ENERGY LAW JOURNAL

Volume 9, No. 2 1988

THE CANADA/UNITED STATES FREE-TRADE AGREEMENT AND TRADE IN ENERGY

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I. INTRODUCTION

International trade in energy has always seemed to play by its own rules. Theoretically, this trade, as least insofar as it comprises trade in goods,[1] has been subject to the trade rules established under the General Agreement on Tariffs and Trade (GATT).[2] In practice, however, relatively little attention has been paid to the GATT in international trade in crude oil,[3] the commodity that has, with its refined products, dominated much of international trade in energy.[4] In times of major changes in world oil markets, trade policies in the oil area have generally been the product of a high stakes, international relations game between governments and, until the emergence of the Oil Produc-

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1. Most energy trade is "trade in goods" the possible exception being electricity, for purposes of the General Agreement on Tariffs and Trade, *opened for signature*, October 30, 1947, 61 Stat. A-11, T.I.A.S. No. 1700, 55 U.N.T.S. 194 [hereinafter GATT].

2. *Id.*

3. Where GATT has been referred to, it has often been to invoke one of the broad exceptions to its coverage, such as the "national security" exception, to justify various restrictive measures, e.g., various U.S. restrictions on oil imports in the 1960s and 1970s.

4. This is certainly true as to volume and value of trade, where crude oil and oil product dominate. In 1985, for instance, more than 22 million barrels per day of crude oil flowed in international commerce. International oil prices have also tended to be the yardstick by which to price other energy trade commodities, especially natural gas and liquified natural gas (LNG). It even became a yardstick, at least for a period, for pricing certain long-term electricity arrangements between Canadian suppliers and U.S. purchasers, a probably ephemeral trend that caused some concern amongst U.S. policymakers in the mid-1980s.

ing and Exporting Countries (OPEC) cartel, of concerted action between major oil companies that dominated the world oil scene.[5] Oil trade has been critically influenced in the 1970s and 1980s by changes in the relative power of the OPEC cartel and of the governments of the industrialized consumer nations, the latter acting alone or in concert through organizations such as the International Energy Agency (IEA).[6]

Trade in oil has been at the center of relations between the major producing and consuming nations and has driven the development of high profile national energy policies in consuming nations. These policies have, at times, played a central role in foreign policy and even defense policy. The 1987-1988 presence of the United States (U.S.) and other Western navies in the Persian Gulf is a constant reminder of this phenomenon. There are few, if any, commodities as widely traded on sophisticated world markets that raise such concerns over national security and economic impact as to continually invite high-level government scrutiny and, potentially, intervention.

The weakening of the OPEC cartel in the 1980s, and the concomitant emergence of an increasingly competitive world market in oil and oil products (enhanced by removal of domestic regulation in the U.S. and other countries) have led to a new forbearance, by the U.S. and Canadian governments in particular, from intervening too readily in that market, even in the face of dramatic price volatility. How much this forbearance is related to current conditions of over-supply and to the market-oriented philosophies of the two governments currently in power only time will tell. The debate over oil import tariffs and alternative measures to protect the U.S. oil and gas infrastructure is far from over; and the role the GATT considerations tend to play in that debate is still embryonic.

However, if the current relatively unfettered, if fragile, world market in oil and oil products does continue, oil may, over time, start to be treated as a more normal commodity, subject to international trade rules like any other commodity. The Canada/United States Free-Trade Agreement (FTA)[7] should give a considerable boost to that development, certainly insofar as it subjects the not insignificant Canada/U.S. bilateral trade in oil to a far more

5. *See, e.g.*, SAMPSON, THE SEVEN SISTERS (1975); BLAIR, THE CONTROL OF OIL (1978).

6. A sub-agency of the Organization for Economic Cooperation and Development, the IEA is the organization responsible for implementing the oil sharing in times of crisis, and related information gathering functions, for the consumer nations participating in the Agreement on an International Energy Program Nov. 18, 1974, *amended* Feb. 5, 1975, 27 U.S.T. 1685, T.I.A.S. No. 8278 [hereinafter IEP]. *See infra* pt. V.

7. Department of External Affairs, The Canada/United States Free-Trade Agreement, December 10, 1987 [hereinafter FTA]. All unascribed references to "article," "annex" or "chapter" refer to articles, annexes or chapters of the FTA. All unascribed references to "party" refer to Canada or the U.S. and to "parties" refer to Canada and the U.S. U.S. legislation implementing the FTA was passed by Congress and signed into law by President Reagan on September 28, 1988. United States/Canada Free-Trade Agreement Implementation Act of 1988, P.L. 100-449. While the FTA itself states (in article 2105) that it shall enter into force on January 1, 1989, the U.S. legislation states that, when the President "determines that Canada has taken measures necessary to comply" with the FTA, the FTA shall enter into force on *or after* January 1, 1989 upon an exchange of notes between the two governments. *Id.* 101(b). This will permit U.S. ratification if the Canadian government has not ratified by January 1, 1989, an eventuality that may be critically affected by the outcome of the Canadian general election scheduled for November 21, 1988.

explicit regime of trade rules that build heavily upon, and expand upon, those in the GATT.

Just as international oil developments since the early 1970s have heavily influenced, if not totally dominated, domestic U.S. energy policy,[8] they have also had a powerful influence on the Canada/U.S. trading relationship in energy. Indeed, as this article will elaborate, it is a fair generalization to state that this relationship has, until recently, tended to be far more the function of the interaction of the domestic energy policies of the two countries than of their broader international trade policies or of private sector market decisions. Moreover, the energy trade relationship itself has, until recently, been quite heavily regulated on both sides of the border; and that regulation has tended to reflect the prevailing energy policies of each trading partner.

