁵ Robert L. Maines, *The Interest Equalization Tax*, 17 STAN. L. REV. 710, 720 (Apr. 1965) (“In a joint Canadian-American statement on July 21, 1963, it was agreed that new Canadian issues would be exempt from the tax...,” discussing the Interest Equalization Tax and the power of the President to exempt foreign securities by Executive order).

²⁶ I.A. Litvak & C.J. Maule, *Conflict Resolution and Extraterritoriality*, 13 J. OF CONFLICT RESOL. 305, 310 (Sep. 1969) (“On May, 1959, it was announced in Parliament that US authorities had lifted the restrictions applied to Canadian trucks carrying Communist Chinese goods in bond through United States territory.”).

²⁷ See generally Key Economic Events 1965 – Canada-United States Auto Pact, Government of Canada, http://www.canadianeconomy.gc.ca/english/economy/1965canada_us_auto_pact.html (last visited Apr. 7, 2008) (“The Auto Pact eliminated trade tariffs between the two countries and created a single North American manufacturing market. Tariffs between the two countries were eliminated on cars, trucks, buses, tires and automotive parts.”).

²⁸ See ANASTAKIS, *supra* note 18, at 119 (“In the end, the waiver passed, on 19 December 1965. The most important reasons for this outcome begin with the fact that the U.S. government puts its full weight behind the request and used the Kennedy Round as a carrot to push other countries towards further tariff reduction.”).

²⁹ Key Economic Events, *supra* note 27.

In 1971, when the Nixon administration and its Secretary of the Treasury John Connolly imposed a surcharge on all imports into the U.S. in order to address its unfavourable balance of payment, (the famous “Nixon Shokku”) Canadian protests were once again heard and the surcharges for Canadian imports into the U.S. were lifted.³⁰

Absolutely key to an understanding of the special relationship is that it corresponded in time not only with the Cold War but also with the period of the imperial presidency. The Congressional role was distinctly subordinate to the administration.³¹ We looked to the administration to keep the Congress in line. Moreover, the powers of Congress were exercised in a disciplined way by the dominant congressional leaders.

Nothing better illustrates the relationship of the time – and the changes that were soon to take place – than the memoirs of Arnold Heeney, our ambassador to Washington twice during these years.³² Heeney wrote that he did not have to deal with economic issues in his time.³³ They were not on his agenda. Nor did he lobby the Congress.³⁴ Nor did a Canadian ambassador until decades later.³⁵ We followed the rules by the book: the Congress, being an internal organ of the government, was off limits.

³⁰ See Richard Veatch, *Review: [Untitled]*, 19 CAN. J. POL. SCI. 388 (Jun. 1986) (reviewing PETER C. DOBELL, *CANADA IN WORLD AFFAIRS, 1971-1973* 471 (Canadian Institute of International Affairs 1985)) (stating, “[t]he 10 per cent surcharge on imports into the United States, the measure about which Canada was most concerned, was lifted in December 1971, and it had not had the drastic short-run effects in Canada which had been anticipated”).

³¹ See WILLIAM BUNDY, *A TANGLED WEB: THE MAKING OF FOREIGN POLICY IN THE NIXON PRESIDENCY* 383 (I.B. Tauris 1998) (stating “Congress had been out of play during the fall because of the election campaign, and in the new year reconvened just as the Paris Agreement was being concluded. Despite the Democratic majorities in both houses, many in Washington felt at the time that Nixon had so much prestige that the Nixon presidency was now more powerful than any since Johnson’s 1965 honeymoon or Eisenhower’s first years.”).

³² Library and Archives of Canada, *Behind the Diary, Arnold Danford Patrick Heeney (1902-1970)*, Library and Archives of Canada, http://www.collectionscanada.gc.ca/king/05320113/053201130454_e.html (last visited Apr. 7, 2008) (“He was Canada’s Ambassador to the United States twice, 1953 to 1957 and 1959 to 1962.”).

³³ See JACOB RYTEN, *THE STERLING PUBLIC SERVANT: A GLOBAL TRIBUTE TO SYLVIA OSTRY* 7 (Mc-Gill-Queen’s Press 2004) (“Arnold Heeney, Canada’s Ambassador to Washington in the late 1950’s, reported to Prime Minister John Diefenbaker that there were no economic issues between Canada and the United States at the time.”).

³⁴ See generally Brian Bow, “*When in Rome,*” *Comparing Canadian and Mexican Strategies for Influencing Policy Outcomes in the United States*, 65 CAN.-AM. PUB. POL’Y 1, 20 (Jan. 2006) (describing how Heeney “reluctantly resorted to calling the Senate Majority Leader,” as the only occasion he felt it necessary to go directly to the Hill).

³⁵ See Robert Wolfe, *See You in Washington? A Pluralist Perspective on North American Institutions*, 9 IRRP CHOICES 14 (Apr. 2003) (discussing how, in the 1960s, foreign diplomats preferred “quiet and regular consultation,” but that during the years of Reagan, a new role was established: “the diplomat as public advocate”).

On one occasion some senators from the mid-west were sponsoring a bill that would have caused a diversion of the waters of the great lakes, to Canada's great detriment.³⁶ Heeney went to the State Department to complain, in accordance with traditional diplomatic practice.³⁷ The senior State Department official told him he could do nothing.

"Complain to the Congress," he told him. "Who should I see?" the ambassador asked. "Lyndon Johnson, the Senate Majority Leader," was the reply. "Will you make the appointment?" Heeney asked. "Yes" was the response. Heeney made the call, told Johnson that he had a problem and explained it. Johnson then said, "No boy, you don't have a problem." "What do you mean?" said Heeney, "I just explained it." Johnson replied "and I just fixed it."

Then came the Trudeau era, and in the U.S., Vietnam and Watergate. There was a sense that the threats of the Cold War were receding and the need for alliance solidarity diminishing. Among Canadian elites, the conviction grew that we needed to assert more vigorously our independence from the Americans on the global stage.

Accordingly the Trudeau government introduced the "third option" aimed at reversing the movement towards greater economic interpenetration between our two nations. It also adopted foreign ownership policies ("FIRA")³⁸ and national energy policies (Petro Canada, N.E.P.)³⁹ aimed at asserting our independence on the global stage and reducing our dependency on the United States.

With this change of direction, it was inevitable that the very notion of a "special relationship" was deemed inappropriate and fell from favour.

But the Trudeau policy in favour of establishing the "ordinariness" of the Canada-U.S. relationship – assumed to be a sign of our new maturity, failed to take account of deep and important political changes underway in the United States.

Ironically, we proclaimed our view that special consideration for our interests was no longer necessary at the very moment when we were going to need it more, i.e. when Congress was reasserting its jurisdictional primacy in the area of external trade.⁴⁰

³⁶ See generally Bow, *supra* note 34, at 20.

³⁷ *Id.*

³⁸ See J.L. GRANATSTEIN & ROBERT BOTHWELL, *PIROUETTE: PIERRE TRUDEAU AND CANADIAN FOREIGN POLICY* 72 (University of Toronto Press 1990) (discussing the establishment of the Foreign Investment Review Agency because of the enlargement of Trudeau's "natural tendencies towards intervention in the management of the economy.").

³⁹ See *id.* at 315 (discussing the government's attempt to "assure" Canadian oil supply).

⁴⁰ See Martha Liebler Gibson, *Managing Conflict: The Role of the Legislative Veto in American Foreign Policy*, 26 *POLITY* 441, 442-443 (Spring 1994) (stating that more than half of the legislative veto provisions written into domestic and foreign policy statutes were

Ottawa was out of touch with the revolution in governance that was taking place in Washington in the wake of Vietnam and Watergate. As the presidency was weakened, so was party discipline.⁴¹ A new crop of younger post Watergate congressmen came to Washington, eager to exert power and influence.

Decision-making in Congress became fragmented and atomized as the spectre of protectionism cast a deep shadow over the corridors of Congress. New trade legislation gave U.S. bodies far-reaching powers to investigate and retaliate, if there was perceived discrimination against U.S. and services.⁴² Section 201 and 301 actions and anti-dumping and countervails mushroomed to the point where almost nothing that came from under the ground or grew on top of it or moved in the sea escaped attack.⁴³

Because of the weakened presidency and the fear of decline in U.S. industrial primacy, the era was over when the U.S. would subordinate its economic interests to its geopolitical goals.⁴⁴ Prominent senators trumpeted this fact to foreign audiences.⁴⁵

Truth to tell, Ottawa was not the only one out of touch with the hanging political realities in the United States. I was too. Today I find it hard to explain why.

After all, it was on my watch as Undersecretary that the historic Canada-U.S. fisheries agreement failed to come to pass. This was because of the opposition of only one senator.⁴⁶

Under the direct authority of President Jimmy Carter and Prime Minister Pierre Trudeau, special ambassadors succeeded in negotiating a radical resource treaty that would have created a new bilateral institution to manage jointly all species of fish exploited on the Northern Atlantic East Coast.⁴⁷

incorporated in the 1970s, with 80 legislative vetoes “enacted between 1975 and 1978 alone”).

⁴¹ See John LeBoutillier, *The Death of Party Discipline*, NEWSMAX, May 21, 2001, <http://archive.newsmax.com/archives/articles/2001/5/21/54822.shtml> (discussing that after Watergate, many Republican candidates for Congress proclaimed themselves independents and viewed party loyalty negatively).

⁴² See Cletus C. Coughlin, *U.S. Trade-Remedy Laws: Do they Facilitate or Hinder Free Trade?*, FED. RES. BANK OF ST. LOUIS REV. July-Aug. 1991, at 3, 8-13, available at http://research.stlouisfed.org/publications/review/91/07/Trade_Jul_Aug1991.pdf.

⁴³ *Id.* at 7-9.

⁴⁴ See e.g., Jonathan Clarke, *America, Know Thyself*, NAT’L INT., 1993/1994 Winter, at 1-9.

⁴⁵ *Id.*

⁴⁶ See *U.S. Moves on Fish Treaty Upset Ottawa*, GLOBE & MAIL, Mar. 7, 1981, at Climate of Past Special Issue.

⁴⁷ See Henry Giniger, *Disputes Await Reagan on Canada Trip*, N.Y. TIMES, Mar. 2, 1951 at A3.

It was perhaps, to that date, the most ambitious economic agreement ever signed by our two governments in the post-war era. And it died in the Senate thanks to the scallop-catching constituents of one or two senators.⁴⁸

With the failure of this historic agreement, it became obvious, or should have been, that Canada could not rely on a powerful U.S. presidency to resolve Canada-U.S. issues or better manage them without the support of Congress.

As Canadian ambassador to Washington, I rapidly became conscious of the power of senators and congressmen to originate legislation that could have far-reaching effects on our relationship. I realized that Congress had not just legislative but co-executive powers.⁴⁹ This was my first and most enduring lesson.

I became convinced that we needed a stronger legal foundation to support our rapidly integrating economies. Accordingly, I enthusiastically participated in Mulroney's historic shift in our approach to Canada-U.S. relations.

Breaking with the past, the Mulroney government ushered in a new era in the management of our relationship. Although not originally in favour of a comprehensive free-trade agreement with the U.S., the Mulroney government changed gears twelve months after its election.⁵⁰

The achievement of a free-trade agreement with the United States was my principal preoccupation in Washington for two years. (If you want a day-by-day harem-scarem account, let me put a plug-in for my recently published diaries.⁵¹)

The free-trade agreement proposed by the Mulroney government was, without question, a radical departure from the past.⁵²

A) It established a new rules-based framework to support the phenomenal flows of trade and economic activity between our two countries.⁵³

B) The free-trade zone was to be bilateral in nature. On a one-on-

⁴⁸ *U.S. Moves on Fish Treaty Upset Ottawa*, *supra* note 46, at A3.

⁴⁹ *See generally*, James Kuhnenn, *GAO Suit is Latest Clash Between Legislative, Executive Branches*, KNIGHT RIDDER/TRIB. NEWS SERVICE, Feb. 25, 2002, at 1-4.

⁵⁰ *See generally* Carol Goar, *The 'Blueing' of Canada*, TORONTO STAR, Dec. 31, 1987 at A16.

⁵¹ ALLAN GOTLIEB, *WASHINGTON DIARIES: 1981-1989* (McClelland & Stewart Ltd. 2006).

⁵² Goar, *supra* note 50.

⁵³ *See* Andrew F. Cooper, *Good Global Governance or Political Opportunism? Mulroney and UN Social Conferences*, in *DIPLOMATIC DEPARTURES: THE CONSERVATIVE ERA IN CANADIAN FOREIGN POLICY, 1984-93* 160, 170 (Nelson Michaud & Kim Richard Nossal eds., 2001).

one basis, we were seeking a closer economic embrace from our neighbour to the south.⁵⁴ Ottawa did not have a more extended North American or Western Hemisphere agreement in mind. It was a preferential regime for Canada and the United States.

- C) It was to include all sectors of the economy with the exception of culture – that meant investment, services, energy, and other resources.⁵⁵
- D) Trade remedies were to be abolished or restrained.⁵⁶
- E) New institutional arrangements were to be entered into to settle disputes – the first innovative proposal in the institutional field in half a century or more of our bilateral relations.⁵⁷

Despite the degree of hostility in the Congress (at one time approximately 40 senators were opposed to the Accord), many of our goals were largely achieved.⁵⁸ The result was a huge increase in the free flow of goods, investment, and services across our boundaries with exports tripling in scale and, softwood lumber notwithstanding, a significant falling off in the number of U.S. Trade actions initiated against Canadian exports.⁵⁹

But the evolution of North American trade since that time revealed that there were problems in going further in the direction of a deeper rules-based integration and common institutions.

First, the Canada-U.S. Free Trade Agreement soon evolved into a trilateral accord, the North American Free Trade Agreement or NAFTA, in

⁵⁴ See generally Denis Stairs, *Architects or Engineers? The Conservatives and Foreign Policy*, in *DIPLOMATIC DEPARTURES: THE CONSERVATIVE ERA IN CANADIAN FOREIGN POLICY, 1984-93* 25, 30-33 (Nelson Michaud & Kim Richard Nossal eds., 2001).

⁵⁵ See e.g., Tammy L. Nemeth, *Continental Drift: Energy Policy and Canadian-American Relations*, in *DIPLOMATIC DEPARTURES: THE CONSERVATIVE ERA IN CANADIAN FOREIGN POLICY, 1984-93* 59, 65 (Nelson Michaud & Kim Richard Nossal eds., 2001).

⁵⁶ See generally Brian W. Tomlin, *Leaving the Past Behind: The Free Trade Initiative Assessed*, in *DIPLOMATIC DEPARTURES: THE CONSERVATIVE ERA IN CANADIAN FOREIGN POLICY, 1984-93* 45, 48-52 (Nelson Michaud & Kim Richard Nossal eds., 2001).

⁵⁷ See, e.g., Claire Turenne Sjolander, *Adding Women but Forgetting to Stir: Gender and Foreign Policy in the Mulroney Era*, in *DIPLOMATIC DEPARTURES: THE CONSERVATIVE ERA IN CANADIAN FOREIGN POLICY, 1984-93* 220, 231 (Nelson Michaud & Kim Richard Nossal eds., 2001).

⁵⁸ See Clyde H. Farnsworth, *Canadian Pact Voted By Senate*, N.Y. TIMES, Sept. 20, 1998 at D1.

⁵⁹ See generally Daniel T. Griswold, Editorial, *By Every Reasonable Measure, NAFTA Has Been a Success*, CHICAGO SUN-TIMES, Dec. 27, 2002, at 39.

which Mexico shares a privileged market-access position into the United States.⁶⁰ Canada lost its unique status. But the problems and challenges in the Mexican-U.S. relationship were very different from ours and, I believe, much more intractable.⁶¹

Second, the free trade agreement fell short of what needed to be attained. There were no agreed rules in the critical area of what constitutes a subsidy; there were serious weaknesses in the dispute settlement provisions; much work needed to be done to embrace unfettered free trade in such areas as agriculture and forest products and to facilitate the free movement of peoples across boundaries.⁶²

Thirdly, neither the Canada-U.S. Free Trade Agreement nor its successor, NAFTA, contained within it the dynamic necessary to lead to its own improvement. Unlike the European Community, there were no internal mechanisms to spur momentum towards deepening and widening the common economic space our countries were forging.⁶³

The consequences for Canada would not have been so serious had the events of September 11, 2001 not taken place. The effect was transformative.

National security soared to the top of the U.S. agenda to an unprecedented degree, and an era was born in which defence of the homeland trumped all other concerns.⁶⁴ New obstacles began to arise impeding cross-border commerce and the movement of peoples. The Canada-U.S. border began to thicken.

The Chrétien government struggled to address the issues through its 'smart border' negotiations with the U.S. This effort evolved into the much broader trilateral process launched in Waco, Texas: the Security and Prosperity Partnership, through which the three North American states sought to address the vast array of regulatory and security obstacles that stood in the way of deepening our common economic space.⁶⁵

⁶⁰ See *OXFORD ANALYTICA: NORTH AMERICA: NAFTA Impact Free Trade Faces Challenges*, GLOBE & MAIL, July 11, 1994.

⁶¹ See generally *id.* (explaining certain unique NAFTA issues that Mexico and Canada had with each country's respective relationship with the United States).

⁶² See Jessica K. Hodges, *When Enough is Too Much: The Threat of Litigation NAFTA's Constitutionality and a Lost Chance to Examine Undue Process in Antidumping and Countervailing Duty Determinations*, 15 GEO MASON L. REV. 201, 219 (2007), available at <http://www.gmu.edu/departments/law/gmulawreview/issues/15-1/documents/Hodges.pdf>.

⁶³ See Gary Clyde Hufbauer & Gustavo Vega- Cánovas, *Whither NAFTA: A Common Frontier?*, THE REBORDERING OF NORTH AM.? INTEGRATION AND EXCLUSION IN A NEW SECURITY CONTEXT (forthcoming 2003) (manuscript, available at <http://iie.com/publications/papers/hufbauer1202.pdf>).

⁶⁴ See e.g., Thomas H. Kean & Lee H. Hamilton, *Reviewing our Defenses, Four Years After 9/11*, THE FORWARD, Sept. 9, 2005, at 1.

⁶⁵ See Richard Tomkins, *Analysis: North America partnership*, UPI, Mar. 23, 2005.

The effort continues to this day. Judging by what is happening at our borders, the process has been moving very slowly, if it is moving at all. It has lacked the leadership, energy and momentum necessary to achieve results. Now, thanks to the Congressionally-inspired Western Hemispheric travel initiative with its requirement for overland passport controls, Canada and the U.S. are at risk of reversing the great historic trend towards reducing the significance of the border in our national life.⁶⁶

So where do we go from here?

We should pursue a deeper and more comprehensive rules-based framework for our economic and security relations. Our goal should be nothing less than a North American community of law. Only in this way can we reduce political arbitrariness in settling disputes and disinvesting our economic interests.

With a minority government in Canada and a lame-duck administration in the United States heavily preoccupied with Iraq, you would be right in saying that this is not the most propitious time for grand initiatives or possibly even for modest ones.⁶⁷

But, the relationship between Ottawa and Washington has significantly improved since the election of Stephen Harper's government.⁶⁸ Moreover, our formidable commitment to fight terrorism in Afghanistan has substantially increased good will towards Canada both in the White House and on The Hill and among both Republicans and Democrats.⁶⁹

Why not propose to the United States that we begin to explore ways to advance our respective national interests through the further development of special bilateral machinery, consultative arrangements, and rule making?

We could at least try to make some progress in this direction. For example, our two governments could:

1. Commit to convene official annual summits between the President and the Prime Minister. These began in the Mulroney-Reagan years and were highly productive.⁷⁰ For unknown reasons, the

⁶⁶ See Doug Struck, *Rush of Passports seen in Canada, U.S.; New Rules Set to Tighten Security*, SUN-SENTINEL, Jan. 14, 2007, at 29A.

⁶⁷ See generally Tim Harper, *U.S. Won't Budge on Khadr; Ahead of Next Week's Talks by Bush, Harper, Calderón, White House Signals Canadian to Face Tribunal at Guantanamo*, THE TORONTO STAR, Aug. 18, 2007, at A13 (President Bush's political capital has long been exhausted and he has been consigned to lame duck status).

⁶⁸ See *Canada-U.S. Relationship gets Warmer; Change in Ottawa Brings Change in D.C.*, GUELPH MERCURY, Apr. 26, 2006, at A7.

⁶⁹ See Jeff Sallot, *Canadian Troops May Not go to Iraq, But to Afghanistan*, THE GLOBE AND MAIL, Feb. 5, 2005, at A10.

⁷⁰ See Martin Cohn, *SUMMIT/Leaders No Longer Sing Same Tune Stakes High for PM in Talks with Reagan*, THE TORONTO STAR, Apr. 24, 1988, at B5.

practice lapsed. Summits of this nature increase dramatically the focus and priority that Canadian issues would receive at the highest echelons of the U.S. system.⁷¹

2. Establish special procedures for the preparation of these summits, under the control and direction of the two leaders.
3. Reinstitute the commitment to hold quarterly meetings of our Foreign Minister and the U.S. Secretary of State, established in the Reagan years, but, again for unknown reasons, allowed to lapse.⁷² This was a unique feature of U.S. diplomatic practice. It guaranteed 'quality time' for top officials to get their counterparts to focus on their grievances and concerns.
4. Adopt the same practice for ministers in other key areas – e.g., energy, the environment, defence, and law enforcement.
5. Develop a protocol between our two governments, which would define principles for cooperation. For example, require that prior notification and opportunity for consultation would be provided with regard to any initiative that could have an adverse impact on the other's interests.

Given the fact that, as with the Western Hemispheric Travel Initiative, so many of our problems originate in the Congress, obtaining such an agreement would be very meaningful for Canada.⁷³ Admittedly, such a commitment will not be easily obtained. But it would also be of substantial benefit to the United States (think legalization of marijuana).⁷⁴

6. Appoint personal envoys or czars, answerable directly to the President and Prime Minister, to take hold of the entire process of border facilitation.

⁷¹ *Id.*

⁷² *Id.*

⁷³ See generally Jim Harper, *U.S.-Imposed Border Bedlam Will Hurt Michigan*, DETROIT NEWS, Jan. 30, 2008, available at http://www.cato.org/pub_display.php?pub_id=9128 (discussing the problems in the implementation of the Western Hemisphere Travel Initiative).

⁷⁴ Cohn, *supra* note 70 (discussing the importance of a strong relationship between the United States and Canadian leaders).

7. Establish the principle that new bilateral institutions should be created to plan, maintain and oversee the openness of our borders. Vast consequences hinge on how well they are managed. Unilateral decision-making affecting the principal choke points should be brought under the responsibility of new trans-border commissions with effective powers.

There is more than a whiff of the 19th century in how we currently go about our business of border management.⁷⁵ The International Bridge at Buffalo / Fort Erie is an example. Years pass and the problems of congestion, insufficient infrastructure, and security remain unresolved: too many players, too many jurisdictions, too little planning, and too much unilateralism.

Almost a century ago, the International Joint Commission was formed by Britain and the U.S. to manage issues relating to our international boundary waters.⁷⁶ A century later, our approach to management of the land frontiers remains mired in obsolete notions of sovereignty.⁷⁷

8. Mandate special envoys to begin planning for the negotiation of a new comprehensive agreement to create a single economic and security space embracing our two countries. This should include adopting a common external tariff, rules of origin, and customs union, strengthening dispute-settlement, abolishing trade remedies, establishing a common competition policy, creating a common security perimeter, and furthering the free movement of people across our boundaries.⁷⁸

In other words, a community of law.

Could such an agreement be obtained? Only with great patience and difficulty. But our free-trade experience shows that in the Congress big

⁷⁵ See *NAFTA Lacks a Sense of Community*, THE TORONTO STAR, Aug. 23, 1998 (unilateral actions have the potential to create serious disputes).

⁷⁶ IJC.com, International Joint Commission- Who We Are, http://www.ijc.org/en/background/biogr_commiss.htm (last visited Apr. 7, 2008).

⁷⁷ See e.g., Editorial, *Stop Bridge Delay: United States, Canada must Resolve Harmful Impasse on Boarder Security*, BUFFALO NEWS, Feb. 25, 2007.

⁷⁸ See generally Danielle Goldfarb, *The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?*, C.D. HOWE INSTITUTE COMMENTARY, July 1, 2003 (discussing the options for a bi-national customs union).

initiatives can have a greater chance of success than small ones.⁷⁹ This is because there are more interests in play, more trade-offs available, and more opportunities for national interests to trump local ones.⁸⁰

In order to ensure our sovereignty and independence, the Canada-U.S. relationship must be based on a stronger and more comprehensive regime of law. We should recognize this and make its attainment our highest foreign-policy priority.

⁷⁹ See C. Fred Bergsten, *Globalizing Free Trade: The Assent of Regionalism*, FOREIGN AFF., May-June 1996, available at <http://www.foreignaffairs.org/19960501faessay4203/c-fred-bergsten/globalizing-free-trade-the-ascent-of-regionalism.html>.

⁸⁰ *Id.*

DIFFERENT ROUTES TO THE SAME “COMPETITIVE”
DESTINATION:

VOIP REGULATION IN THE UNITED STATES AND CANADA

Stephen Rodini[†]

Internet Telephony, also known as Voice over the Internet Protocol (“VoIP”) has changed the way people communicate with one another. Not only is it cheap, but it also offers many features previously unavailable with telephones. This innovation, however, comes at a price for regulators, as the nature of the technology creates unique (and previously unheard of) regulatory obstacles. As such, VoIP presents an interesting scenario for both the U.S. and Canadian governments. In response, both have attempted to address the issue via their own methods. However, for the technology to be truly viable, these governments need to pay close attention to the consumer uptake of VoIP, as well as the potential for anti-competitive harm by providers. In doing so, they must apply the appropriate regulation where necessary *and* leave certain portions of the market unregulated. If properly executed, regulators stand to have a great chance of ensuring VoIP’s viability for the near future.

I. What is VoIP anyway?

VoIP allows users to make phone calls over an Internet broadband connection.¹ This use of Internet technology is a dramatic shift from “traditional” telephony (which is based over phone lines). By using the Internet, VoIP allows users to access many more features than with traditional telephony.² For instance, industry analysts invite us to “imagine a phone call with your mother, she instantly messages you her meatloaf recipe,

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^{*} Case Western Reserve University School of Law Student Note.

¹ *Voice-Over-Internet Protocol*, Consumer & Governmental Aff. Bureau, <http://www.fcc.gov/voip> (last visited Mar. 20, 2008).

² Konrad L. Trope, *Voice over Internet Protocol: The Revolution in America’s Telecommunications Infrastructure*, 22 *COMPUTER & INTERNET LAW*. 1, 1 (2005).

which appears on your computer screen while the phone call takes place through your computer system.”³ VoIP also allows users to clean the “spam” from their voicemail, pager, and email with “a single click of a computer mouse.”⁴ What makes VoIP most attractive, however, is its low price.⁵ Since the majority of the connection takes place in cyberspace, VoIP consumers avoid most of the expensive surcharges that telecommunications companies levy for use of their networks, which also allows VoIP consumers to avoid state and federal taxes associated with the use of such networks.⁶

Another selling point is that many features, which would cost extra under normal telephony, are free with VoIP.⁷ In fact, VoIP users can even have their voicemail sent directly to their email inboxes!⁸ An additional appealing feature is VoIP’s “portability.” This allows users “to create a ‘Virtual Presence’ to provide friends and family with a local number to reach you and thereby avoid long distance toll charges.”⁹

VoIP has many features that make it very attractive for business users as well. Like consumers, businesses also enjoy VoIP’s low prices.¹⁰ In fact, over 80% of the companies planning to deploy VoIP expect a payback on their investment within three years of implementation.¹¹ In reality, however, many companies using VoIP have experienced a complete return within the first year.¹²

Another attractive feature is that VoIP allows businesses to have multiple inbound numbers going to the same phone, which can save a large amount of money on “call centers.”¹³ VoIP also permits companies to provide individual phone lines for employees without having to install and maintain the expensive “private branch exchanges” associated with traditional telephony.¹⁴ This distinction is important because under traditional

³ *Id.* at 1.

⁴ *Id.*

⁵ Craig Ellison, *Talk is Cheaper: Pricing Plans Galore*, PC MAG., Jan. 12, 2005, available at <http://www.pcmag.com/article2/0,1895,1746592,00.asp> (noting that some VoIP services are free, other VoIP services cost more, and traditional calling plans cost even more for both domestic and international calls).

⁶ See Jim Mele, *VoIP: A Fad or the Future?*, FLEETOWNER MAG., Sep. 1, 2004, available at http://fleetowner.com/information_technology/feature/fleet_voip_fad_future/index.html.

⁷ VoIP Advanced Features, http://www.voipaction.com/adv_feat.php (last visited Apr. 1, 2008).

⁸ Benefits of VoIP, <http://www.voipaction.com/benefits.php> (last visited Mar. 20, 2008).

⁹ See *id.*

¹⁰ VOIP EZ, Voice Over IP for Business - Benefits, <http://www.voipez.com/business/benefits.html> (last visited Mar. 20, 2008).

¹¹ See *id.*

¹² See *id.*

¹³ VoIP Advanced Features, *supra* note 7.

¹⁴ Mele, *supra* note 6.

telephony, a business’s phone system only had a limited number of telephone ports.¹⁵ VoIP systems, on the other hand, allow a business to run a number of “virtual users” through each network socket, thereby increasing scalability.¹⁶ Moreover, since VoIP is rooted in software rather than hardware, it is easier to maintain (thus dramatically reducing operating costs).¹⁷

However, VoIP’s greatest benefit is, perhaps, its increase in worker productivity.¹⁸ VoIP technology treats voice data as if it were any other kind of data, allowing users to attach documents to voice messages and to participate in virtual meetings using shared data.¹⁹ As such, VoIP is compatible with Blackberrys and other personal digital assistants (“PDA”), creating a seamless connection between an employee and his or her company’s network.²⁰ “It’s not just having the information, it’s how you use it,” said Ingrid Tremblay, Nortel’s senior manager of product marketing for multimedia.²¹ She continued:

In the past, I would have called a colleague and gone to voice mail if that person was on the phone. Now I can look on my dashboard, check my friend’s [sic] list and see if that person is on the phone, and if they are, I’ll use an IM to invoke a response. It makes better use of everyone’s time.²²

By using VoIP, businesses can cut costs, produce more, earn more, and deliver better services to their customers. For consumers, VoIP allows more features at a much-reduced cost. Therefore, VoIP represents a potential goldmine for both sectors of the market.

II. How does VoIP work and how is it different from traditional telephony?

While traditional telephony and VoIP are essentially the same product, the underlying technologies behind their operations differ dramatically. For example, traditional telephony uses a process known as “circuit switching” to

¹⁵ Voice Over Internet Protocol (VoIP), is4profit.com, http://www.is4profit.com/business-advice/it-telecoms/voip_3.html (last visited Mar. 20, 2008).

¹⁶ *Id.*

¹⁷ *See id.*

¹⁸ *See id.*

¹⁹ *Id.*

²⁰ *See id.*

²¹ Carol Wilson, *VoIP Brings New Productivity to Many Businesses*, TELEPHONY ONLINE, May 23, 2005, available at http://telephonyonline.com/mag/telecom_voip_brings_new.

²² *Id.*

connect phone calls, while VoIP uses “packet switching.”²³ Circuit switching is more complicated and more expensive than packet switching.²⁴

When a person makes a phone call via traditional telephony, the call is routed through a “switch” (a piece of phone call relaying equipment) at the telephone carrier’s “local exchange.”²⁵ Depending on the type of call, the routing is either terminated within the local exchange’s calling area (typically a city and its adjacent suburbs, although larger cities often have multiple local exchanges) or routed through to another network.²⁶ Local calls terminate within the local exchange area.²⁷ Long distance calls, on the other hand, are a little more complicated.²⁸

While similar to local calls, long distance calls go through an additional step in their execution. Instead of terminating within a local exchange area, these calls are routed to a long distance network (usually run by a separate carrier), which transports the data to another local exchange (usually run by another carrier) where it is connected to the other party.²⁹ It is important to note that this process can involve three or more carriers, especially those calling internationally.³⁰ In addition, each step involves “access charges” by local exchange owners for the connecting carrier’s use of its facilities.³¹ These access charges are passed directly to consumers.³²

VoIP calls use a different process called “packet switching.”³³ Packet switching is how data is transmitted over the Internet.³⁴ Vint Cerf, the “Father of the Internet,” described this process using the following analogy:

²³ How Does VOIP Work?, Intertangent Technology Directory, www.intertangent.com/023346/Articles_and_News/more2.html (last visited Mar. 20, 2008) [hereinafter How Does VOIP Work?].

²⁴ Packet versus Circuit Switching: Fundamental Differences, Zvon, <http://www.zvon.org/tmRFC/RFC3439/Output/chapter5.html> (last visited Apr. 3, 2007).

²⁵ See *id.*

²⁶ How Long Distance Works, http://www.phone-bill-busters.com/how_ld.htm (last visited Mar. 20, 2008).

²⁷ See *id.*

²⁸ How Does a Long-Distance Call Work?, Howstuffworks, <http://electronics.howstuffworks.com/question354.htm> (last visited Mar. 20, 2008).

²⁹ How Long Distance Works, *supra* note 26.

³⁰ See *id.*

³¹ CyberTelecom, Access Charge, <http://www.cybertelecom.org/ci/access.htm> (last visited Apr. 1, 2008).

³² See Understanding Your Telephone Bill, Consumer & Governmental Aff. Bureau, <http://www.fcc.gov/cgb/consumerfacts/understanding.html> (last visited Mar. 20, 2008).

³³ How Packet Switching Works, <http://www.voip-voice-over-ip.com/technology/packet-switching.htm> (last visited Mar. 20, 2008).

³⁴ What is a Packet?, Howstuffworks, <http://computer.howstuffworks.com/question525.htm> (last visited Mar. 20, 2008).

[T]hink of a packet as postcards sent via postal mail. A postcard contains just a limited amount of information. To deliver a very long message, one must send a lot of postcards. Of course, the post office might lose one or more postcards. One also has to assemble the received postcards in order, so some kind of mechanism must be used to properly order [the] postcards, such as placing a sequence number on the bottom right corner. One can think of data packets in an IP network as postcards.³⁵

While this may seem a bit abstract, packet switching has many advantages over circuit switching. First, packet switched data takes up less space over a network than circuit switched data.³⁶ This extra space allows VoIP providers to make three or four calls (instead of a single call) on a circuit.³⁷ This makes VoIP calls cheaper.³⁸

VoIP comes in three varieties.³⁹ Analog Telephone Adaptor, also known as “Hybrid

VoIP,” is the most common.⁴⁰ This technology involves hooking up a regular telephone to a computer with an Internet connection.⁴¹ A second variety is one that uses a specialized Internet Protocol (“IP”) Phone.⁴² This device looks just like a regular telephone except that it has an Ethernet adapter plugged into an Internet router.⁴³ IP Phones allow users to circumvent their computers, thereby eliminating the need to install software.⁴⁴ In practice, it operates just like a traditional phone, yet it bypasses the traditional phone network entirely.⁴⁵ A final variety involves a personal computer headset or microphone plugged into an Internet-enabled computer.⁴⁶ These latter two types are collectively known as “Pure VoIP.”⁴⁷

³⁵ Understanding VoIP – How Does VoIP Work?, http://www.packetizer.com/voip/papers/understanding_voip/how_voip_works.html (last visited Mar. 20, 2008).

³⁶ How Does VoIP Work?, *supra* note 23.

³⁷ *See id.*

³⁸ VoIP Cheaper Home Solutions Australia, <http://www.ozvoip.com/home-solutions/> (last visited Mar. 20, 2008).

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *See generally* Jim Hanks, Which VoIP Service Is Best for You?, <http://telecom.hellodirect.com/docs/Tutorials/VOIP.1.010902.asp> (last visited Mar. 20, 2008) (profiling various VoIP services).

⁴⁷ *See generally* Ben Charny, *Qwest Drops Access Fees on “Pure VoIP”*, CNET NEWS, Apr. 26, 2004, http://news.com.com/2100-7352_3-5200236.html.

Since it is subject to certain access charges, Hybrid VoIP is the most expensive form of VoIP.⁴⁸ However, because most of the call still travels across the Internet, Hybrid VoIP's prices are significantly less than traditional telephony.⁴⁹ As one would expect then, Pure VoIP is the least expensive since it never connects to the telephone network.⁵⁰

VoIP is a dynamic technology that will change the way people communicate. Because it is so new, special care must be given in attempting to regulate this technology. These issues are examined below.

III. VoIP Regulation in the U.S.

A. *A Brief History of U.S. Telecommunications Regulation*

VoIP's characteristics as both a "telephone" and a "data" service have presented an interesting quandary for American telecommunications regulators. As such, this has led to much litigation as well as multiple rulemaking proceedings. Yet, in order to appreciate VoIP's place in American regulation, one must first understand the history of the Federal Communications Commission ("FCC") (the American telecommunications regulator).

Congress created the FCC in the *Telecommunications Regulation Act of 1934* ("34 Act").⁵¹ The most relevant portion of the '34 Act is its classification of telecommunications companies as "common carriers."⁵² Under this definition, telecommunications companies are common carriers that hold themselves out to the public for hire to provide communications transmission services.⁵³ In doing so, Congress laid the foundation for the FCC's oversight into the provision of telephone services.⁵⁴ As such, these rules were primarily concerned with AT&T, since it held a virtual monopoly on the American telephony market.⁵⁵

⁴⁸ See David Sims, *VoIP to Pay PSTN Access Charges?*, <http://www.tmcnet.com/tmcnet/articles/2005/voip-pstn-charges-fcc-level3-forbearance.htm> (last visited Mar. 20, 2008).

⁴⁹ VoIP FAQ's, <http://www.voipaction.com/faq.php#savemoney> (last visited Mar. 20, 2008).

⁵⁰ See generally Charny, *supra* note 47.

⁵¹ About the FCC, Federal Communications Commission, <http://www.fcc.gov/aboutus.html> (last visited Mar. 20, 2008).

⁵² See Jared S. Dinkes, *Rethinking the Revolution: Competitive Telephony in a Voice Over the Internet Protocol Era*, 66 OHIO ST. L. J. 833, 849 (2005), available at <http://moritzlaw.osu.edu/lawjournal/issues/volume66/number4/dinkes.doc>.

⁵³ See Communications Act of 1934, 47 U.S.C. § 151 (1934) available at <http://www.fcc.gov/Reports/1934new.pdf>.

⁵⁴ Dinkes, *supra* note 52, at 848.

⁵⁵ See generally *id.* at 847.

The Department of Justice (“DOJ”) has also had a tremendous influence on the FCC’s remit. This influence was, perhaps, most clearly evinced in the 1982 Modified Final Judgment (“MFJ”) mandating the breakup of AT&T’s monopoly.⁵⁶ In 1974, the DOJ sued AT&T in federal court for violations of the Sherman Antitrust Act.⁵⁷ After a seven-year legal battle (November ‘74 – January ‘82), AT&T agreed to the DOJ’s settlement proposals.⁵⁸ The MFJ was a part of this agreement; it forced the company to relinquish all of its local subsidiaries (known as the “Bells”) and exit the local telecommunications market entirely.⁵⁹ AT&T then became a competitive long distance carrier, as it was also forced to open its long distance networks to competition.⁶⁰ AT&T’s former subsidiaries became known as the “Regional Bell Operating Companies” (“RBOCs”), which retained control over their local exchanges and possessed monopolies in their respective regions.⁶¹ Over the next two decades, these RBOCs would become some of the most powerful companies in the world: Verizon, SBC, Qwest, and BellSouth.⁶²

With the help of the FCC, Congress addressed the RBOCs’ monopolies in the 1996 *Telecommunications Act* (“‘96 Act”). The ‘96 Act’s goal was to open up the local exchange and exchange access markets to competition.⁶³ The ‘96 Act forced each RBOC to completely open its network to competitors through a process known as “unbundling the local loop.”⁶⁴ This has proven quite difficult.⁶⁵

The ‘96 Act also had a dramatic effect on Internet-based technologies. It did this by making a distinction as to which activities would be subject to federal regulation.⁶⁶ Under the Act, “telecommunications services” would be regulated, while “information services” would not.⁶⁷ Telecommunications

⁵⁶ Legal History of Telecommunication, <http://www.technologyforall.com/TechForAll/legalHistory.html> (last visited Mar. 20, 2008).

⁵⁷ *Id.*

⁵⁸ See Bell System Memorial: AT&T Divestiture or “Breaking Up Is Hard To Do”, http://www.porticus.org/bell/att_divestiture.html (last visited Mar. 20, 2008) [hereinafter Bell System Memorial].

⁵⁹ See generally Dinkes, *supra* note 52 at 850.

⁶⁰ See Bell System Memorial, *supra* note 58.

⁶¹ *Id.*

⁶² ILLINOIS ECONOMIC AND FISCAL COMMISSION, SPECIAL REPORT ON TELECOMMUNICATIONS DEREGULATION ISSUES AND IMPACTS, at 4 (2001), available at http://12.43.67.2/commission/cgfa2006/Upload/telecom_dereg01.pdf.

⁶³ Legal History of Telecommunication, *supra* note 56.

⁶⁴ See generally Nicholas Economides, The Telecommunications Act of 1996 and Its Impact, <http://www.stern.nyu.edu/networks/telco96.html> (last visited Mar. 20, 2008).

⁶⁵ See generally James L. Gattuso, Local Telephone Competition: Unbundling the FCC’s Rules, <http://www.heritage.org/Research/Regulation/bg1621.cfm> (last visited Apr. 1, 2008).

⁶⁶ Trope, *supra* note 2, at 7.

⁶⁷ *Id.*

services were defined as “the offering of telecommunications for a fee directly to the public . . . regardless of the facilities used.”⁶⁸ Information services were defined as:

the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing or making available information via telecommunications . . . but does not include any use of any such capability for the management, control or operation of a telecommunication system or the management of a telecommunication service.⁶⁹

All telecommunications service providers are obligated to provide “common carrier obligations,” which include things like 911 emergency calling, Universal Access, and special services for the hearing and sight impaired.⁷⁰ Information service providers, on the other hand, are considered to reside “in an area in which less regulation would be imposed so as to promote the growth and development of the information superhighway.”⁷¹ These classifications have set off many disputes between state regulators, telecommunications companies, and even the U.S. Supreme Court.⁷²

On February 12, 2004, the FCC classified Pure VoIP as an information service.⁷³ In doing so, then Commissioner Michael Powell noted that “[Pure VoIP] is in no way different than e-mail and other peer-to-peer applications blossoming on the Internet. Such services have never been held to be telecommunications services.”⁷⁴ The FCC has yet to classify whether Hybrid VoIP is such a service.⁷⁵ It is important to note, however, that both Pure and Hybrid VoIP will have certain common carrier obligations regardless of how the FCC chooses to define them under the ‘96 Act.

B. Wiretapping the Bad Guys: VoIP and CALEA

The above trend started in March of 2004, when several law enforcement agencies requested that the FCC authorize the wiretapping of VoIP

⁶⁸ Communications Act of 1934, 47 U.S.C. § 153(46) (2000), available at http://supreme.lp.findlaw.com/supreme_court/briefs/04-277/04-277.mer.resp.private.app.pdf.

⁶⁹ *Id.* at § 153(20).

⁷⁰ Trope, *supra* note 2, at 7.

⁷¹ *Id.*

⁷² *Id.* at 8, 9.

⁷³ Declan McCullagh & Ben Charny, *FCC: ‘Pure’ VoIP Not a Phone Service*, CNET NEWS, Feb. 12, 2004, http://news.com.com/2100-7352_3-5158105.html.

⁷⁴ *Id.*

⁷⁵ *See generally id.*

communications.⁷⁶ These agencies also asked the FCC to require that VoIP providers make their networks accessible to interception efforts.⁷⁷ Such requests fell under the Communications Assistance for Law Enforcement Act (“CALEA”).⁷⁸ On August 5, 2005, the FCC agreed and mandated that VoIP providers allow law enforcement agencies access in its CALEA Order.⁷⁹ The providers were given until March 2007 to implement this order.⁸⁰

To do this, the FCC applied the CALEA Act’s definition of “telecommunications carrier” to all VoIP providers.⁸¹ While this may seem confusing (and not to mention opposed to Pure VoIP’s classification as an information service), the FCC explained that:

[t]he Commission found that the definition of “telecommunications carrier” in CALEA is broader than the definition of that term in the Communications Act and can encompass providers of services that are not classified as telecommunications services under the Communications Act. CALEA contains a provision that authorizes the Commission to deem an entity a telecommunications carrier if the Commission “finds that such service is a replacement for a substantial portion of the local telephone exchange.”⁸²

Whether the FCC follows this logic in the application of other federal mandates remains to be seen. It is interesting to note, however, the flexibility the Commission is willing to apply to this standard.

In response, in January 2006, various academic, business, and interest groups, including the ACLU, challenged the CALEA Order in the U.S. Court of Appeals for the D.C. Circuit.⁸³ In their opening brief, the petitioners alleged that the FCC inappropriately widened Congress’s limited scope of CALEA.⁸⁴ The petitioners also alleged that “[d]espite the shared regulatory history and nearly identical definitions of ‘information service’ in the

⁷⁶ Trope, *supra* note 2, at 11.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ Press Release, Fed. Comm’n Comm’n, FCC Requires Certain Broadband and VoIP Providers Accommodate Wiretaps (Aug. 5, 2005) *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-260434A1.doc [hereinafter FCC Requires Certain Broadband].

⁸⁰ Trope, *supra* note 2, at 13.

⁸¹ FCC Requires Certain Broadband, *supra* note 79.

⁸² *Id.*

⁸³ Others File Brief with Court Challenging FCC Wiretapping Ruling, Center for Democracy and Technology, <http://www.cdt.org/headlines/855> (last visited Mar. 20, 2008).

⁸⁴ See Brief for Petitioners at 6-9, *American Council on Educ. v. Fed. Comm’n Comm’n*, No. 01-1404, (D.C. Cir. Jan. 26, 2006).

Communications Act and in CALEA, the Commission adopted a diametrically opposed construction of ‘information service’ in the *CALEA Order*.⁸⁵ Moreover, the petitioners explained that this treatment of information services was “arbitrary and capricious.”⁸⁶ Finally, the petitioners urged the D.C. Circuit to vacate the CALEA Order in its entirety and remand the issue to the FCC for further hearings.⁸⁷

In a 2-1 decision, the D.C. Circuit affirmed the Order.⁸⁸ It agreed with the Commission that the CALEA definitions differed from the ‘96 Act.⁸⁹ This was because the CALEA Act did not treat the phrases “telecommunications carrier” and “information services” as mutually exclusive terms.⁹⁰ As such, the court found the FCC’s interpretation of the law reasonable.⁹¹

Lost in this litigation is the very real problem that VoIP providers may not actually possess the technology to implement the CALEA Order. Many industry experts concede that such compliance is “years down the road.”⁹² Moreover, the technology that would allow law enforcement officials access to a VoIP transmission would also enable computer virus attacks or other intrusions.⁹³ This is a troubling scenario, which needs the FCC’s full attention.

C. *Calling for Help in an Emergency: VoIP and E911*

Another issue involves the application of “Enhanced 911” (“E911”) services to VoIP. The FCC requires all telecommunications *and* VoIP providers to furnish this service.⁹⁴ E911 is a location technology that enables emergency services to find the geographic position of callers.⁹⁵ It works by having 911 calls routed through “public safety answering points (“PSAPs”), which display the number and location of the caller to the dispatcher.⁹⁶ CNet notes, however, that the tracing of VoIP calls is extremely difficult since:

⁸⁵ *Id.* at 14.

⁸⁶ *Id.* at 31.

⁸⁷ *Id.* at 47.

⁸⁸ *See* American Council on Educ. v. Fed. Comm’n Comm’n, 451 F.3d 226, 236 (D.C. Cir. 2006).

⁸⁹ *Id.* at 233.

⁹⁰ *Id.*

⁹¹ *Id.* at 234.

⁹² Trope, *supra* note 2, at 14.

⁹³ *Id.*

⁹⁴ Press Release, Fed. Comm’n Comm’n, Commission Requires Interconnected VoIP Providers to Provide Enhanced 911 Service, (May 19, 2005) *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-258818A1.pdf.

⁹⁵ Enhanced 911 – Wireless Services, Federal Communications Commission, <http://www.fcc.gov/911/enhanced> (last visited Mar. 20, 2008).

⁹⁶ *Id.*

the user’s phone number is associated with the router/telephone adapter provided by the VoIP service vendor. That router/adapter can be moved anywhere a broadband connection is available, which means that a phone number with a 415 area code might be anywhere from Kalamazoo to Honolulu.⁹⁷

Nevertheless, AT&T claims that it can comply with the FCC’s requirements through its “Heartbeat Process.”⁹⁸ This process apparently requires VoIP callers “to verify their location each time they initiate a connection for their service.”⁹⁹ Whether or not this is a viable solution remains to be seen.

Regardless of its feasibility, VoIP providers have fought this requirement. One such instance is when a consortium of providers (led by Nuvio) filed an emergency motion to stay E911’s mandatory implementation date in the D.C. Circuit.¹⁰⁰ Nuvio argued that in order to implement E911, they would have to provide these services at “every point in the United States” and they did not have the resources to do so.¹⁰¹ Moreover, Nuvio argued that E911’s implementation would force the company to disconnect “90% of its customers.”¹⁰² In turn, Nuvio argued that the disconnection of such large numbers of their customers would actually decrease “the risk that an individual user would have trouble getting help in a true emergency.”¹⁰³ The D.C. Circuit felt otherwise, ruling that the FCC “adequately considered not only the technical and economic feasibility of the deadline, inquiries made necessary by the bar against arbitrary and capricious decision-making, but also the public safety objectives the Commission is required to achieve.”¹⁰⁴

While the prospects may seem dim for companies like Nuvio, the FCC has seemingly provided an “escape clause” for most other entities. Namely, the Commission decided to limit the enforcement of E911 obligations for those VoIP providers that have notified at least 90% of their customers as to the limitations of VoIP in emergency calling.¹⁰⁵ This would seemingly give competitors an “out,” which would allow their continued operation.

⁹⁷ Felisa Young, *Is VoIP Dangerous?*, CNET REVIEWS, Jun. 22, 2005, http://reviews.cnet.com/4520-9238_7-6250226-1.html.

⁹⁸ Walaika K. Haskins, *AT&T Claims Solution to E911 Problem*, TOP TECH NEWS, Oct. 11, 2005, http://www.toptechnews.com/story.xhtml?story_Id=38607.

⁹⁹ *Id.*

¹⁰⁰ *See Nuvio v. Fed. Commc’n Comm’n*, 473 F.3d 302 (D.C. Cir. 2006).

¹⁰¹ *See id.* at 305.

¹⁰² Brief for Petitioner, *Nuvio v. Fed. Commc’n Comm’n*, No. 05-1248 (D.C. Cir. Nov. 1, 2005).

¹⁰³ *Id.* at 19.

¹⁰⁴ *Nuvio v. Fed. Commc’n Comm’n*, *supra* note 100, at 303.

¹⁰⁵ Carol Wilson, *FCC to Limit VoIP E911 Enforcement*, TELEPHONY ONLINE, Sept. 28, 2005, available at http://telephonyonline.com/voip/regulatory/FCC_VoIP_E911_092805.

D. Ensuring Access to All: VoIP and Universal Service Tariffs

Another interesting regulatory question is what, if any, Universal Service Fund contributions VoIP providers owe. These funds are a way to ensure that *all* Americans, even those in rural, remote, or those under economic hardship, receive access to a telephone. Universal Service was mandated in the '96 Act, and its goals are three-fold: 1) to promote the availability of quality services at just, reasonable, and affordable rates; 2) to increase access to advanced telecommunications services throughout the U.S.; and 3) to advance the availability of services to all consumers (including those in low income, rural, insular, and high cost areas) at rates that are reasonably comparable to those charged in urban areas.¹⁰⁶ In addition to federal and state funding for the program, the FCC mandates that providers charge their customers for this on their phone bills.¹⁰⁷

As one would expect, the applicability of such tariffs to VoIP has proven quite controversial. For a while, it was unclear as to whether the FCC would mandate such charges. However, the FCC clarified this situation when it ordered Hybrid VoIP providers to contribute to the Universal Service fund in June 2006.¹⁰⁸ The next step for the FCC is the implementation of such requirements, which recently has been subject to suit in the D.C. Circuit Court of Appeals.¹⁰⁹

E. The U.S. Regulatory Quandary: Complaints and Court Cases

While the U.S. is heading in the right direction by applying the above provisions to VoIP, its current regulatory scheme is needlessly complex and very confusing. For example, the FCC uses *multiple* definitions for VoIP in order to "fit" it into various regulations, yet it has no overarching classification as to whether it is an information or telecommunications service. This gray area desperately needs clarification. Having a clear regulatory scheme for VoIP would allow more efficiency among providers. They also would be able to determine what common carrier obligations apply, and plan their budgets accordingly. This would also benefit consumers because they would not be subject to any unforeseen rate increases due to

¹⁰⁶ See *Universal Service*, Fed. Comm'n Comm'n, http://www.fcc.gov/wcb/tapd/universal_service (last visited Mar. 20, 2008).

¹⁰⁷ See generally *id.*

¹⁰⁸ Anne Broache, *FCC Approves New Internet Phone Taxes*, CNET NEWS, Jun. 21, 2006, http://news.zdnet.com/2100-1035_22-6086437.html.

¹⁰⁹ See Respondents Brief, *Vonage v. Fed. Comm'n Comm'n*, No. 06-1276, (D.C. Cir. Nov. 21, 2006) available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-268700A1.pdf.

regulatory surcharges on their services. Finally, a concrete classification would eliminate the need for future litigation on this issue – thus freeing up many court dockets. As such, Congress has two remedies for this situation: 1) create a new regulatory regime, or 2) classify Hybrid VoIP according to the ‘96 Act’s definitions.

To date, state telecommunications regulators have attempted to rectify this issue. One example is *Vonage Holdings Corp. v. Minnesota Public Utilities Commission*, 290 F. Supp. 2d 993 (Minn. Oct. 16, 2003). Here, the Minnesota Public Utilities Commission (“Minnesota PUC”) attempted to apply common carrier regulations to the VoIP provider Vonage, ultimately threatening to pull the company’s license to operate in the state if it did not comply.¹¹⁰ In essence, the Minnesota PUC was attempting to classify VoIP as a telecommunications service. In response, Vonage sought an injunction against the regulator in federal District Court.¹¹¹

In reaching its decision to grant the injunction, the Court went ahead and classified VoIP as an information service, stating that it offered the “capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications.”¹¹² As such, the court concluded that until Congress speaks more clearly on this issue, states cannot regulate an information services provider such as Vonage as if they offered telecommunication services.¹¹³ U.S. District Courts in New York, Missouri, and Nebraska have applied this holding to cases involving VoIP in their districts.¹¹⁴

The Eighth Circuit Court of Appeals upheld the holding, but it did so for different reasons.¹¹⁵ The Eighth Circuit based its decision on a FCC memorandum released while *Vonage* was pending appeal.¹¹⁶ This memo concluded that VoIP could not be separated into interstate and intrastate components for regulation, and that the FCC had *exclusive* jurisdiction over the technology.¹¹⁷

¹¹⁰ See generally, *Vonage Holdings Corp. v. Minn. Pub. Utilities Comm’n*, 290 F. Supp. 2d 993, 996 (Minn. Oct. 16, 2003).

¹¹¹ *Id.* at 994.

¹¹² *Id.* at 999 (quoting 47 U.S.C. § 153(20)).

¹¹³ Clinton Howard Brannon, *COMMENTARY: Reach Out and Tax Someone: What Does the Future Hold for the Taxation and Regulation of Voice Over Internet Protocol Telephone Services?*, 57 ALA. L. REV. 173, 186 (2005).

¹¹⁴ See, e.g., *Verizon N.Y., Inc. v. Global NAPS, Inc.*, 463 F.Supp.2d 330 (E.D.N.Y. 2006); *Vonage Holdings Corp. v. N.Y. State PSC*, 2005 U.S. Dist. LEXIS 33121, at *27 (S.D.N.Y. Dec. 14, 2005); *Sw. Bell Tel., L.P. v. Mo. PSC*, 461 F.Supp.2d 1055, 1086 (E.D. Mo. 2006); and *Qwest Comm. Corp. v. Neb. PSC*, 2005 U.S. Dist. LEXIS 23620, at *11 (D. Neb. Oct. 7, 2005).

¹¹⁵ Brannon, *supra* note 113, at 186.

¹¹⁶ *Id.*

¹¹⁷ *Id.* (quoting 19 FCC Rcd 22404, 22405).

While the Eighth Circuit's holding resolved who has jurisdiction over VoIP, it has done nothing to clarify what type of services it is. As noted above, the FCC has classified Pure VoIP as an Information Service, but to date, has not classified Hybrid VoIP.¹¹⁸

In an attempt to address this gray area, commenters have called the '96 Act's definitions "outdated."¹¹⁹ Their reasoning is that "[t]echnological innovations and converging markets make it increasingly troublesome for regulators and courts to compartmentalize services using classifications that trigger different types and natures of regulation."¹²⁰ Such convergence leads to much confusion, as courts applying these classifications can reach many different and inconsistent conclusions.¹²¹ Service classifications directly affect the range of regulation, the applicability of tax obligations, and the scope of jurisdiction by federal, state, and municipal agencies.¹²² Inconsistent standards among judicial districts or circuits for a nationally based technology like VoIP is a scary proposition!

As a solution, some commenters call for Congress to institute a "layered regulatory approach."¹²³ This would call for the reclassification telecommunications services according to five factors:

1. their functional equivalence to traditional telephony;
2. the substitutability between services;
3. whether they access the traditional telephone network and use North American-styled numbering Plan;
4. whether they are peer-to-peer communications versus services broadcast across a telephone network services; and
5. the underlying transmission technology used by the service.¹²⁴

While this is a compelling suggestion, it would require the repeal of a major portion of the '96 Act. If Congress were to institute such a regime, it could also serve to undo all the clarity that the Act has brought. Every

¹¹⁸ McCullagh & Charny, *supra* note 73.

¹¹⁹ See Rob Freden, *The FCC's Name Game: How Shifting Regulatory Classifications Affect Competition*, 20 BERKELEY TECH. L.J., 1275, 1278 (2004).

¹²⁰ *Id.*

¹²¹ *Id.* at 1280.

¹²² *Id.* at 1281.

¹²³ See *id.* at 1293.

¹²⁴ *Id.* at 1312.

telecommunications and Internet service would have to be reclassified according to this complex criterion. This would undoubtedly lead to numerous court actions, as well as countless amounts of money spent on litigation.

F. Hybrid VoIP IS a Telecommunications Service

The correct solution to the above dilemma would be to classify Hybrid VoIP as a telecommunications service. This solution would avoid any complicated overhauls to the regulatory regime and provide definite clarity to VoIP providers at the same time. Hybrid VoIP is the functional equivalent of traditional telephony.¹²⁵ Most of the time it involves the same telephones used for traditional telephony, and it connects to the traditional phone network. Why then should Hybrid VoIP be classified as anything but a telecommunications service? Moreover, if VoIP were not classified as such, traditional telephony providers would ask: “If we have to expend resources to comply with regulatory requirements, why are VoIP telephony providers, who offer virtually the same services, exempt from the requirements?”¹²⁶ For the sake of fairness, the FCC should impose those same obligations on Hybrid VoIP providers.

Proponents of a new regulatory scheme may point to the fact that the ‘96 Act’s definitions are outdated.¹²⁷ Yet, the FCC has already accounted for this situation by classifying Pure VoIP as an information service.¹²⁸ In doing so, the FCC left Hybrid VoIP open to classification as a telecommunications service. As such, the relative ease with which one is able to fit these into the ‘96 Act’s categories makes it relevant today. Moreover, this classification is critical to ensure fairness to the other competitors in the market. Proponents of ‘96 Act classification argue, “if it looks like a duck, walks like a duck, quacks like a duck, it must be a duck” and it “should be regulated accordingly.”¹²⁹ I agree with this logic. Hybrid VoIP looks like traditional telephony, “quacks” like traditional telephony, and therefore, must be regulated as a telecommunications service.

The FCC is correct to apply common carrier obligations on Hybrid VoIP providers for the time being. It is the same product as traditional telephony and uses the same equipment. To be blunt, Hybrid VoIP is not distinct enough from traditional telephony to warrant the complete overhaul of the

¹²⁵ See Amy L. Leisinger, *If It Looks Like a Duck: The Need for Regulatory Parity in VoIP Telephony*, 45 WASHBURN L.J. 585, 613 (2006).

¹²⁶ *Id.* at 614.

¹²⁷ Freden, *supra* note 119.

¹²⁸ See Declan McCullagh & Ben Charny, *supra* note 73.

¹²⁹ Leisinger, *supra* note 125, at 613.

'96 Act. Such a task would be prohibitively expensive – both in man hours and subsequent litigation. The FCC has a perfectly adequate regulatory tool in its arsenal at the present.

While it may seem confusing why the Commission chose not to impose common carrier obligations on Pure VoIP, in reality it is not. Pure VoIP, by its very nature, is an information service.¹³⁰ It never connects to the phone network and therefore, does not use the same facilities as Hybrid VoIP. However, Congress needs to pay careful attention to the uptake of Pure VoIP services. If such services become predominant, Congress could very well have to impose regulatory obligations on Pure VoIP as well – either by creating a new classification for it (and associated technologies) or completely overhauling the '96 Act.

IV. VoIP Regulation in Canada

A. *A Brief History of Canadian Telecommunications Regulation*

Canada has taken a different approach to VoIP regulation. Namely, the CRTC (Canada's telecommunications regulator) installed a regime of limited regulation.¹³¹ However, like in the U.S., one needs to understand the historical context of Canadian telecommunications regulation in order to appreciate the CRTC's approach.

Canadian telecommunications regulation began in 1906 under the auspices of its railroad regulator, the Board of Railway Commissioners ("BRC").¹³² Parliament granted the BRC this power through the expansion of the *Railway Act*.¹³³ The semi-autonomous BRC's remit was to ensure "just and reasonable" telephone rates that were not "unjustly discriminatory or

¹³⁰ Ben Charney & Evan Hansen, *Court Hangs Up State VoIP Rules*, CNET NEWS, Oct. 17, 2003, http://news.com.com/2100-7352_3-5092708.html.

¹³¹ See generally Dwayne Winseck, *Canadian Telecommunications: A History and Political Economy of Media Reconvergence*, 22-2 CANADIAN J. OF COMM. (1997), available at <http://www.google.com> (search "Dwayne Winseck Canadian Telecommunications A History and Political Economy of Media"; then follow "Canadian Journal of Communication – Vol. 22, No. 2 (1997)" hyperlink) [hereinafter *Canadian History of Media Reconvergence*] (discussing how the CRTC's historical treatment of media technologies has led to the current boundaries between different media technologies; encouraging the CRTC to revisit and disband its regulation strategy in favor of policies promoting reconvergence and broadband telecommunications).

¹³² Dwayne Winseck, *A Social History of Canadian Telecommunications*, 20-2 CANADIAN J. OF COMM. (1995), available at <http://www.google.com> (search "Dwayne Winseck Social History of Canadian Telecommunications"; then follow "Canadian Journal of Communication – Vol. 22, No. 2 (1995)" hyperlink)[hereinafter *A Social History of Canadian Telecommunications*].

¹³³ *Canadian History of Media Reconvergence*, *supra* note 131.

unduly preferential.”¹³⁴ In practice, however, the BRC was reluctant to exercise this authority.¹³⁵ This allowed Canadian telecommunications carriers to form “natural” monopolies in their respective markets.¹³⁶ As such, by the end of World War II, the fundamentals of Canadian regulation were in place.¹³⁷

Like the U.S., Canada regards telecommunications providers as “common carriers.”¹³⁸ However, Canada’s concept gives more weight to social welfare.¹³⁹ For example, the BRC mandated that company charters reflect public interest notions.¹⁴⁰ Canadian regulators perceive telecommunications as a part of the social and economic infrastructure of a community.¹⁴¹ One can see this in the BRC’s emphasis on policies that prevented providers from influencing the messages flowing through their networks, and the requirement to offer non-discriminatory access to their system based on just and reasonable rates.¹⁴² As would happen, such rates were guaranteed using heavy government subsidies to telecommunications providers.¹⁴³

Under this regulatory scheme, a number of regional providers flourished. These would each become quite powerful and eventually comprise the juggernaut “Stentor Alliance” industry group.¹⁴⁴ Members included Bell Canada (the largest operator), TELUS, and Manitoba Telecom Services.¹⁴⁵ These companies are referred to as Canada’s “incumbent local exchange carriers,” due to their ownership of every local exchange in their respective markets.¹⁴⁶

¹³⁴ *A Social History of Canadian Telecommunications*, *supra* note 132.

¹³⁵ *See id.*

¹³⁶ *See id.*

¹³⁷ *Id.*

¹³⁸ *Canadian History of Media Reconvergence*, *supra* note 131.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *See Id.*

¹⁴³ *See generally* Neil Quigley and Margaret Sanderson, *Going Mobile – Slowly: How Wireline Telephone Regulation Slows Cellular Network Development*, C.D. HOWE INST. COMMENT., Dec. 1, 2005, available at http://www.cdhowe.org/pdf/commentary_222.pdf.

¹⁴⁴ *See generally* Warren Caragata, *Call-Net Takeover Shakeup*, The Canadian Encyclopedia, July 13, 1998, available at <http://www.canadianencyclopedia.ca/index.cfm?PgNm=TCE&Params=M1ARTM0011735>.

¹⁴⁵ Telecom Decision: Telephone Service to High-cost Serving Areas, Canadian Radio-television and Communications Commission, ¶ 1, Oct. 19, 1999, available at <http://www.crtc.gc.ca/archive/eng/Decisions/1999/DT99-16.htm> [hereinafter *CRTC Telecom Decision*] (The Stentor Alliance, which was comprised of SaskTel, a non-federally-regulated company, and the federally-regulated companies of BC TEL, Bell Canada, Island Telecom, MTT, MTS, NBTel, NewTel, and TELUS, disbanded in 1998.); *see also* Press Release, Industry Canada, *Industry Canada and the Stentor Companies Announce Extension of High Speed Internet Access for All First Nations Schools to 2003* (Nov. 22, 1997).

¹⁴⁶ *See CRTC Telecom Decision*, *supra* note 145, ¶¶ 1, 3.

In 1968, Parliament passed the *Broadcasting Act*, which created the Canadian Radio-television Commission.¹⁴⁷ Eight years later, Parliament modified the Commission's remit to include the regulation of telecommunications providers.¹⁴⁸ In doing so, the Canadian Radio-television Commission became known as the Canadian Radio-television and Telecommunications Commission – today's CRTC.¹⁴⁹ The CRTC continued Canada's tradition of preserving the social role of telecommunications.¹⁵⁰ In fact, the Commission has gone so far as to describe its role as “to maintain a delicate balance in the public interest between the cultural, social, and economic goals of broadcasting and telecommunications” legislation.¹⁵¹

Currently, the CRTC is governed by the *1993 Telecommunications Act* (“‘93 Act”).¹⁵² However, unlike the ‘96 Act, the ‘93 Act does not differentiate between telecommunications and information service providers.¹⁵³ The ‘93 Act also did not force open any services to competition. That process started before its passing. Instead, it mandated the CRTC's forbearance from acting once it found specific markets sufficiently competitive.¹⁵⁴

Another interesting aspect of Canadian telecommunications regulation is the “Canadian Ownership Policy.” This mandates that all publicly traded Canadian providers who own telecommunications transmission facilities have at least 80% of their shares owned by Canadians.¹⁵⁵ In addition, their board of directors must be comprised of at least 80% of Canadians – ensuring perpetual Canadian control.¹⁵⁶

As mentioned above, the CRTC actually began opening up its telecommunications markets to competition a year before the ‘93 Act.¹⁵⁷ This

¹⁴⁷ See *The CRTC's Origin*, Canadian Radio-television and Telecommunications Commission, <http://www.crtc.gc.ca/eng/BACKGRND/Brochures/B19903.htm> (last visited Mar. 20, 2008).

¹⁴⁸ See *id.*

¹⁴⁹ *Id.*

¹⁵⁰ See generally *id.*

¹⁵¹ *The CRTC*, Canadian Radio-television and Telecommunications Commission, <http://www.crtc.gc.ca/eng/BACKGRND/Brochures/B29903.htm> (last visited Mar. 20, 2008).

¹⁵² *Id.*

¹⁵³ See Telecommunications Act of 1993 S.C., ch. 38, § 2(1) (1993) (Can.), available at <http://www.canlii.ca/ca/sta/t-3.4>.

¹⁵⁴ *Telecommunications Services in Canada: An Industry Overview, Section 6: The Evolution of Competition in the Canadian Telecommunications Service Market*, Industry Canada, Jun. 8, 2005, <http://strategis.ic.gc.ca/epic/internet/insmt-gst.nsf/en/sf06286e.html>.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ See generally Francoise Bertrand, Chairperson, Canadian Radio-television Telecomm. Comm'n, Address to the Canadian Turnaround Management Association: The Future of the CRTC: More Referee than Regulator (April 1, 1997), available at <http://www.crtc.gc.ca/ENG/NEWS/SPEECHES/1997/S970401.HTM> (describing how toll

process started in Canada’s long distance markets.¹⁵⁸ What was so interesting about this decision, however, was that the CRTC decided to almost completely deregulate these services – literally, the opposite of what the FCC did in its ‘96 Act.¹⁵⁹ As such, this allowed incumbent local exchange providers to charge their competitors whatever they wanted for access to their networks (with the resulting huge rate increases for consumers).¹⁶⁰ As a response, the CRTC asserted that it would only “re-balance” local rates after carefully considering the need from a broader telecommunications industry standpoint.¹⁶¹ This decision would have disastrous consequences for the quality of Canada’s telecommunications services.¹⁶² In fact, while telecommunications companies were required to adhere to stringent service standards under Canada’s old regulatory system, service quality has actually deteriorated under the new regime.¹⁶³ The CRTC has yet to effectively address this issue.

In 1997, the CRTC opened up local telephone services to competition.¹⁶⁴ Perhaps taking a lesson from the past, however, the CRTC decided not to deregulate the incumbent local exchange carriers’ rates.¹⁶⁵ As such, it remains to be seen whether these attempts are truly viable.

B. *Less is More: Canada’s Limited Regulation of VoIP*

The CRTC has taken a similar approach regarding VoIP. On May 12,

usage has grown by 10% since the introduction of long-distance competition in the telecom industry).

¹⁵⁸ *See id.*

¹⁵⁹ *See generally* Willie Grieve & Stanford Levin, *Telecom Competition in Canada and the U.S.: The Tortoise and the Hare*, Twenty-Fifth Annual Telecommunications Policy Research Conference, Sept. 27-29, 1997 (describing the distinctions between Canada and U.S. policies and how Canada’s policies, which do not discriminate against facilities-based competition, will see more competition, more bundling, and more convergence).

¹⁶⁰ *See generally* *CRTC Hearings into Phone Rates Begin*, CBC NEWS, Oct 5, 2001, available at http://www.cbc.ca/news/story/2001/10/01/phonehearings_011001.html (describing huge rate increases that customers suffered, including how customers paid up to \$137 more for phones service in 2000 than they did in 1995, as a result of the way the CRTC opened up local markets for competition in 1998).

¹⁶¹ Grieve & Levin, *supra* note 159.

¹⁶² *See generally* Marsha Niemeijer, *Canadian Telecommunications Industry Rocked by Deregulation, Competition, Mergers, Technology*, LAB. NOTES, Aug. 2004, at 6, available at http://www.cpcs.umb.edu/labor_notes/files/30506.pdf.

¹⁶³ *See id.*

¹⁶⁴ *See* Press Release, Françoise Bertrand, Chairperson, Canadian Radio-television Telecomm. Comm’n, Green Light to Local Telephone Competition (May 1, 1997), available at <http://www.crtc.gc.ca/eng/NEWS/RELEASES/1997/r970501.htm>.

¹⁶⁵ Press Release, Canadian Radio-Television and Telecomm. Comm’n, CRTC Decides on Limited Regulation for VoIP Telephone Services to Foster Competition (May 12, 2005), available at <http://www.crtc.gc.ca/eng/NEWS/RELEASES/2005/r050512.htm>

2005, the CRTC determined that it would adopt a policy of limited regulation for VoIP.¹⁶⁶ At the same time, it imposed price floors on incumbent local exchange carriers' VoIP services.¹⁶⁷ In addition, the CRTC classified VoIP as a "local service" since it connects to local exchanges.¹⁶⁸

So far, the reaction to this decision has been mixed. Naturally, competitive providers have been eager to embrace the ruling. Shaw Communications hailed this as an opportunity to enter the VoIP market.¹⁶⁹ It noted that it would be "virtually impossible for smaller firms to enter the sector if the CRTC had not imposed price regulations on the incumbents. They clearly would be pricing in a Machiavellian way to make it economically unviable for us to get into that business."¹⁷⁰

As expected, incumbent local exchange operators have objected to the ruling. Bell Canada called the ruling "a[n] historic mistake for Canada and for our consumers."¹⁷¹ It also accused the CRTC of "retarding investment and choice," and that it "doesn't understand where technology is heading."¹⁷²

C. Applying Wiretaps, E911, and Universal Service to Canadian VoIP

Like CALEA in the United States, Canada also has wiretapping provisions. As such, the CRTC is currently investigating its applicability to VoIP.¹⁷³ If it were to implement such a requirement, it would do so in conjunction with the Canadian Department of Justice.¹⁷⁴ One would do well to pay attention for any potential developments on this critical issue.

The CRTC has also made E911 mandatory for certain VoIP providers. To that end, E911 is now mandatory for "Fixed VoIP" providers, which only allow users of their service to place a telephone call from the location where their service is being provided.¹⁷⁵ This is contrasted with Nomadic/Foreign

¹⁶⁶ See *id.*

¹⁶⁷ Edward Iacobucci, Michael Trebilcock & Ralph A. Winter, *The Canadian Experience with Deregulation*, 56 U. TORONTO L.J. 1, 11 (2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=704841; then follow "Social Science Research Network" hyperlink).

¹⁶⁸ *Id.* at 12.

¹⁶⁹ See *Stinging Reaction to VoIP Decision*, OTTAWA BUS. J., May 13, 2005, <http://www.ottawabusinessjournal.com/283290464307521.php>.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ Stefan Dubowski, *VoIP Wiretap Laws in the Spotlight*, IT WORLD CAN., Aug. 6, 2004, <http://www.itworldcanada.com/Pages/Docbase/ViewArticle.aspx?Id=idgml-dacfe041-da65-4c73-9e0d-829e6cd0e5d2>.

¹⁷⁴ See *id.*

¹⁷⁵ *CRTC Issues 911 Ruling for VoIP Providers*, Digital Home, Apr. 4, 2005, available at <http://www.google.com> (search "Digital Home CRTC Issues 911 Ruling for VoIP Providers");

Exchange VoIP, which allows users in one exchange to receive telephone calls dialed as local calls in another exchange that they have selected.¹⁷⁶ Regardless of this classification, the CRTC required “all VoIP providers to provide customers with notification, both before service commencement and during service provision, regarding any limitations associated with their 9-1-1 services.”¹⁷⁷

Like the U.S., universal access to telephone services has played a big part in Canadian telecommunications regulation. To that end, the CRTC requires VoIP providers to fund the service.¹⁷⁸ However, Canada regards VoIP as local telephone service,¹⁷⁹ thereby avoiding the legal frictions of the ‘96 Act’s information and telecommunications service classifications. This classification is clearer and will lead to less litigation on this issue.

D. Bottoming out at the Price Floors? Complaints on Canadian Regulation

The CRTC has mandated an interesting regime for VoIP regulation. The fact that Canada has no ‘96 Act-like definitions to apply has allowed it much more regulatory leeway. This allowed the CRTC to easily regulate VoIP as a whole, rather than breaking it out into Pure and Hybrid classifications (or contend with various Acts’ definitions). This also allows the CRTC to have greater flexibility for future regulations if Pure VoIP becomes the dominant form of communication in the future. Yet, while the CRTC certainly has a more efficient regulatory scheme for VoIP than the FCC, it has not stopped critics from attacking the Commission’s policies.

Many critics have claimed that the CRTC has micromanaged VoIP.¹⁸⁰ In making this argument, they take issue with the imposition of price floors for incumbent local exchange carriers, noting, “the tighter price-floor constraints run against the general trend of relaxing regulation.”¹⁸¹ They reinforce this by claiming that the costs of entering the VoIP market are surprisingly *low*.¹⁸² These critics go onto allege that “... dozens of companies could offer VoIP services at very little up-front cost,” and that CRTC’s theory of an incumbent

then follow “Digital Home – CRTC Issues 911 Ruling for VoIP Providers” hyperlink).

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ See CRTC Establishes Rules for VoIP Services, Blake, Cassels and Graydon LLP, May 2005, *available at* http://www.blakes.com/english/legal_updates/communications/may_2005/BlakesVoIPBulletin05.pdf.

¹⁷⁹ Iacobucci, Trebilcock & Winter, *supra* note 167, at 12.

¹⁸⁰ See *id.* at 24.

¹⁸¹ *Id.*

¹⁸² See *id.* at 26.

carrier's anti-competitive price cuts are "implausible."¹⁸³ Other critics note that the CRTC's price floors are the product of unsound economics.¹⁸⁴ They also note that "[b]y constraining the ILECs to a certain VoIP offering price level, there is nothing preventing the MSOs (the other major VoIP players in terms of human and capital resources) from setting a price just below that level."¹⁸⁵

Other critics accuse the CRTC of relying on "an old and static theory that measures the number of competitors and their market shares to estimate the level of competition in an industry."¹⁸⁶ They argue, "what drives competition is freedom of entry into the industry, not regulation."¹⁸⁷ In fact, these critics go so far as to accuse the Commission of doing a "180-degree" turn from its former strategy of giving deference to the incumbents.¹⁸⁸ For them, the CRTC "grants privileges to the competitors of its former protégés."¹⁸⁹

E. A Necessary Extension: How the CRTC Must Eventually Apply its Regulations to All VoIP Providers

Each of the above criticisms is part of a larger movement against the CRTC's current method of regulating incumbents. However, these critics fail to take into account the difficulty that Canada has had with incumbent anti-competitive behavior. Canadian consumers paid a very high price due the CRTC's mismanagement of the opening up of the long distance market.¹⁹⁰

These critics also fail to recognize the leerness that CRTC has toward potential incumbent anti-competitive behavior. What is to keep incumbents from engaging in the very same anti-competitive practices with VoIP? As Shaw Communications notes, "[w]e have a regulatory framework in place that promotes real choice and benefits for consumer. Competition is beginning to take hold and this [is] a direct result of the CRTC's framework."¹⁹¹ One could say that the fact that the incumbents are outraged

¹⁸³ *Id.*

¹⁸⁴ Technology Futurist, http://gruia.blogware.com/blog/_archives/2005/5/12/857964.html (May 12, 2005, 21:31 EDT).

¹⁸⁵ *Id.*

¹⁸⁶ *Why the CRTC Should Keep Its Hands Off VoIP*, Sept. 26, 2004, SIPthat, <http://sipthat.com/archives/000157.html>.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ See generally, Vincent Mosco, *Telecommunications in Canada: Technology, Industry, Policy and Labor*, National Telecommunications Conference of the Communication, Energy and Paperworkers Union, Montreal, January 26-27, 2006, (discussing the future of the telecommunications industry in Canada; specifically addressing new technology, market share of incumbent carriers, and labor unions).

¹⁹¹ *Shaw Supports CRTC on VoIP Decision*, WiTeC Alberta,

might show that these regulations are working.

However, for the CRTC to truly foster effective VoIP competition, it *must* ensure that these competitors do not benefit at the expense of incumbents. Therefore, I propose that the CRTC extend its price floor regulations to *all* VoIP providers. This need not take place immediately, as competition is still in its nascent stages, but this *must* be done eventually. If the CRTC were to not do so, the competitive providers could actually participate in the same anti-competitive behavior as the incumbents could.

In doing so, the CRTC must keep close tabs on the state of the VoIP market. Once it reaches a “competitive” level, it should then apply its incumbent provisions to all providers. How the CRTC would go about doing this would be up to the Commission. One possible way would be for it to investigate this situation once per year at most. Factors to examine could include: 1) the revenue for VoIP providers, 2) the amount of subscribers, 3) the number of competitors in each market, and 4) the expected growth in customers. This scenario could lead to an interesting situation where there is effective competition in one market, while in another there is not. The CRTC must be mindful of such a scenario should it occur and plan accordingly.

V. The U.S. and Canada: Heading in the Right Direction

Overall, both the FCC and CRTC have taken the necessary steps in order to ensure competition in their respective VoIP markets. However, both must be aware of potential pitfalls in their own unique circumstances. If these can be avoided, then VoIP will be a viable, competitive technology for many years to come.

The FCC *must* go ahead and classify Hybrid VoIP as a telecommunications service. This is the only way to ensure harmony with previous regulations (i.e. the ‘96 Act). If the FCC were to do otherwise – or worse not classify Hybrid VoIP at all – there would be a noticeable ambiguity in U.S. telecommunications regulation. Such a situation could result in a large number of anti-competitive actions by RBOC’s determined to squeeze out their smaller competitors. Classifying VoIP in this manner could serve to avoid such a scenario, as incumbents would know that their actions are being monitored *and* would act accordingly.

The CRTC, on the other hand, must make sure that their regulation of incumbent local exchange carriers does not go too far. In that, they *must* pay attention to the VoIP market to ensure that their regulations are not overly burdensome. Competition is a level playing field. Once this is achieved, there is no longer any need to have restrictions that apply to only certain providers.

Therefore, these price floors need to be applied universally in order to ensure a truly competitive market.

In the end, the U.S. and Canada seem to be going in opposite directions to achieve the same goal. On one hand, there is the U.S., which wants to ensure that VoIP providers are subject to certain essential common carrier obligations (at great cost to competitors). On the other, there is Canada, which wants to ensure the viability of competition (at great cost to incumbents). Finding a harmony between the two should be the ultimate goal of both regulators. For in this harmony, there is a dynamic and viable VoIP market just waiting to be mined.

2007 -2008 NIAGARA INTERNATIONAL MOOT COURT COMPETITION

WASHINGTON, D.C.

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Queen's University Faculty of Law

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2007-08

NIAGARA INTERNATIONAL MOOT COURT COMPETITION

A Dispute Arising Under

The Statute of the International Court of Justice

March 2008

THE GOVERNMENT OF
THE UNITED STATES OF AMERICA

(Applicant)

v.

THE GOVERNMENT OF
CANADA

(Respondent)

MEMORIAL OF THE APPLICANT

American University Washington College of Law

QUESTIONS PRESENTED

- I. Whether the fuel export charge is inconsistent with Canada's obligations under NAFTA Chapters 3 and 6 and GATT Articles I, VIII, and XI, when the charge is not applied to domestic consumption of fuel or fuel delivered to other contracting parties, and is imposed in order to raise revenue for a project unrelated to fuel transportation?
- II. Whether Canada can justify the fuel export charge under the general exceptions or national security exception of NAFTA Chapter 21 or GATT Articles XX or XXI, when there is a reasonable alternative measure available to Canada that is consistent with Canada's obligations under NAFTA and GATT?
- III. Whether the Animal and Plant Health Inspection Service user fees are consistent with the United States' obligations under NAFTA Article 310 and GATT Articles I and VIII, when the user fees are uniformly applied to all contracting parties, are limited to the approximate cost of services rendered, and are further justified by the general exceptions or national security exceptions of NAFTA and GATT because they are necessary to protect animal and plant life from foreign pests and diseases, as well as to protect the national security interests of the United States from bioterrorism?
- IV. Whether the Western Hemisphere Travel Initiative is consistent with the United States' obligations under GATS and Chapters 12 and 16 of NAFTA, where the passport requirement is uniformly applied to citizens of all countries, including American citizens, and where it is further justified by the national security exception under NAFTA and GATS?

JURISDICTIONAL STATEMENT

The United States and Canada, the Parties to the dispute, appear before this Court pursuant to Articles 40(1) and 36(1) of the Statute of the International Court of Justice.¹ The Parties have met all the requirements of Articles 40(1) and 36(1), and by Special Agreement have agreed to submit their dispute to the International Court of Justice. The Parties have stipulated to the Court’s jurisdiction and the admissibility of this case. Mexico was notified of the decision by Canada and the United States to bring this case before the International Court of Justice, lifting it out of the North American Free Trade Agreement context, and had no objection to its loss of right to appear.

STATEMENT OF THE CASE

1. The Western Hemisphere Travel Initiative

The Western Hemisphere Travel Initiative (“WHTI”), which was announced by the United States’ Department of Homeland Security on November 24, 2006, requires all travelers entering the United States to carry a valid passport or other appropriate secure documentation when entering the United States.² The WHTI applies to all travelers, regardless of nationality, including Canadian and American citizens.³ Prior to the implementation of the WHTI, Canada had been exempted from these requirements and Canadian and American citizens could cross the U.S. – Canada border with only a valid photo identification (driver’s license) and a birth certificate.⁴ The WHTI also applies to Mexico and Bermuda which had also previously been exempted from this requirement.⁵

2. Animal and Plant Health Inspection Services User Fees

On August 25, 2006, the United States Animal and Plant Health Inspection Services (“APHIS”) announced the introduction of agricultural quarantine and inspection user fees on all commercial shipments and passengers entering the United States from Canada.⁶ Canada was previously

¹ Statute of the International Court of Justice, arts. 40, 36, June 26, 1945, 59 Stat. 1055.

² The Western Hemisphere Travel Initiative, 71 Fed. Reg. 68412, 68412 (Nov. 24, 2006).

³ *Id.* at 68412-13.

⁴ *Id.* at 68413.

⁵ *Id.* at 68423.

⁶ Agricultural Inspection and AQI User Fees Along the U.S./Canada Border, 71 Fed. Reg. 50320, 50320 (Aug. 25, 2006).

exempted from the user fees.⁷ The exemption was lifted due to the need to expand border inspection efforts to combat the rising number of prohibited items crossing the border into the United States.⁸ Most of these prohibited materials originate from outside of Canada and present a high risk of carrying plant pests and animal diseases into the United States.⁹ The exemption was lifted in order to recover the cost of the United States' current inspection activities at the border and to expand inspections in order to keep pace with the increase in traffic coming across the border.¹⁰

APHIS sets the price of the user fees by calculating the annual cost of the agricultural inspection program for each mode of transportation and then dividing that amount by the estimated number of air passengers for the given mode of transportation to determine the individual user fee for each mode of transportation.¹¹ APHIS user fees are only spent on agricultural quarantine and inspections activities.¹²

The cost of the user fee for each mode of transportation is listed in the table below.

APHIS User Fees

Air Passengers	\$USD 5.00
Aircrafts	\$USD 70.50
Commercial Vessels	\$USD 490.00
Rail Cars	\$USD 7.75
Trucks	\$USD 10.75 or \$USD 205.00 annually

3. "Smart and Secure Borders"

On August 21, 2007, U.S. President Bush, Canada's Prime Minister Harper, and Mexico's President Calderon, issued a Joint Statement asking their Ministers to focus on five priority areas for the next year, including a "Smart and Secure Borders" initiative.¹³ The leaders of the three countries recognized their long cooperative history of border management and committed themselves to facilitating the safe and secure movement of trade

⁷ *Id.* at 50321.

⁸ *Id.* at 50320.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 50323.

¹² *Id.* at 50324.

¹³ Montebello North American Leaders' Summit, Joint Statement of Aug. 21, 2007.

and travelers across their borders.¹⁴

On September 11, 2007, Canada and the United States issued a Joint Statement that Canada would spend \$1 billion on a variety of border initiatives, including building screening facilities and erecting ground sensor towers along the U.S. – Canada border.¹⁵

4. The Fuel Export Charge

On September 11, 2007, Prime Minister Harper’s Office announced the implementation of a fuel export charge for all fuel transported by way of pipeline of \$CDN 25/barrel.¹⁶ The Fuel Export Charge legislation requires all exporters of fuel by pipeline to register for export tax purposes, to file monthly returns, and remit the export tax on a monthly basis according to the barrels of fuel put into the pipeline for export to a location outside of Canada. It also requires all fuel exporters to apply for export permits for each transaction involving an export of fuel by way of pipeline and to provide prescribed information.¹⁷

Canadian Prime Minister Harper stated that Canada is imposing the fuel export charge because “the security of North America depends upon Canada playing its part” and Canada is “willingly taking the steps requested by its closest trading partner, the United States.”¹⁸ Prime Minister Harper added that his government recognized its obligation to ensure a secure North America as well its obligation to its citizens to lower taxes instead of raising them. To that end, Harper stated that Canada is imposing the export charge on fuel transported by pipeline “to raise the money to pay for the infrastructure projects and technology purchases that it has agreed to make.”¹⁹

5. Procedural Posture

On September 23, 2007, the United States filed a dispute with the International Court of Justice (ICJ) regarding the fuel export charge.²⁰ On October 23, 2007, Canada responded by filing a dispute with the ICJ

¹⁴ *Id.*

¹⁵ Press Release, Office of Prime Minister Harper, Joint Statement of the United States and Canada (Sep. 11, 2007).

¹⁶ Press Release, Office of Prime Minister Harper, Statement of the Prime Minister (Sep. 11, 2007).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Press Release Concerning *The Government of the United States of America v. The Government of Canada*, I.C.J. (Sep. 23, 2007).

regarding the WHTI and the APHIS user fees.²¹ Both governments agreed to refer their disputes to the ICJ rather than the Dispute Settlement Body of the World Trade Organization (WTO), a Chapter 20 North American Free Trade Agreement (NAFTA) panel or any other body. Both governments also agreed that the ICJ would have jurisdiction to consider the issues set out below.²²

Regarding the fuel export charge, the United States takes the position that it is contrary to NAFTA Articles 309, 314, 315, 604, and 605 and General Agreement on Tariffs and Trade (GATT) Articles I, VIII, and XI and not justified under with the general or national security exceptions of NAFTA or GATT. Canada takes the position that the fuel export charge is consistent with its obligations under NAFTA and GATT or that it is justified under the general or national security exceptions of each agreement.²³

Additionally, Canada takes the position that the APHIS user fees are contrary to NAFTA Article 310 and GATT Article I and VIII, and that the user fees are not justified under either the general or national security exceptions of NAFTA and GATT.²⁴ The United States argues that the APHIS user fees are consistent with its obligations under NAFTA and GATT or in the alternative, that the user fees are justified under either the general or national security exceptions of NAFTA and GATT.²⁵

SUMMARY OF THE ARGUMENT

The fuel export charge is not consistent with Canada's obligations under GATT Articles I and XI and NAFTA Chapters 3 and 6 because it is not imposed on domestic consumption, or on fuel exports not transported by way of pipeline, and fails to grant the United States most favored nation status. In addition, the charge violates GATT Article VIII, because Canada is imposing the charge for a fiscal purpose and raising revenue for a project unrelated to the transportation of fuel. Further, the fuel export charge cannot be justified by either the general or national security exceptions under NAFTA or GATT because it is not "necessary" to the essential security interests of Canada.

Additionally, the APHIS user fees are consistent with the United States' most favored nation obligations under GATT Articles I because the user fees are applied consistently to all contracting parties. Furthermore, the APHIS user fees are consistent with the United States' obligations under GATT Article VIII because the user fees are limited to the approximate cost of

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

inspection services rendered and do not serve a fiscal purpose. Moreover, even if the user fees are not consistent with the United States' obligations under NAFTA Article 310 or GATT Articles I and VIII, the user fees are nonetheless justified under the general exceptions or the national security exception of NAFTA and GATT because the user fees are necessary to protect animal and plant life from foreign pests and diseases, as well as to protect the national security interests of the United States from bioterrorism.

Furthermore, the WHTI is consistent with the United States' obligations under GATS and NAFTA Chapters 12 because the passport requirement is uniformly applied to all travelers entering the United States, including American citizens. Additionally, the WHTI is consistent with the United States' obligations under NAFTA Chapter 16 because it does not place any further restrictions on business travelers. Further, even if the WHTI is not consistent with the United States' obligations under NAFTA or GATS, it is justified under the national security exception of NAFTA and GATS because it is necessary to prevent terrorists from fraudulently entering the United States.

ARGUMENT

I. CANADA'S FUEL EXPORT CHARGE VIOLATES EIGHT PROVISIONS OF NAFTA AND GATT BECAUSE IT DOES NOT IMPOSE THE CHARGE ON DOMESTIC CONSUMPTION OR LIKE PRODUCTS DESTINED FOR OTHER COUNTRIES AND IT CONSTITUTES A TAXATION OF EXPORTS FOR FISCAL PURPOSES.

This Court should find that the fuel export charge is inconsistent with Canada's obligations under NAFTA and GATT. NAFTA Chapters 3 and 6 and GATT Article XI obligate each contracting party to impose any charge on exports to domestic consumption of the same product. GATT Article I requires that any advantage, favour, privilege or immunity granted to one contracting party in connection with importation or exportation must be extended to all other contracting parties. Additionally, GATT Article VIII prohibits taxation of exports for a fiscal purpose. Canada did not impose the charge on domestic consumption of fuel. It also did not impose the charge on fuel delivered by means other than pipeline. Therefore, Canada is granting a privilege to other contracting parties that it is not granting to the United States because other parties that do not accept fuel delivered by pipeline do not have to pay the charge. Additionally, the charge is a taxation for a fiscal purpose because Canada imposed it in order to raise revenue to fund a project unrelated to transporting fuel.

- A. The fuel export charge is contrary to NAFTA Chapters 3 and 6 and GATT Article XI because the fuel charge is not imposed on domestic consumption of fuel.

Canada's fuel export charge is contrary to NAFTA Article 309(1) and GATT Article XI. GATT Article XI, which is incorporated into NAFTA under Article 309(1), states that, "[n]o prohibitions or restrictions other than duties, taxes or other charges...shall be instituted or maintained by any contracting party on the...exportation or sale for export of any product destined for the territory of any other contracting party."²⁶ Where the primary effect of a measure is the regulation of export transactions, the measure is considered a restriction if it imposes a materially greater commercial burden on exports than it does on domestic sales.²⁷ In other words, a restriction alters the competitive relationship between foreign and domestic buyers.²⁸ The primary effect of the export charge is to regulate the price of fuel transported by pipeline and in doing so, the charge alters the competitive relationship between domestic Canadian buyers and potential United States purchasers. \$CDN 25 per barrel is a materially greater commercial burden on export sales than on domestic sales.

Furthermore, the fuel export charge is contrary to NAFTA Chapters 3 and 6 because the charge is not imposed on domestic fuel consumption. Article 314 provides that a party cannot adopt or maintain a charge on exports to another country unless the charge is also adopted or maintained on "exports of any such good to the territory of all other Parties and any such good when destined for domestic consumption."²⁹ Article 315 states that, a Party may adopt or maintain a restriction only if, among other things,

- (a) the restriction does not reduce the proportion of the total export shipments of the specific good...relative to the total supply of that good of the Party maintaining the restriction as compared to the proportion prevailing in the most recent 36-month period for which data are available prior to the imposition of the measure...and (b) the Party does not impose a higher price for exports of a good to that other Party than the price charged for such good when consumed

²⁶ North American Free Trade Agreement, U.S.-Can.-Mex., art. 309(1), Dec. 17, 1992, 32 I.L.M. 289 [hereinafter NAFTA]; General Agreement on Tariffs and Trade, art. XI, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT].

²⁷ *In the matter of: Canada's Landing Requirement for Pacific Coast Salmon and Herring*, ¶ 6.09, United States-Canada Free Trade Agreement Binational Panel Review, Panel No. CDA-89-1807-01 (Oct. 16, 1989).

²⁸ *Id.*

²⁹ NAFTA, *supra* note 25, art. 314.

domestically....³⁰

Articles 604 and 605 are identical to 314 and 315 respectively, but apply specifically to energy or basic petrochemical goods.³¹ The charge violates all four articles because the charge is not imposed on domestic consumption and thus establishes a higher price on the export of fuel than on its domestic consumption.

- B. The fuel export charge violates GATT Article I because it fails to grant most favored nation status to the United States by not imposing the charge on oil exported to all other contracting parties.

The fuel export charge is not consistent with Canada's most favored nation obligations under GATT Article I, which states that,

any advantage, favour, privilege or immunity granted by any contracting party to any product...destined for any other country shall be accorded immediately and unconditionally to the like product...destined for the territories of all other contracting parties.³²

What is considered a "like product" is determined on a case-by-case basis.³³ However, the Panel Report on *Border Tax Adjustments* has suggested criteria for determining whether a product is "similar": "the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; and the product's properties, nature and quality."³⁴ Applying these criteria to the instant case, any fuel exported from Canada is considered a "like product" regardless of whether the fuel is transported by pipeline or other means.

Canada is only imposing a charge on fuel delivered by pipeline. Fuel delivered by other means, such as truck, ship, or plane, is not charged a higher price. The United States is the only country that receives fuel from Canada by means of pipeline and thus the only country that pays the charge. The charge violates Canada's most favored nation obligations under GATT Article I by affording a privilege to countries that accept fuel exports by any

³⁰ *Id.* at art. 315.

³¹ *Id.* at Chapter 6.

³² GATT, *supra* note 25, art. I.

³³ See Report of the Working Party, *Border Tax Adjustments*, ¶ 18, L/3464, (Dec. 2, 1970) GATT B.I.S.D. 18S/97 (1970) [hereinafter *Border Tax*]; see also Report of the Appellate Body, *Japan – Taxes on Alcoholic Beverages*, p. 20, WT/DS8/AB/R (Oct. 4, 1996) [hereinafter *Japan*].

³⁴ See *Border Tax* ¶ 18; see also *Japan* p. 20.

means other than pipeline.

- C. The fuel export charge violates GATT Article VIII because it is a taxation of an export for a fiscal purpose.

Additionally, the fuel export tax is contrary to GATT Article VIII, which states that all fees and charges on exports “shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of...exports for fiscal purposes.”³⁵ To be consistent with Article VIII, the fuel charge would have to be equal to the approximate cost of the border services rendered to the given purchaser of fuel.³⁶ Canada has failed to demonstrate that the charge is limited to the costs of any supposed services rendered to United States fuel purchasers.

Additionally, the charge is imposed for “fiscal purposes” because the total revenues exceed the total attributable costs. Here, attributable costs can only be considered costs incurred in the process of transporting the fuel by pipeline. The revenue collected from the fuel charge will far exceed Canada’s attributable costs because Canada does not attempt to attribute the charge to the costs of exporting the fuel. By its own admission, it is imposing the fuel export charge for fiscal purposes. Canadian Prime Minister Harper announced that Canada intended the charge “to raise the money to pay for the infrastructure projects and technology purchases that it has agreed to make.”³⁷

Canada’s fuel export charge violates eight NAFTA and GATT provisions. Furthermore, the charge cannot be justified under any of the NAFTA or GATT exceptions.

II. THE FUEL EXPORT CHARGE IS NOT JUSTIFIED BY EITHER THE GENERAL OR NATIONAL SECURITY EXCEPTIONS UNDER NAFTA OR GATT BECAUSE IT IS NOT “NECESSARY” TO CANADA’S ESSENTIAL SECURITY INTERESTS.

Canada’s fuel export charge is not justified under the general exceptions of NAFTA Article 2101 or GATT Article XX. NAFTA Article 2101 incorporates Article XX of GATT, which allows the adoption of measures

³⁵ GATT, *supra* note 25, art. VIII.

³⁶ See Report by the Panel, *United States Customs User Fees*, ¶ 86, L/6264-35S/245, (Feb. 2, 1988).

³⁷ Press Release, Office of Prime Minister Harper, Statement of the Prime Minister, (Sep. 11, 2007).

necessary to secure compliance with laws or regulations, including those relating to safety, but only when they are not applied in a manner “that would constitute a means of arbitrary or unjustifiable discrimination...or a disguised restriction on trade.”³⁸ Article XX however, lists exceptions that a party may adopt, so long as they do not constitute “a means of arbitrary or unjustifiable discrimination.”³⁹ These include measures:

(b) necessary to protect human, animal, or plant life...(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement...(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.⁴⁰

Under XX(b) and (d), a measure is necessary only when there is no other alternative measure which it could reasonably be expected to employ and which is not inconsistent with any other GATT provision.⁴¹ In other words, if a party could reasonably secure enforcement in a manner that is consistent with other GATT provisions, it is required to do so.⁴² If a measure consistent with GATT is not reasonably available, the party is bound to pursue the measure that is least inconsistent with other GATT provisions.⁴³

Canada may claim that the charge is necessary to comply with the border initiatives, which are in place to protect human life through the reinforcement of security measures. The fuel export charge however, is not necessary to the border initiatives because Canada can raise the money for the security efforts through means that do not restrict trade. For example, Canada could raise the money by taxing its citizens, a reasonable revenue-raising method commonly used in countries all over the world. Canada acknowledged this possibility, but dismissed it simply because it would rather lower taxes than raise them. Furthermore, Canada cannot sustain an argument under XX(g) because the charge is not made in conjunction with restrictions on domestic production or consumption and Canada has made no argument that the fuel charge is made in an effort to conserve a natural resource.

Similarly, Canada’s fuel export charge cannot be justified under the

³⁸ NAFTA, *supra* note 25, art. 2101.

³⁹ GATT, *supra* note 25, art. XX.

⁴⁰ *Id.*

⁴¹ See Report of the Panel, *United States – Section 337 of the Tariff Act of 1930*, ¶ 5.26, L/3469, (Nov. 7, 1989) GATT B.I.S.D. 36S/345 (1989) [hereinafter *Section 337*]; see also Panel Report, *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes* ¶ 74, DS10/R – 37S/200, (Nov. 7, 1990) [hereinafter *Thailand – Cigarettes*].

⁴² See *Section 337* ¶ 5.26; see also *Thailand – Cigarettes* ¶ 74.

⁴³ See *Section 337* ¶ 5.26.

national security exceptions of NAFTA Articles 607 and 2102 or GATT Article XXI. Article 607 provides that no party shall maintain a measure restricting exports except to the extent necessary to “respond to a situation of armed conflict involving the Party taking the measure.”⁴⁴ NAFTA Article 2102 and GATT Article XXI are identical in their language and provide that nothing in either agreement shall be construed “to prevent any Party from taking any actions that it considers necessary for the protection of its essential security interests.”⁴⁵ The essential security interests include those “(c) taken in time of war or other emergency in international relations.”⁴⁶ The Panel in *Thailand Cigarettes* adopted the same definition of “necessary” for the national security exceptions as that applied for the general exceptions.⁴⁷

Though Canada may claim that the fuel export charge is necessary to raise money for the security of its borders through the border security initiatives, the charge does not meet the Panel’s accepted definition of “necessary.” The charge is not necessary because there are less restrictive reasonable alternative measures available to Canada that are not inconsistent with GATT. Specifically, Canada can raise the money for the Smart and Secure Borders initiatives by taxing its citizens.⁴⁸ Thus, with a reasonable and less inconsistent alternative available, Canada cannot justify the fuel export charge under either the general exceptions or national security exceptions of NAFTA or GATT.

III. THE APHIS USER FEES ARE CONSISTENT WITH THE UNITED STATES’ OBLIGATIONS UNDER GATT ARTICLES I AND VIII BECAUSE THEY ARE APPLIED UNIFORMLY TO ALL CONTRACTING PARTIES AND ARE LIMITED TO THE APPROXIMATE COST OF SERVICES RENDERED.

This Court should find that the APHIS user fees are consistent with the United States’ obligations under GATT Articles I and VII because they are applied uniformly to all contracting parties and are limited to the approximate cost of services rendered. The APHIS user fees are applied to all people and imports coming into the United States regardless of country of origin and therefore satisfy the United States’ most favored nation obligations under GATT Article I. Furthermore, the user fees are limited to the average cost of an inspection for each mode of transportation and the user

⁴⁴ NAFTA, *supra* note 25, art. 607.

⁴⁵ NAFTA, *supra* note 25, art. 2102; GATT, *supra* note 25, art. XXI.

⁴⁶ NAFTA, *supra* note 25, art. 2102; GATT, *supra* note 25, art. XXI.

⁴⁷ See *Thailand – Cigarettes* ¶ 74.

⁴⁸ *Id.*

fees, as a matter of United States law, can only be spent on the inspection program for each separate mode of transportation. Thus, the APHIS user fees are consistent with GATT Article VIII because they are limited to the approximate cost of services rendered and do not serve a fiscal purpose.

Further, even if the APHIS user fees violate GATT Articles I or VIII or NAFTA Article 310, the user fees are justified pursuant to the general exceptions or the national security exceptions of GATT and NAFTA. The APHIS user fees are necessary to protect plant and animal life from pests and diseases and are therefore justified under GATT Article XX(b), which is incorporated into NAFTA under Article 2101. Additionally, the APHIS user fees are necessary to protect the essential security interests of the United States from bioterrorism while the United States is engaged in the war against terror and therefore are justified under GATT Article XXI, which is incorporated into NAFTA under Article 2102.

- A. The APHIS user fees are consistent with the United States' most favored nation obligations under GATT Article I because the user fees are uniformly applied to all imports and people entering the United States.

The APHIS user fees are consistent with the United States' most favored nation obligations under GATT Article I because they are uniformly applied to all people and imports coming into the United States, regardless of country of origin. Previously Canada had been granted an exemption from the APHIS user fees. However, this exemption amounted to a "privilege or immunity" not "accorded . . . to . . . all other contracting parties"⁴⁹ and therefore was inconsistent with GATT Article I.⁵⁰ The United States' most favored nation obligations require that Canada be treated in the same manner as all other contracting parties and therefore must be subject to the APHIS user fees.

The APHIS user fees apply uniformly to all people and imports entering the United States and no country is granted any privilege or immunity not also accorded to Canada.⁵¹ Therefore, the APHIS user fees are consistent with GATT Article I.

⁴⁹ GATT, *supra* note 25, art. I:1.

⁵⁰ See Report of the Panel, *United States – Customs User Fee*, ¶¶122-23, L/6264-35S/245 (Nov. 25, 1987) B.I.S.D. 35S/245 (1988) [hereinafter *Customs User Fee*].

⁵¹ See *Agricultural Inspection User Fees Along the U.S./Canada Border*, 71 Fed. Reg. at 50321.

- B. The APHIS user fees are consistent with the United States' obligations under GATT Article VIII because they are limited to the approximate cost of services rendered, do not represent an indirect protection of domestic products, and do not have a fiscal purpose.

The APHIS user fees are consistent with the United States obligations under GATT Article VIII because they are "limited to the approximate cost of services rendered" and do "not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes."⁵² GATT Article VIII states that:

All fees and charges of whatever character . . . imposed by contracting parties on or in connection with importation or exportation shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes.⁵³

The APHIS user fees are limited to the average cost of the agricultural quarantine and inspection activities for each separate mode of transportation, thus limiting the fees to the approximate cost of services rendered.⁵⁴ The "approximate cost" does not mean the exact or precise cost of services rendered. The cost of any single inspection is difficult to calculate and is a function of the time and thoroughness spent on a given inspection. By charging the average cost of a given type of inspection, the user fees are limited as closely as is practicable to the approximate cost of services rendered.

Furthermore, the APHIS user fees are not an *ad valorem* user fee with no set maximum such as the one that was found to be inconsistent with Article VIII by the World Trade Organization ("WTO") Panel in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*.⁵⁵ An *ad valorem* user fee is calculated based upon the appraised value of the merchandise being imported. The Panel stated that "[a]n ad valorem duty with no fixed maximum fee, by its very nature, is not 'limited in amount to the approximate cost of services rendered.'"⁵⁶

⁵² GATT, *supra* note 25, art. VIII:1(a).

⁵³ *Id.*

⁵⁴ Agricultural Inspection User Fees Along the U.S./Canada Border, 71 Fed. Reg. at 50323-24.

⁵⁵ Panel Report, *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R (Nov. 25, 1997) [hereinafter *Argentina*]; *See generally* *Customs User Fee*.

⁵⁶ *Argentina* ¶ 6.75.

However, unlike in *Argentina*, the APHIS user fees are not potentially unlimited in nature. Where the user fees in *Argentina* were calculated based upon the value of the imports, which has no relation to the actual cost of the inspection services, the APHIS user fees are limited to the average cost of the inspection services for the applicable mode of transportation. Whereas the *ad valorem* user fees in *Argentina* were not consistent with Article VIII because they were not limited to the cost of services rendered, the APHIS user fees are consistent with Article VIII because they are limited to the approximate cost of services rendered.

- C. Even if the APHIS user fees are contrary to NAFTA or GATT, the APHIS user fees are nonetheless justified under the general exceptions or the national security exception of NAFTA and GATT.

While the APHIS user fees may violate NAFTA Article 310, and even if this Court were to find that the user fees violate GATT Article I or VIII, the APHIS user fees are nonetheless justified under the general exceptions or the national security exceptions of GATT and NAFTA.

- i. The APHIS user fees are justified under the general exceptions of NAFTA Article 2101 and GATT Article XX(b) because they are consistent with the Agreement on the Application of Sanitary and Phytosanitary Measures.

As is reflected in Article 2.1 of the Agreement on the Application of Sanitary and Phytosanitary Measures (“SPS Agreement”), Article XX(b) of GATT, and Article 2101 of NAFTA, the United States has the right to take measures necessary to protect the health and life of its people, its food supply, and its agricultural industry. Article XX of GATT, which is incorporated into NAFTA under Article 2101, states that “nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures . . . necessary to protect human, animal or plant life or health.”⁵⁷ Similarly, Article 2.1 of the SPS Agreement states that, “[m]embers have the right to take sanitary and phytosanitary measures necessary for the protection of human, animal or plant life or health . . .”⁵⁸

“Sanitary or phytosanitary measures which conform” with the SPS Agreement are “presumed to be in accordance with the obligations of the

⁵⁷ GATT, *supra* note 25, art. XX.

⁵⁸ Agreement on the Application of Sanitary and Phytosanitary Measures, art. 3, Apr. 15, 1994, 1867 U.N.T.S. 493 [hereinafter SPS Agreement].

Members under the provisions of GATT 1994 . . . Article XX(b).”⁵⁹ Therefore, as long as the APHIS user fees are consistent with the SPS Agreement, they are also consistent with NAFTA Article 2101, which incorporates GATT Article XX(b).

The SPS Agreement requires that sanitary or phytosanitary measures only be applied “to the extent necessary to protect human, animal or plant life or health” and that such measures be based upon “scientific principles” and “do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail” or “constitute a disguised restriction on international trade.”⁶⁰ The APHIS user fees are consistent with these obligations because: 1) they relate to the enforcement of already existing and accepted phytosanitary standards; 2) they are applied uniformly to all imports and people entering the United States, regardless of national origin; and 3) inspections are the least trade restrictive means of enforcing the United States’ phytosanitary requirements.

First, people and imports entering the United States are already subject to inspection.⁶¹ The APHIS user fees merely allow for inspection efforts to be expanded.⁶² While prior to the imposition of the APHIS user fees, inspections of certain imports were infrequent, the user fees do not bring with them any further requirements or prohibitions regarding the importation of goods or the entry of people into the United States.⁶³

Furthermore, pre-existing phytosanitary requirements are supported by “scientific evidence” as is required by Article 2.1 of the SPS Agreement.⁶⁴ In *Japan – Agricultural Products*, the WTO Appellate Body held that there must “be a rational or objective relationship between the SPS measure and the scientific evidence” for the measure to be consistent with Article 2.2 of the SPS Agreement.⁶⁵ The United States’ phytosanitary requirements are consistent with prevailing international standards and restrict the means of importation for goods that pose a risk of carrying foot-and-mouth disease, fruit flies, and a host of other exotic pests and diseases.⁶⁶

Smuggling from Canada is a particular risk to the United States because unlike the United States, the Canadian territories all possess cool or cold

⁵⁹ SPS Agreement, *supra* note 56, art. 2.1.

⁶⁰ *Id.* at art. 2.

⁶¹ *See* Agricultural Inspection User Fees Along the U.S./Canada Border, 71 Fed. Reg. at 50323.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ SPS Agreement, *supra* note 56, art. 2.2.

⁶⁵ Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, ¶ 84, WT/DS76/AB/R (Feb. 22, 1999) (*adopted* Mar. 19, 1999).

⁶⁶ *See* Agricultural Inspection User Fees Along the U.S./Canada Border, 71 Fed. Reg. at 50321.

climates.⁶⁷ As a result, Canada imposes fewer phytosanitary requirements than the United States on the imports of plant products from countries where tropical or subtropical pests may be present.⁶⁸ For example, “[o]f the 402 species on the U.S. regulated plant pest list . . . 349, or 87 percent, we not regulated pests in Canada.”⁶⁹ Imports that would normally be refused entry or subjected to strict phytosanitary requirements before being allowed to enter into the United States can be imported into Canada without any such impediments.⁷⁰ Products that would be denied entry into the United States can bypass the United States’ stricter phytosanitary requirements by first being brought into Canada and then being re-exported into the United States.⁷¹ Border inspections are needed to prevent the smuggling of agricultural products that can harbor plant pests and diseases. The APHIS user fees are necessary to fund the border inspections and thus bear a rational relationship to preventing the smuggling of dangerous plant pests and diseases.

Second, the APHIS user fees do not constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade and therefore comply with Article 2.3 of the SPS Agreement. The APHIS user fees are applied uniformly to all imports and people entering the United States.⁷² No country is exempted from the APHIS user fees.⁷³ Further, as was previously noted, exempting Canada from the APHIS user fees would be inconsistent with both the SPS Agreement and GATT.

Lastly, border inspections fees amounting to approximately the costs of services rendered presents the least restrictive means of ensuring compliance with United States’ phytosanitary requirements. The relationship between the APHIS user fees and the prevention of the introduction of pests and diseases in the United States is an observably close one. Inspections are the least intrusive and most effective means of ensuring that prohibited materials are not smuggled into the United States via the U.S. – Canada border.

- ii. The APHIS user fees are justified under the national security exception of NAFTA Article 2102 and GATT Article XXI because they are necessary to protect the essential security interests of the United States from bioterrorism.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

The APHIS user fees are justified under the national security exception of NAFTA Article 2102 and GATT Article XXI because they are necessary to protect the United States from bioterrorism while the United States is engaged in the war against terror. NAFTA Article 2102 and GATT Article XXI, state that “[n]othing in this Agreement shall be construed . . . to prevent any . . . party from taking any action which it considers necessary for the protection of its essential security interests . . . taken in time of war or other emergency in international relations . . .”⁷⁴ Additionally, the United States has fulfilled its obligation to notify the contracting parties of its invocation of XXI(b)(iii) by announcing the introduction of the APHIS user fees in the U.S. Federal Register on August 25, 2006,⁷⁵ as is required by the “Decision Concerning Article XXI of the General Agreement.”⁷⁶

Since September 11, 2001 ushered the United States into the ongoing war against terror, awareness of America’s vulnerability to a bioterrorist attack has greatly risen.⁷⁷ The World Health Organization has recognized that “malicious contamination of food for terrorist purposes is a real and current threat” and that “[t]he key to preventing food terrorism is [the] establishment and enhancement of existing food safety management programmes and implementation of reasonable security measures.”⁷⁸

The U.S. - Canada border is the longest undefended border in the world.⁷⁹ Without the proper inspection network in place, the United States is left vulnerable to terrorists exploiting this fact and mounting a successful bioterrorist attack which could devastate U.S. agriculture and lead to widespread illness and death.⁸⁰ Maintaining a strong inspection program at the border is necessary to protect the national security interests of the United States from bioterrorism and therefore the APHIS user fees are justified under the security exception of NAFTA and GATT.

⁷⁴ GATT, *supra* note 25, art. XXI(b); NAFTA, *supra* note 25, art. 2101:1(b).

⁷⁵ Agricultural Inspection User Fees Along the U.S./Canada Border, 71 Fed. Reg. at 50320.

⁷⁶ *Decision Concerning Article XXI of the General Agreement*, L/5426 (Nov. 30, 1982) GATT B.I.S.D. (29th Supp.) at 23 (1983) [hereinafter *Decision Concerning Article XXI*].

⁷⁷ See Agricultural Inspection User Fees Along the U.S./Canada Border, 71 Fed. Reg. at 50321.

⁷⁸ WORLD HEALTH ORGANIZATION, EXECUTIVE SUMMARY ON TERRORIST THREATS TO FOOD - GUIDELINES FOR ESTABLISHING AND STRENGTHENING PREVENTION AND RESPONSE SYSTEMS 1 (2002).

⁷⁹ See Agricultural Inspection User Fees Along the U.S./Canada Border, 71 Fed. Reg. at 50322.

⁸⁰ *Id.*

IV. THE WHTI IS CONSISTENT WITH THE UNITED STATES OBLIGATIONS UNDER NAFTA AND GATS BECAUSE IT IS APPLIED UNIFORMLY TO ALL PEOPLE ENTERING THE UNITED STATES, INCLUDING AMERICAN CITIZENS, AND IT PLACES NO RESTRICTIONS ON BUSINESS TRAVELERS ENTERING THE UNITED STATES.

- A. The WHTI is consistent with the United States' most favored nation and national treatment obligations under NAFTA Chapter 12 and GATS Articles II and XVII because the passport requirement is applied uniformly to the citizens of all contracting parties and American citizens.

The WHTI applies equally to the citizens of all countries, including American citizens, thus satisfying the United States' most favored nation and national treatment obligations under NAFTA and GATS. NAFTA Article 1202 and 1203 and GATS Articles II and XVII require that each contracting party accord most favored nation treatment and national treatment to the service providers of all contracting parties.⁸¹

No country is granted preferable treatment to Canada under the WHTI and furthermore, since United States' citizens are also subject to the WHTI, Canada is afforded national treatment thus satisfying the United States' obligations under Chapter 12 of NAFTA and Articles II and XVII of GATT. The WHTI removes all previous exceptions to the passport requirement granted to various countries, including Canada, Mexico and Bermuda,⁸² and in doing so brings the United States into compliance with NAFTA Chapter 12 and GATS Articles II and XVII.

- B. The WHTI is consistent with the United States' obligations under NAFTA Chapter 16 because requiring a universally accepted secure form of identification at the border does not restrict the entry of business persons into the United States.

The WHTI is not contrary to Chapter 16 of NAFTA because it does not place any restrictions on business persons entering the United States and in fact, furthers the principles of Chapter 16 by facilitating entry through the use of passports which are a more efficient and secure form of identification.

Annex 1603 details what requirements may and may not be imposed on

⁸¹ NAFTA, *supra* note 25, art. 1202, 1203; General Agreement on Trade in Services, arts. II:1, XVII:1 Apr. 15, 1994, 1869 U.N.T.S. 183, 33 I.L.M. 1167 [hereinafter GATS].

⁸² The Western Hemisphere Travel Initiative, 71 Fed. Reg. at 68423.

business persons wishing to enter the United States.⁸³ Section A: Business Visitors states that

[e]ach Party shall grant temporary entry to a business person . . . on presentation of: 1) proof of citizenship of a Party; 2) documentation . . . describing the purpose of entry; and 3) evidence demonstrating that . . . the business person is not seeking to enter the local labor market.⁸⁴

The United States, under Chapter 16, is allowed to require proof of citizenship, and by extension identity. The WHTI merely requires that a passport, which is a secure and widely used form of identification be used at the border.

Additionally, Annex 1603 states that, “[n]o Party may: 1) as a condition for temporary entry . . . require prior approval procedures, petitions, labor certification tests or other procedures of similar effect; or 2) impose or maintain any numerical restriction . . .”⁸⁵ The WHTI does not have any of these restrictions. Furthermore, “a Party may require a business person . . . to obtain a visa . . . prior to entry.”⁸⁶ Under Annex 1603, the United States has the right to impose a visa requirement on all business persons entering the United States; however the United States has opted to impose a less burdensome requirement than is even permissible under Chapter 16.

Moreover, requiring passports speeds up the customs process at the border because passports can be scanned instead of being entered manually into the computer system and agents at the border do not have to contend with deciphering the authenticity of birth certificates and drivers licenses from numerous states and provinces.⁸⁷ Thus, the WHTI furthers the principles of Chapter 16 by better “facilitating temporary entry . . . establishing transparent criteria,⁸⁸ [and] expeditiously” applying such measures so “as to avoid unduly impairing or delaying [the] trade in goods or services”⁸⁹ and does so without imposing any restrictions on business travelers that are prohibited under Chapter 16.

C. Even if the WHTI is contrary to NAFTA or GATS, the WHTI is justified under the national security exceptions of NAFTA Article 2102 and GATS Article XIV because it is necessary to prevent terrorists from fraudulently entering the United States.

⁸³ NAFTA, *supra* note 25, annex 1603.

⁸⁴ *Id.* at annex 1603, sec. A(1).

⁸⁵ *Id.* at annex 1603, sec. A(4).

⁸⁶ *Id.* at annex 1603, sec. A(5).

⁸⁷ The Western Hemisphere Travel Initiative, 71 Fed. Reg. at 68413.

⁸⁸ NAFTA, *supra* note 25, art. 1601.

⁸⁹ *Id.* at art. 1602.

The WHTI is justified under NAFTA Article 2101 and GATS Article XIV, even if *arguendo*, it is contrary to NAFTA or GATS, because it is “necessary for the protection of [the United States’] essential security interests” and is “taken in . . . [an] emergency in international relations.”⁹⁰ Furthermore, the United States has fulfilled its obligation to notify the contracting parties of its invocation of XXI(b)(iii) by announcing the lifting of the exception in the U.S. Federal Register on November 24, 2006⁹¹, as is required by the “Decision Concerning Article XXI of the General Agreement.”⁹²

The WHTI allows for “increased security in the air environment provided by more secure documents and facilitation of inspections” and it “addresses a vulnerability of the United States to entry by terrorists or other person by false documents or fraud under current documentary exemptions . . .”⁹³ As was previously stated, the United States is currently engaged in the war against terror. Therefore, under NAFTA Article 2101 and GATS Article XIV, the APHIS user fees are justified because they are necessary to protect the security interests of the United States by preventing people from fraudulently entering the United States.

CONCLUSION

For these reasons, the Government of the United States of America respectfully requests this Court find: a) that Canada’s imposition of the Fuel Export Charge is not consistent with NAFTA Chapters 3 and 6 and GATT Articles I, VIII, and XI and is not justified under the national security exception or general exception of NAFTA Chapters 6 and 21 or GATT Articles XX and XXI; 2) that the APHIS user fees are consistent with the United States’ obligations under NAFTA Article 310 and GATT Article I and VIII or are justified pursuant to the national security exception or the general exceptions of NAFTA and GATT; and 3) that the WHTI is consistent with the United States’ obligations under NAFTA Chapters 12 and 16 and GATS or is justified pursuant to the national security exception of NAFTA and GATS.

⁹⁰ GATS, *supra* note 79, art. XIV(b).

⁹¹ The Western Hemisphere Travel Initiative, 71 Fed. Reg. at 68412.

⁹² *Decision Concerning Article XXI* at 23.

⁹³ The Western Hemisphere Travel Initiative, 71 Fed. Reg. at 68423.

2007-08

NIAGARA INTERNATIONAL MOOT COURT COMPETITION

A Dispute Arising Under

The Statute of the International Court of Justice

March 2008

THE GOVERNMENT OF
THE UNITED STATES OF AMERICA

(Applicant)

v.

THE GOVERNMENT OF
CANADA

(Respondent)

MEMORIAL OF THE RESPONDENT

The John Marshall Law School

QUESTIONS PRESENTED

1. Whether the Western Hemisphere Travel Initiative (WHTI) is contrary to the North American Free Trade Agreement (NAFTA) Chapters 12 and 16 and the General Agreement on Trade in Services (GATS) and falls outside of a national security or general exception under NAFTA, the General Agreement on Tariffs and Trade (GATT), or the GATS.
2. Whether the Animal and Plant Health Inspection Service (APHIS) user fees are contrary to NAFTA Article 310 and GATT Articles I and VIII and fall outside of a national security or general exception under NAFTA, GATT, or the GATS.
3. Whether the Fuel Export Charge violates NAFTA Articles 314, 315, 604, and 605 or GATT Articles I, VIII and XI and falls within the national security or general exceptions under NAFTA Articles 607, 2101, 2102 or GATT Articles XX and XXI.

JURISDICTIONAL STATEMENT

The parties to this matter, Canada and the United States of America, hereby submit this dispute to a Chamber of the International Court of Justice pursuant to Articles 40(1) and 36(1) of the *Statute of the International Court of Justice*.¹ Both Parties have agreed to immediately bring their actions and positions into conformity with the conclusions of this Court.

STATEMENT OF FACTS

On August 25, 2006, the United States (U.S.) Animal and Plant Health Inspection Service (APHIS) of the U.S. Department of Agriculture (USDA) announced in the U.S. Federal Register (Volume 71, No. 165) an interim rule to impose Agricultural Quarantine and Inspection (AQI) user fees on all commercial shipments entering the U.S. from Canada beginning on November 24, 2006.² Canada was exempted from the user fees.³ However, this exception was removed.⁴ Starting January 1, 2007, air passengers arriving in the U.S. from Canada began paying user fees regardless of whether they were traveling with fruits or vegetables or whether they were processed through customs and immigration at a Canadian airport.⁵ The amount of the user fee for air passengers is \$USD 5.00 per passenger and \$USD 70.50 per aircraft entering the U.S. from Canada. These fees are incorporated into the price of airline tickets.⁶

Beginning March 1, 2007, APHIS removed the inspection exemption for all commercial vessels (ships) entering the U.S. from Canada.⁷ The amount of the user fee for each maritime vessel is \$USD 490.00 per entry and is imposed irrespective of its cargo.⁸ Furthermore, as of June 1, 2007, a user fee of \$USD 7.75 is imposed on each rail car moving from Canada to the U.S. and \$USD 10.75 on each truck moving from Canada to the U.S.⁹ Canada's Department of Foreign Affairs and International Trade (DFAIT) conveyed to its counterparts at the Department of Homeland Security (DHS) and the U.S. Trade Representative its view that the APHIS user fees are customs user fees and contrary to NAFTA and GATT.

¹ Statute of the International Court of Justice, 26 June 1945, T.S. No. 933, 59 Stat.1055.

² See Animal and Plant Health Inspection Service User Fees, 71 Fed. Reg. 50320 (Aug. 25, 2006) (to be codified at 7 C.F.R. pts. 319 and 354) [hereinafter APHIS].

³ See *Id.*

⁴ See *Id.*

⁵ See *Id.*

⁶ See *Id.*

⁷ See *Id.*

⁸ See *Id.*

⁹ See *Id.*

On June 26, 2007, the U.S. Department of State (D.O.S.) and the DHS jointly published a Notice of Proposed Rulemaking to implement the second phase of the Western Hemisphere Travel Initiative (WHTI).¹⁰ The WHTI requires all travelers to carry a valid passport or other appropriate secure documentation when traveling to the U.S. from within the Western Hemisphere.¹¹ Specifically, this second phase requires U.S. citizens and non-resident aliens from the Western Hemisphere, including Canada, to possess and provide at the time of entry in the U.S. a valid passport or certain prescribed identification.¹² Canada raised issues with the U.S. government that the WHTI disproportionately affects Canada given the extent to which the free movement of persons limits the free movement of goods and service. Nevertheless, the U.S. justified the WHTI as a national security-related measure.

On August 21, 2007, Canada's Prime Minister Harper, U.S. President Bush, and Mexico's President Calderon issued a Joint Statement at the conclusion of the 2007 Montebello North American Leader's Summit.¹³ In the Joint Statement, the leaders asked their Ministers to focus their collaboration on five priority areas for the next year.¹⁴ The priority that is relevant to the dispute at hand is "Smart and Secure Borders," which call for effective border strategies that minimize security risks, while facilitating the efficient and safe movement of goods, services and people, as trade and cross-border travel increase in North America.¹⁵

After the release of the Joint Statement, a number of U.S. Presidential candidates made statements in the media that Canada must take the security of North America seriously. Additionally, these candidates made unsupported statements that the September 11, 2001 hijackers entered the U.S. from Canada. Thereafter, U.S. Secretary of Homeland Security Chertoff, U.S. Vice President Cheney, and Canada's Prime Minister of Public Safety Day immediately began discussions with the view to make an announcement on September 11, 2007 that plans were developed to meet the security-related action points in the Joint Statement.

On September 11, 2007, Canada and the U.S. issued a Joint Statement that Canada would spend one billion dollars to implement a variety of border

¹⁰ See The Western Hemisphere Travel Initiative, 72 Fed. Reg. 74169 (Dec. 31, 2007) (to be codified at 22 C.F.R. pts. 22 and 51) [hereinafter WHTI].

¹¹ See *Id.*

¹² See *Id.*

¹³ Prime Minister Harper, President Bush, and President Calderón, Joint Statement, Montebello North American Leaders' Summit (Aug. 21, 2007) [hereinafter Montebello Summit Joint Statement], <http://www.montebello2007.gc.ca/statement-declaration-eng.html>.

¹⁴ *Id.*

¹⁵ *Id.*

initiatives.¹⁶ These initiatives include building screening facilities at least one kilometer from border crossings, erecting ground sensor towers, and installing advanced radiological detection technology at all its ports.¹⁷ In addition to announcing these initiatives, Canada's Prime Minister's Office also announced an export tax of twenty-five Canadian dollars per barrel on fuel transported via pipeline.¹⁸

During the announcement of the export tax, Canada's Prime Minister Harper explained that the imposition of the fuel export tax was necessary for Canada to fully partake in ensuring the security of North America.¹⁹ Prime Minister Harper stated that Canada is imposing an export tax on fuel to raise money to pay for the infrastructure projects and technology purchases that it agreed to make.²⁰

In order to support the Fuel Export Charge legislation, the *Softwood Lumber Product Export Charge Act, 2006* was used as precedent. The Fuel Export Charge requires that all exporters of fuel by pipeline register for export tax purposes, file monthly returns, and remit the export taxes on a monthly basis according to the barrels of fuel put into the pipeline for export. All exporters of fuel by pipeline are required to apply for export permits for each transaction involving such an export of fuel and provide prescribed information. Opposed to Canada's imposition of the export tax on fuel, the U.S. took the position that the export tax was contrary to several NAFTA and GATT provisions. However, Canadian Ambassador Wilson reaffirmed that the Fuel Export Charge would remain in effect.

On September 23, 2007, the U.S. filed a dispute with this Court with respect to the Fuel Export Charge. Canada responded on October 23, 2007 by filing a dispute with this Court regarding the WHTI requirement that all American and Canadian citizens provide a passport as identification to border and immigration officials, as well as to the APHIS user fees.

SUMMARY OF ARGUMENT

The Applicant violated international law by enacting the WHTI because it accords less favorable treatment to Canadian service suppliers and adversely affects trade in services. APHIS user fees also constitute customs user fees, thereby violating both NAFTA and MFN treatment. Neither the WHTI nor the APHIS user fees are justified by general or national security exceptions. Accordingly, both the WHTI and APHIS user fees are unlawful. Further,

¹⁶ Joint Statement, Can. and U.S. (Sept. 11, 2007).

¹⁷ *Id.*

¹⁸ Stephen Harper, Can. Prime Minister (Sept. 11, 2007).

¹⁹ *Id.*

²⁰ *Id.*

Canada's Fuel Export Charge is valid because the Softwood Lumber Agreement permits parties to implement export charges and it is justified by general and national security exceptions.

ARGUMENT

I. THE WHTI IS CONTRARY TO NAFTA CHAPTERS 12 AND 16 AND THE GATS AND FALLS OUTSIDE OF A NATIONAL SECURITY OR GENERAL EXCEPTION UNDER NAFTA, GATT, OR THE GATS.

Article 26 of the *Vienna Convention on the Law of Treaties* (VCLT) requires a party to perform its treaty obligations according to the principles of *pacta sunt servanda*, which states that “[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith.”²¹ As such, a treaty interpreter must “seek to give effect to the object and purpose”²² of the treaty. As the specific nature of the treaty is so significant to its interpretation,²³ international tribunals have not hesitated to resort to the preamble of a treaty in order to determine the treaty’s principal object.²⁴

All three treaties, NAFTA, GATT, and the GATS, should be interpreted pursuant to the rules of the VCLT.²⁵ Under Articles 31 and 32 of the VCLT, a treaty’s terms must be interpreted according to their ordinary meaning, and if terms remain ambiguous, the *travaux préparatoires* may be consulted.²⁶ Specifically, NAFTA Article 102(2) provides a mandatory standard for the

²¹ Vienna Convention on the Law of Treaties, 23 May 1969, 1155 U.N.T.S. 331, art. 26 [hereinafter VCLT]; see generally *Sanchez-Llamas v. Oregon*, 126 S. Ct. 2669 (2006); see generally *Sale v. Haitian Ctrs. Council*, 509 U.S. 155 (1993).

²² *SGS Societe Generale de Surveillance SA v. Islamic Republic of Pakistan*, 18 ICSID 301, No. ARB/01/13 (2003); see also *Application of Convention of 1902 Governing Guardianship of Infants* (Neth. v. Swed.), 1958 I.C.J. 55, 67 (Nov. 28).

²³ See *Prevention and Punishment of Crime of Genocide* (Bosn. & Herz. v. Yugo.), 1996 I.C.J. 91 (July 11).

²⁴ See *S.S. Lotus* (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No.10, at 17 (Sept. 7); see also *Free Zones of Upper Savoy and District of Gex*, Judgment, 1929 P.C.I.J. (ser. A) No. 22, at 12 (June 7); see also *Asylum (Colom./Perú)*, 1950 I.C.J. 266, 276, 282 (Nov. 20); see also *Rights of U.S. Nationals in Morocco* (Fr. v. U.S.), 1950 I.C.J. 176 (Aug. 27); see also D.P. O’Connell, *International Law* 260 (2d ed. 1970).

²⁵ Manfred Nowak, *U.N. Covenant on Civil and Political Rights CPPR Commentary* 952, 953 (2d ed. 2005).

²⁶ *Lighthouse Case* (Fr. v. Greece), 1934 P.C.I.J. (ser. A/B) No. 62, at 4, 13 (Oct. 8); see also *Polish Postal Service in Danzig*, Advisory Opinion, 1925 P.C.I.J. (ser. B) No. 11, at 6, 39 (Dec. 15); see also *Membership in United Nations*, 1948 I.C.J. 56, 63 (May 28); see also *Competence of General Assembly for Admission of a State to United Nations*, 1950 I.C.J. 4, 8 (Mar. 3).

interpretation of the detailed provisions of the Agreement.²⁷ It states, “[t]he Parties shall interpret and apply the provisions of this Agreement in the light of its objectives ... and in accordance with applicable rules of international law.”²⁸ As a free trade agreement, NAFTA has “the specific objective of eliminating barriers to trade among the three contracting Parties.”²⁹ As a result, “[a]ny interpretation adopted by ... [a] Panel must, therefore, promote rather than inhibit NAFTA’s objectives.”³⁰

A. The WHTI Accords “Less Favorable” Treatment to Canadian Service Suppliers than to American Domestic Suppliers and Obstructs the “Temporary Entry for Business Persons” Between the Countries.

The WHTI is contrary to Articles 1202 (national treatment for cross-border services) and 1203 (most-favored-nation treatment (MFN) for cross-border services), as well as Chapter 16 (temporary entry for business persons) of NAFTA because it accords “less favorable” treatment to Canadian service suppliers than it does to American domestic suppliers,³¹ and because it obstructs the temporary entry of otherwise qualified business persons into the U.S. and Canada.³² As a result, the U.S. is violating its treaty obligations under NAFTA to accord equal treatment to Canadian service suppliers.

1. The WHTI accords “less favorable” treatment to Canada’s service providers than it does to American domestic service suppliers.

Article 1202 of NAFTA states in pertinent part that “[e]ach Party shall accord to service providers of another Party treatment no less favorable than it accords, in like circumstances, to its own service providers.”³³ Similarly, Article 1203 states that “[e]ach Party shall accord to service providers of

²⁷ North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA].

²⁸ *Id.*

²⁹ Final Report, *In the Matter of Tariffs Applied by Canada to Certain United States Origin Agricultural Products*, para. 122, No. CDA 95-2008-01 (Dec. 2, 1996).

³⁰ *Id.*

³¹ NAFTA, *supra* note 27, arts. 1202(1), 1203(1).

³² *Id.*, arts. 1601, 1603.

³³ NAFTA, *supra* note 27, art. 1202.

another Party treatment no less favorable than it accords, in like circumstances, to service providers of any other Party or of a non-Party.”³⁴

The proper interpretation of NAFTA Article 1202 requires that any “differential treatment should be no greater than *necessary* for legitimate regulatory reasons such as safety, and that such different[ial] treatment be equivalent to the treatment accorded to domestic service providers”³⁵ (emphasis added). For instance, in *Cross-Border Trucking Services*, a NAFTA Panel found that the U.S. violated Article 1202 when it failed to phase out restrictions on Mexican cross-border trucking services despite affording Canada national treatment in the industry.³⁶ Reasoning that the object of Article 1202 is to “provide no less favorable treatment to service providers,” the Panel held that, absent other justification, the U.S.’s refusal to process applications of Mexican trucking firms constituted a “*de jure* violation of the national treatment obligation in Article 1202.”³⁷

Similar to the “less favorable” treatment in *Cross-Border Trucking Services*, the WHTI accords “less favorable” treatment to Canada’s service suppliers than it does to American suppliers.³⁸ The WHTI’s passport requirement has, and will, continue to result in many Americans changing their travel plans to avoid the hassle of obtaining a passport.³⁹ This in turn, will have a devastating effect on Canada’s economy, depriving its tourism industry of billions of dollars in expected revenue. To illustrate, a recent Canadian Tourism Commission (CTC) report estimates that the WHTI’s passport requirement will result in 14.1 million fewer trips by U.S. citizens into Canada and a \$3.6 billion⁴⁰ loss in revenue. As such, it is clear that the WHTI accords significantly less favorable treatment to Canadian service suppliers than to American suppliers. Thus, the U.S. is in violation of NAFTA Articles 1202 and 1203.

2. The WHTI obstructs the “temporary entry for business persons,” and in doing so, does not promote NAFTA’s “object and purpose.”

³⁴ *Id.*, art. 1203.

³⁵ Final Report, *In the Matter of Cross-Border Trucking Services*, No. USA-Mex-98-2008-01, at para. 258 (Feb. 6, 2001) [hereinafter *Cross-Border Trucking Services*].

³⁶ *Id.* at para. 287.

³⁷ *Id.* at para. 257.

³⁸ *Id.* at para. 257.

³⁹ Jessica Shook, *Executive Branch: New Identification Requirements for Travelers by Air*, 21 *Geo. Immigr. L.J.* 325, 327 (2007).

⁴⁰ Canadian Tourism Commission, *The Potential Impact of a Western Hemisphere Travel Initiative Passport Requirement on Canada’s Tourism Industry*, Research Report (2005) [hereinafter CTC Report].

The first of NAFTA's listed objectives is to "eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties."⁴¹ To accomplish this goal, the people of North America require the ability to move between borders.⁴² For this reason, Article 1603 of NAFTA states that "[e]ach Party shall grant temporary entry to business persons who are otherwise qualified for entry under applicable measures relating to public health and safety and national security."⁴³ By requiring all travelers to provide a valid passport at the time of entry into the U.S.,⁴⁴ the WHTI is hindering, not furthering, this objective.

Recently, the U.S. has "focused on security-based initiatives, in which trade liberalization and trade facilitation are secondary goals."⁴⁵ Not surprisingly, many of the "specific features of these initiatives have the potential to impede trade."⁴⁶ For example, the WHTI, while perhaps marginally improving security, has drastically reduced the amount of eligible truck driver's crossing the US-Canada border.⁴⁷ In doing so, the WHTI is not hampering just any service, but rather, an essential service⁴⁸ critical to establishing the North American market NAFTA seeks to create. As a result, the WHTI is in conflict with NAFTA's expressed object and purpose and should be repealed.

B. The WHTI Violates the GATS Because it Adversely "Affects Trade in Services" and Violates the Agreement's MFN Provision.

According to the World Trade Organization's (WTO) Appellate Body in *Canada – Certain Measures Affecting the Automotive Industry*, determining if a measure is one affecting trade in services requires examining two key issues.⁴⁹ First, it must be determined whether there is "trade in services" as defined by Article I:2 of the GATS. Second, it needs to be determined whether the measure "affects" such trade in services within the meaning of Article I:1.⁵⁰

⁴¹ NAFTA, *supra* note 27, art. 102(1)(a).

⁴² Dunniela Kaufman, *Does Security Trump Trade*, 13 Law & Bus. Rev. Am. 619, 628 (2007).

⁴³ NAFTA, *supra* note 27, art. 1603(1).

⁴⁴ *See* WHTI, *supra* note 10.

⁴⁵ Kaufman, *supra* note 42.

⁴⁶ *Id.*

⁴⁷ CTC Report, *supra* note 40.

⁴⁸ Jeffrey Atik, *National Treatment in the NAFTA Trucking Case*, 42 S. Tex. L. Rev. 1249 (2001).

⁴⁹ Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry*, para. 155, WT/DS139/AB/R, WT/DS142/AB/R (June 19, 2000) [hereinafter *Canada – Autos*].

⁵⁰ *Id.*

1. Canada's tourism industry constitutes trade in services.

Article I:2 of the GATS defines the concept of trade in services as the supply of a service within one of four enumerated modes of supply.⁵¹ Paragraph (b) of Article I:2 – or mode 2 – describes the mode of supply known as consumption abroad.⁵² This consumption abroad mode of supply deals with the situation where the consumer of a service travels to the territory of another member in order to consume the service.⁵³ The most common example of services provided under mode 2 is tourism services.⁵⁴ Canada's tourism industry, which relies heavily on an influx of Americans to consume the country's many services, undoubtedly is an example of trade in services as enumerated in Article I:2 of the GATS.

2. The WHTI clearly affects Canada's trade in services.

The WTO's Appellate Body in *European Communities – Regime for Importation, Sale and Distribution of Bananas*, concluded that the term “affecting” in Article I:1 of the GATS required a broad interpretation.⁵⁵ The Appellate Body stated:

[T]he term “affecting” reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word “affecting” implies a measure that has “an effect on”, which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term “affecting” in the context of Article III of the GATT is wider in scope than such terms as “regulating” or “governing”.⁵⁶

With such a broad interpretation, the WHTI is clearly affecting Canada's trade in services.⁵⁷ Currently, the initial cost of U.S. passports for a family of four is \$388,⁵⁸ while Canadian costs are comparable.⁵⁹ The staggeringly low

⁵¹ See General Agreement on Trade in Services, Apr. 15, 1994, 33 I.L.M. 1125, 1869 U.N.T.S. 183, art. I:2 [hereinafter GATS].

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Appellate Body Report, *European Communities – Regime for Importation, Sale and Distribution of Bananas*, para. 220, WT/DS27/AB/R (Sept. 25, 1997) [hereinafter *EC - Bananas III*].

⁵⁶ *Id.*

⁵⁷ See *id.*

⁵⁸ U.S. Department of State, *Passport Fees*, http://travel.state.gov/passport/get/fees/fees_837.html (last visited Feb. 12, 2008).

⁵⁹ See, e.g., Passport Canada, <http://www.pptc.gc.ca/cdn/section6.aspx?lang=eng> (last

percentage of Americans who possess valid passports,⁶⁰ coupled with the high costs associated with procuring one, undoubtedly affects Canada's tourism industry. As such, the WHTI constitutes a measure affecting trade in services under the GATS and should be remedied accordingly.

3. The WHTI violates the GATS' MFN treatment.

In addition to covering measures affecting trade in services, the GATS requires both MFN and national treatment for services and service suppliers.⁶¹ Specifically, Article II of the GATS states that "each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than it accords to like services and service suppliers of any other country."⁶² To determine whether services or service suppliers of one member have been treated less favorably than services or service suppliers of another nation, a court must decide whether the "measure adopted has altered, or has the potential to alter, the conditions of competition"⁶³ between the countries.

The WHTI constitutes treatment less favorable to Canada's tourism industry and suppliers than is given to American service suppliers. The U.S. fails to recognize that the majority of people do not possess passports as demonstrated by a CTC study finding "that 41% of Canadian residents over the age of 18 have a passport, while only 34% of United States residents over the age of 18 have a passport."⁶⁴ As a result, the WHTI significantly alters the conditions of competition between the countries by according significantly less favorable treatment to Canadian service suppliers than to those located in the U.S.⁶⁵

C. The WHTI is Not Justified Under a National Security or General Exception Found in NAFTA, GATT, or the GATS.

NAFTA, GATT, and the GATS each provide for the availability of trade-restrictive measures imposed for national security reasons.⁶⁶ Under each agreement, states may adopt or enforce measures necessary to protect human,

visited Feb. 10, 2008).

⁶⁰ See CTC Report, *supra* note 40.

⁶¹ GATS, *supra* note 51, art. II.

⁶² *Id.*

⁶³ *EC – Bananas III*, *supra* note 55, para. 234.

⁶⁴ CTC Report, *supra* note 40.

⁶⁵ See *EC – Bananas III*, *supra* note 55.

⁶⁶ See General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194, art. XX(b) [hereinafter GATT]; see also NAFTA, *supra* note 27, art. 2101(a); see also GATS, *supra* note 51, art. XIV bis.

animal, or plant life or health.⁶⁷ Nevertheless, there are still limitations as to when a party may deviate from the terms of the treaties.

For example, under NAFTA Article 2101, which incorporates GATT Article XX by reference, the safety measures adopted by a party may be justified only to the extent that they are “necessary to secure compliance” with laws or regulations that are otherwise consistent with the Agreement.⁶⁸ In addition, the adopted measures must not be “applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination ... or a disguised restriction on trade.”⁶⁹ Here, GATT/WTO jurisprudence helps to determine what “necessary to secure compliance” and “unjustifiable discrimination” mean.

1. The WHTI is not necessary to secure compliance with another consistent law or regulation.

The “necessary to secure compliance” language in GATT Article XX, which was expressly incorporated into NAFTA, has been interpreted strictly in several GATT/WTO decisions.⁷⁰ For instance, in *Canada – Certain Measures Concerning Periodicals*, Canada argued that its import ban on certain periodicals for economic reasons was justified under GATT as a measure necessary to secure compliance with other GATT-consistent regulations.⁷¹ However, the WTO Panel rejected Canada’s interpretation and determined that the measure was not one that sought compliance with another law, and thus, was not justified under the GATT exception.⁷²

Much like the government-adopted measure in *Periodicals*, the WHTI is also not necessary to secure compliance with other laws or regulations consistent with the Agreements. By contrast, the WHTI simply acts as an unnecessary barrier to trade, creating confusion, long delays, and disrupting the flow of international business. Therefore, the WHTI does not satisfy the

⁶⁷ GATT, *supra*, art. XX(b); see also GATS, *supra* note 51, art. XIV; see also NAFTA, *supra* note 27, art. 2101

⁶⁸ NAFTA, *supra* note 27, art. 2101(2)(a).

⁶⁹ *Id.*; see also Appellate Body Report, *United States – Section 337 of the Tariff Act of 1930*, BISD/34S (Nov. 7, 1989) [hereinafter *Tariff Act of 1930*].

⁷⁰ See *Tariff Act of 1930*, *supra* note 69; see also Appellate Body Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/R (Mar. 14, 1957) [hereinafter *Periodicals*]; see also Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/R (May 20, 1996) [hereinafter *Reformulated Gasoline*]; see also Appellate Body Report, *United States – Import Prohibition on Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (Oct. 12, 1998) [hereinafter *Shrimp*].

⁷¹ *Periodicals*, *supra* note 70, paras. 5.8-5.11.

⁷² *Id.*

first prong of invoking a national security exception under NAFTA, GATT, or the GATS.

2. The WHTI constitutes unjustifiable discrimination and a disguised restriction on international trade.

In general, security exceptions represent “a classic exception to liberal trade policies and rules.”⁷³ The problem these exceptions present in international agreements is that it is “virtually impossible to determine their limits.”⁷⁴ For this reason, the principle that exceptions in a treaty are to be construed narrowly is well accepted in the interpretation of GATT.⁷⁵ If this Court concludes otherwise, parties would be “free to circumvent virtually any provision ... on that basis, contrary to the principle of effectiveness.”⁷⁶

Currently, the U.S. argues that the WHTI is justified as a national security measure. However, the WHTI’s possible security benefits are substantially outweighed by the economic burden it creates. GATT Article XX specifically requires that a party adopt measures “reasonably available to it that ... [are] the least inconsistent”⁷⁷ with the Agreement. The U.S. has failed to demonstrate that they have considered more acceptable, less trade restrictive alternatives than those of the WHTI in order to reach their safety goals. Accordingly, the national security and general exceptions must be construed narrowly in order to avoid undermining the fundamental objectives of the relevant Agreements.

II. THE APHIS USER FEES ARE CONTRARY TO NAFTA ARTICLE 310 AND GATT ARTICLES I AND VIII AND FALL OUTSIDE OF A NATIONAL SECURITY OR GENERAL EXCEPTION UNDER NAFTA, GATT, OR THE GATS.

A. The APHIS User Fees are Contrary to NAFTA Article 310.

⁷³ See J.H. Jackson, W.J. Davey & A.O. Sykes, Jr., *Legal Problems of International Economic Relations* 983 (3d ed. 1995); see also World Trade Organization, *Analytical Index: Guide to GATT Law and Practice* 600-610 (6th ed. 1995).

⁷⁴ Jackson, *supra* note 73, at 983.

⁷⁵ See Appellate Body Report, *United States – Prohibition of Imports of Tuna and Tuna Products from Canada*, L/5198-29S/91 (Feb. 22, 1982); see also *Reformulated Gasoline*, *supra* note 70; see also *Shrimp*, *supra* note 70; see also Appellate Body Report, *Thailand Restrictions on Importation of and Internal Taxes on Cigarettes*, DS10/R-37S/200 (Nov. 7, 1990).

⁷⁶ *Cross-Border Trucking Services*, *supra* note 35, para. 108.

⁷⁷ *Reformulated Gasoline*, *supra* note 70, paras. 24-28.

A domestic law can “signal a country’s nonconformance with an international treaty obligation.”⁷⁸ In the present case, the APHIS user fees are contrary to NAFTA Article 310, because they constitute a customs user fee for originating goods, which is strictly prohibited under NAFTA.⁷⁹ Specifically, Article 310 of NAFTA, discussing “Customs User Fees,” states that “[n]o Party may adopt any customs user fee ... for originating goods.”⁸⁰ In addition, NAFTA Annex 310.1 mandates that as of January 1, 1994, the United States is required to eliminate its merchandise-processing fee on originating goods that qualify to be marked as goods of Canada.⁸¹

Yet, by imposing inspection fees on all planes, trains, and sea vessels entering the U. S., regardless of the cargo, the APHIS user fees are effectively acting as merchandise processing or customs user fees on all originating commercial shipments entering the U.S. from Canada.⁸² These commercial shipments will often contain considerable quantities of originating goods.⁸³ Thus, pursuant to NAFTA Article 310(1) and its corresponding Annex, commercial shipments entering the U.S. from Canada by way of plane, train, or sea vessel should not be subject to any type of user fee.⁸⁴

B. The APHIS User Fees are Contrary to GATT Articles I and VIII.

In addition to violating NAFTA Article 310, the APHIS user fees are contrary to GATT Article I (general MFN treatment) and Article VIII (fees and formalities connected with importation and exportation).

1. The APHIS user fees are contrary to GATT’s MFN provision.

GATT Article I states that “[w]ith respect to customs duties and charges of any kind imposed on or in connection with importation ... any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”⁸⁵ The primary purpose of this provision is to “prohibit discrimination among like products

⁷⁸ Ian Brownlie, *Principles of Public International Law* 39 (6th ed. 2003); *see also Avena and Other Mexican Nationals* (Mex. v. U.S.), 2004 I.C.J. 12 (Mar. 31).

⁷⁹ NAFTA, *supra* note 27, art. 310(1).

⁸⁰ *Id.*

⁸¹ NAFTA, *supra* note 27, Annex 310.1.

⁸² *See* APHIS, *supra* note 2.

⁸³ NAFTA, *supra* note 27, art. 401(a).

⁸⁴ *Id.*, art. 310(1), Annex 310.1.

⁸⁵ GATT, *supra* note 66, art. I:1.

originating in or destined for different countries.”⁸⁶ The Appellate Body in *EC- Bananas III* confirmed that “to establish a violation of Article I, there must be an advantage, of the type covered by Article I and which is not accorded unconditionally to all ‘like products’ of all WTO Members.”⁸⁷

By imposing user fees on all commercial shipments coming from Canada, the U.S. is granting an advantage to products from some members that it has not “accorded immediately and unconditionally to like products originating in or destined for the territories of all other Members.”⁸⁸ Although each individual fee appears nominal, in the aggregate, the APHIS user fees constitute *de facto* discrimination against Canada’s like products and will have a devastating affect on trade. The “essence of the non-discrimination obligations is that like products should be treated equally, irrespective of their origin.”⁸⁹ However, the APHIS user fees do not accord such equal treatment, and therefore, are in violation of GATT’s MFN provision.

2. The APHIS user fees are contrary to GATT Article VIII because they do not represent the approximate cost of the service rendered.

Article VIII of GATT mandates that, “[a]ll fees and charges of whatever character ... imposed by contracting parties on or in connection with importation or exportation shall be limited in amount to the approximate cost of services rendered.”⁹⁰ This provision serves as a dual requirement “because the charge in question must first involve a ‘service rendered,’ and then the level of the charge must not exceed the approximate cost of that ‘service.’”⁹¹ It is important to note that Article VIII’s provisions extend to all fees and charges imposed by governmental authorities relating to “inspection, quarantine, and sanitation.”⁹² Hence, the APHIS user fees fall within the requirements of this Article.

To illustrate, in *Argentina – Textiles and Apparel*, the panel addressed an Argentine *ad velorem* tax on imports of three percent designed to cover the cost of providing a reliable database for trade operators.⁹³ However, the panel concluded that an *ad velorem* tax with no fixed minimum fee, by its very

⁸⁶ *Canada – Autos*, *supra* note 49, para. 84.

⁸⁷ *EC – Bananas III*, *supra* note 55, para. 161.

⁸⁸ *See* GATT, *supra* note 66, art. I:1.

⁸⁹ *EC – Bananas III*, *supra* note 55, para. 172.

⁹⁰ GATT, *supra* note 66, art. VIII.

⁹¹ Panel Report, *Argentina – Textiles and Apparel*, para. 2.4, WT/DS56/R (Nov. 25, 1997) [hereinafter *Argentina Textiles*] (citing Panel Report, *United States – Customs User Fee*, para. 69, BISD 35S/245 (Feb. 2, 1988)).

⁹² GATT, *supra* note 66, art. VIII(4)(g)-(h).

⁹³ *Argentina – Textiles*, *supra* note 91, para. 2.4.

nature, is not “limited in amount to the approximate cost of the service rendered.”⁹⁴ The panel stated that “high price items necessarily will bear a much greater tax burden than low-price goods, yet the service accorded to both is essentially the same.”⁹⁵

Similarly, in the present case, the APHIS user fees do not represent the approximate cost of the service rendered.⁹⁶ In particular, the APHIS user fees require passengers arriving in the U.S. from Canada to pay the inspection fees “regardless of (i) whether they [are] traveling with fruits or vegetables, or (ii) whether they [are] processed through customs and immigration at a Canadian airport.”⁹⁷ As a result, the U.S. is imposing user fees for a service that, in many cases, has already been rendered, as the U.S. may require passengers to be processed in both countries. In sum, the U.S. has failed to submit any evidence that the user fees represent any such approximate cost of any service.

C. The APHIS User Fees Fall Outside of a National Security or General Exception to NAFTA, GATT, or the GATS.

The term “national security” has been interpreted by international tribunals to be “a concern about the safety or protection of the country or nation as a whole from international threat.”⁹⁸ However, with regards to international agreements, it is “virtually impossible to determine [the] limits”⁹⁹ of national security provisions. Accordingly, international tribunals often invoke the old legal principle, expressed in Latin as *exceptio est strictissimae applicationis*, which has been used to signify that exceptions “to treaty obligations are to be construed restrictively.”¹⁰⁰

In the present case, the exceptions sought by the U.S. should also be construed restrictively. Much like the reasoning set forth with regards to the WHTI, the APHIS user fees do not fall under a national security or general exception to the Agreements because they are not necessary to secure

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ See *Argentina – Textiles*, *supra* note 91; see also Appellate Body Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R (Dec. 11, 2000).

⁹⁷ See APHIS, *supra* note 2.

⁹⁸ *Lotus Development Canada Limited, Novell Canada, Ltd., and Netscape Communications Canada Inc.* (14 Aug. 1998), PR-98-005, PR-98-006 and PR-98-009, at 10 (CITT); see also *M.D. Charlton Co. Ltd. v. Dept. of Pub. Works and Govt. Serv.* (10 May 2001), PR-2000-075 (CITT).

⁹⁹ Jackson, *supra* note 73, at 983.

¹⁰⁰ See *Cross Border Trucking Services*, *supra* note 35; see also *Certain German Interests in Upper Silesia*, 1923 P.C.I.J. (ser. A) No. 7, at 56 (Aug. 25); see also *Free City of Danzig*, 1935 P.C.I.J. (ser. A/B) No. 65, at 71 (Dec. 4).

compliance with other NAFTA or GATT consistent laws or regulations. Here, no such laws or regulations exist. Rather, the APHIS user fees are unnecessarily being applied to Canadian passengers and commercial shipments that often require no additional inspection. As such, the APHIS user fees stand in direct conflict with the second prong of invoking exceptions in that they “constitute a means of arbitrary [and] unjustifiable discrimination between the countries.”¹⁰¹ Accordingly, we request this Court to construe the exceptions to NAFTA, GATT, and the GATS restrictively, and find that the APHIS user fees do not fall within one of the enumerated exceptions.

III. THE FUEL EXPORT CHARGE NEITHER VIOLATES NAFTA NOR GATT, AND IN THE ALTERNATIVE, IS JUSTIFIED BY THE GENERAL AND NATIONAL SECURITY EXCEPTIONS IN THE AGREEMENTS.

The provisions of NAFTA Articles 314, 315, 604, and 605 together prevent the adoption or maintenance of an export tax “unless such duty, tax, or charge is adopted or maintained”¹⁰² on all the parties to the treaty¹⁰³ and on “any such good when destined for domestic consumption.”¹⁰⁴ However, parties may adopt restrictions “justified under Articles XI:2(a) or XX(g), (i), or (j) of the GATT¹⁰⁵” only if “the restriction does not reduce the proportion of the total export shipments of the specific good made available to that other Party relative to the total supply of that good of the Party maintaining the restriction;”¹⁰⁶ the Party does not impose a higher tax for exports than goods destined for domestic consumption;¹⁰⁷ and there is no disruption in the supply to the restricted colony.¹⁰⁸

Similarly, the Fuel Export Charge implicates GATT Articles I, VIII, and XI. Article I of GATT, the MFN treatment provision, states that “any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting Parties.”¹⁰⁹ Article VIII states, “all fees and charges of whatever character (other than import and

¹⁰¹ NAFTA, *supra* note 27, art. 2101(2).

¹⁰² NAFTA, *supra* note 27, art. 314, 604.

¹⁰³ NAFTA, *supra* note 27, art. 314(a), 604(a).

¹⁰⁴ NAFTA, *supra* note 27, art. 314(b) and 604(b).

¹⁰⁵ NAFTA, *supra* note 27, art. 315(1)/605(1).

¹⁰⁶ NAFTA, *supra* note 27, art. 315(1)(a)/605(1)(a).

¹⁰⁷ NAFTA, *supra* note 27, art. 315(1)(b)/605(1)(b).

¹⁰⁸ NAFTA, *supra* note 42, art. 315(1)(c)/605(1)(c).

¹⁰⁹ GATT, *supra* note 66, art. I:1.

export duties...) shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or taxation of imports or exports for fiscal purposes.”¹¹⁰ Finally, Article XI provides that “[n]o prohibitions or restrictions other than duties, taxes or other charges...shall be instituted or maintained by” any contracting party on the exportation or sale of goods.¹¹¹

A. The Softwood Lumber Agreement Constitutes a Revision of NAFTA and GATT Sufficient to Separate the Relevant Treaty Provisions.

Article 44 of the VCLT permits the separability of a specific treaty provision in response to a fundamental change in circumstances.¹¹² However, to separate a provision from a treaty, a party must show: 1) the provision is in fact “separable from the remainder of the treaty;”¹¹³ 2) acceptance of the provision “was not an essential basis of the consent” of a party to be bound by the whole treaty;¹¹⁴ and 3) “continued performance of the remainder of the treaty would not be unjust.”¹¹⁵

1. The Softwood Lumber Agreement.

The Softwood Lumber cases between the U.S. and Canada concerned a nearly twenty-five-year dispute over the harvesting and distribution of lumber.¹¹⁶ The U.S. argued that Canadian stumpage programs constituted unfair subsidies, violating NAFTA and WTO provisions, while Canada maintained that stumpage programs included no subsidies, and were thus valid.¹¹⁷ After both parties were dissatisfied by traditional dispute settlement mechanisms, the U.S. and Canada concluded The Softwood Lumber Agreement of 2006 (SLA), which “established a managed trade regime based on export quotas and export taxes.”¹¹⁸

¹¹⁰ GATT, *supra* note 66, art. VIII:1(a).

¹¹¹ See GATT, *supra* note 66, art. XI(1).

¹¹² Matthew T. Simpson, *Note and Comment: Chopping Away At Chapter 11: The Softwood Lumber Agreement’s Effect on the NAFTA Investor-State Dispute Resolution Mechanism*, 22 Am. U. Int’l L. Rev. 479, 494 (2007).

¹¹³ VCLT, *supra* note 21, art. 44(3)(a).

¹¹⁴ VCLT, *supra* note 21, art. 44(3)(b).

¹¹⁵ VCLT, *supra* note 21, art. 44(3)(c).

¹¹⁶ See Andrea K. Bjorklund, *Private Rights and Public International Law: Why Competition Among International Economic Law Tribunals Is Not Working*, 59 Hastings L.J. 241, 274-5 (2007).

¹¹⁷ *Id.* at 275.

¹¹⁸ *Id.* at 284.

2. The SLA separated NAFTA Articles 314, 315, 604, and 605 thereby permitting export taxes.

Article 39 of the VCLT permits parties to a treaty to amend a portion of the agreement.¹¹⁹ However, questions arise when the parties have not officially ratified the amendments. Although revisions to an agreement must eventually be ratified by the participants, these revisions may still create obligations on the party.¹²⁰ For example, in the Amsterdam Conference in 1997 and the Nice Conference in 2000, European countries discussed revisions to the EU Charter that were later added as amendments to the original Constitution.¹²¹ Prior to their ratification, however, the revisions were still deemed to create obligations on the EU countries.¹²²

The SLA necessitated the separation of NAFTA and GATT provisions, because these agreements specifically prohibit export taxes, a central element of the Agreement. Thus, the SLA necessitated the exercise of Article 44 of the VCLT by the U.S. and Canada. Although neither country has officially ratified the removal of these NAFTA and GATT provisions, the presence of an export tax in the SLA necessitated revisions. These revisions may be treated as creating obligations on Canada and the U.S. and prevent either country from challenging such a fuel export tax because the export tax provisions in NAFTA and GATT are effectively nonexistent.

B. The Fuel Export Charge is Justified by General and National Security Exceptions.

Assuming, *arguendo*, that the Fuel Export Charge is found to be inconsistent with NAFTA and GATT, the exceptions available in GATT Articles XX and XXI and its sister provision, NAFTA Article 2101, justify the charge.

1. The Fuel Export Charge is necessary to secure compliance with “thick border” initiatives.

GATT Article XX provides that “nothing in this agreement shall be construed to prevent the adoption...by any contracting party of measures” necessary for compliance with laws or regulations not inconsistent with GATT.¹²³ Unlike the ban in *Periodicals* that restricted imports on certain

¹¹⁹ VCLT, *supra* note 21, art. 39.

¹²⁰ See Anne Peters, *Völkerrecht: Allgemeiner Teil* 100-101 (Schulthess 2006).

¹²¹ See *id.*

¹²² See *id.*

¹²³ See GATT, *supra* note 66, art. XXI(d).

printed materials entering Canada, the fuel export charge does seek to secure compliance with another agreement.¹²⁴ The fuel export charge is in place to implement the “thick border” initiatives and the Montebello Summit Joint Statement and is necessary because of the one billion dollar expense Canada will incur due to these agreements.¹²⁵

2. The Fuel Export Charge is necessary to protect essential security interests.

GATT Article XXI states that GATT shall not be construed to prevent a state from taking measures necessary for the protection of its essential security interests “taken in a time of war or other emergency in international relations.”¹²⁶ The Fuel Export Charge is a direct response to the “thick border” initiatives in place to meet the security-related action points in the Montebello Summit Joint Statement.¹²⁷ The “thick border” initiatives are thus implemented in response to an emergency in international relations created by concerns over terrorism and border security. These concerns are demonstrated by statements of U.S. Presidential candidates that the September 11, 2001 hijackers had entered the U.S. through Canada.¹²⁸

3. Invocation of exceptions for the Fuel Export Charge is consistent with the chapeau of the general exceptions in GATT.

Although the chapeau of GATT Article XX provides that measures not be applied in a manner that would result in “arbitrary or unjustifiable discrimination,” the task of interpreting the chapeau requires balancing the rights of one party to invoke the exception and the rights of the other to enforce GATT/NAFTA provisions.¹²⁹ This balancing must be done on a case-by-case basis by examining the surrounding circumstances, including the legal context of the dispute.¹³⁰ As the U.S. was willing to allow an export charge in the SLA, its rights to enforce the same provisions related to the fuel export charge should be inferior to the rights of Canada to invoke the exception. Further, the dispute has arisen because of the U.S.’s desire to protect its borders at Canada’s expense. Taking this into account, Canada should be allowed to invoke the exceptions in GATT and NAFTA.

¹²⁴ See *Periodicals*, *supra* note 70, paras. 5.8-5.11.

¹²⁵ Montebello Summit Joint Statement, *supra* note 13.

¹²⁶ GATT, *supra* note 66, art. XXI(b)(iii).

¹²⁷ Montebello Summit Joint Statement, *supra* note 13.

¹²⁸ *Id.*

¹²⁹ See *Shrimp*, *supra* note 70, para. 159.

¹³⁰ See *Reformulated Gasoline*, *supra* note 70, at 18.

CONCLUSION

THEREFORE, we respectfully submit that this Honorable Court adjudge and declare that:

- I. The United States violated international law by enacting the WHTI because it accords less favorable treatment to Canadian service suppliers and adversely affects trade in services.
- II. The APHIS user fees constitute customs user fees, thereby violating both NAFTA and MFN treatment.
- III. Neither the WHTI nor the APHIS user fees are justified by general or national security exceptions.
- IV. Canada's Fuel Export Charge is lawful because the Softwood Lumber Agreement permits parties to implement export charges and the Fuel Export Charge is justified by general and national security exceptions.

ALL OF WHICH IS RESPECTFULLY SUBMITTED BY:

Counsel for the Respondent, the Government of Canada (Team #2008-03R).

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