The FTA will alter the basic influences on the bilateral energy trade and should engender a new mentality towards resolution of Canadian and U.S. energy trade problems. First, energy trade will comprise only a part, albeit an important part,[9] of the world's largest and most complex trading relationship—with total two-way trade in goods and services valued at approximately $160.1 billion (U.S.) per annum.[10] Energy trade issues are weaved by the FTA into a complex web with other trade issues that touch many aspects of the two economies. No longer can either country afford to address energy trade issues, however strongly contested, without also addressing their impact upon the whole bilateral trade relationship. That relationship is simply too important. For Canada, it is absolutely critical. Exports account for about 30% of Canada's Gross National Product (GNP). Exports to the U.S. comprise 76% of total Canadian exports; hence they account for close to one-quarter of Canada's total GNP.[11] The relationship is also important to the U.S. because Canada accounts for approximately 20% of its imports and 24% of its exports. Additionally, U.S. exports to Canada in 1987 exceeded U.S. exports to the entire European Economic Community.[12]

Secondly, the FTA builds centrally upon the fundamental notions of the GATT. Indeed, the FTA specifically purports to be consistent with article XXIV of the GATT, which provides the framework in international law for negotiating free-trade agreements.[13] Moreover, both governments appear very conscious of the fact that the FTA makes significant advances on the GATT provisions in creating freer trade regimes in major areas such as trade in services, investment and business travel. Both countries appear to see this progress as an important precursor or building block for similar progress in the

8. Even today, the percentage of crude oil imported is widely viewed as the single most significant barometer of how successful domestic energy policy has been or of how concerned over "energy security" the nation should become.

9. Energy trade has comprised about 10% of the total bilateral trade in goods in the mid-1980s. The year of 1987 was a record for volumes of Canadian natural gas and electricity exports to the U.S.

10. Information from Statistics Canada. All figures throughout the paper are for 1987, unless otherwise stated.

11. Information from Statistics Canada.

12. Information from U.S. Dept. of Commerce. All figures throughout the paper are for 1987, unless otherwise stated.

13. FTA, *supra* note 7, art. 101.

Uruguay Round of the GATT.[14] Indeed, some U.S. officials have expressed a clear priority for pursuing FTA-based reforms in the multilateral context of the Uruguay Round rather than attempting to conclude similar bilateral agreements with other countries, such as Mexico.[15]

The lesson for those who practice and make policy in the energy trade area is clear. Energy practitioners, who might previously have thought the word GATT to describe some tropical stomach disorder, will be confronted in the Canada/U.S. energy arena with a relatively new notion: transborder energy transactions being subject to the same broad set of international trade rules, to be monitored and enforced by both governments, that govern the trade in most products between the industrialized nations subject to the GATT.

More challenging still may be the notion, also implicit in the FTA, of recognizing some obligation, at least on the part of the two national governments, to address the impact of domestic energy regulation on the cross-border trading relationship. It was recognized, well before the FTA itself was concluded, that such a large and complex bilateral relationship as that between the U.S. and Canada would present special problems not typically addressed in the more dispersed context of multilateral trade agreements.[16] Their geographical proximity and the high level of integration[17] of the two economies indicated the need for special attention to the impact of trade policies on the domestic economies of each country and the interaction between them. That complexity is accentuated in the energy area, where some major markets have until recently been pervasively regulated. Today, some functions remain regulated, some have recently been deregulated, and some are in the process of total or partial deregulation.

What has been distinctive, perhaps unique, about the Canada/U.S. energy trade relationship, especially over the last fifteen years, is that it has involved a complex, often troublesome, interaction between three very different levels of policy-making on each side of the border. These are trade policy, energy policy and, for industries such as natural gas and electricity, the domestic regulatory policies of Canada's National Energy Board (NEB) and the U.S. Federal Energy Regulatory Commission (FERC). Hence, the governance of Canada/U.S. energy trade is the product of a six-part matrix of policy-making processes, three at the federal level on each side of the border. That alone renders geometrically more probable complex policy conflicts, such as the FERC's 1987 "as billed" decision,[18] however well coordinated the two country's national policies are.

However, the policy-making matrix involved is even more complex than

14. *See, e.g.*, remarks of William Schofield, Office of Trade, U.S. Department of State and of Charles Stedman, Deputy Chief Negotiator, Canadian Trade Negotiations Office, at the Third Annual Conference on Canada/U.S. Trade in Energy, American Bar Association, Montreal (May 18-20, 1988), Draft Proceedings, at 37, 48 [hereinafter Montreal Conference Proceedings].

15. *See, e.g.*, *id.* at 56-57.

16. *See, e.g.*, FINLAYSON & THOMAS: THE ELEMENTS OF A CANADA-UNITED STATES COMPREHENSIVE TRADE AGREEMENT, 20 INT'L LAW. 1307, 1308 (1986).

17. *Id.*

18. *See infra* pt. IV.

that. On the U.S. side, federal regulatory authority is split between the Economic Regulatory Administration of the Department of Energy (ERA), which directly regulates aspects of the energy trade with Canada, and the FERC, which regulates domestic U.S. markets at the federal level and some trade matters.[19] Further, regulatory authority over electricity and natural gas (and, perhaps, oil)[20] is split between federal agencies and the state public utility commissions (PUCs) on the U.S. side. While the NEB regulates both international and some inter-provincial energy matters, its powers too are constrained by the considerable powers of the provinces.[21] Hence, notwithstanding doctrines such as the supremacy of federal law, there has always been the potential for state or provincial governments to disrupt the national policies of their federal counterparts; or, at least, the potential to require the exercise of some type of federal preemption, seldom a popular notion, to avoid that result. The FTA will affect this potential.[22]

The emphasis of this article will be upon how the FTA will affect the energy trade between the two countries and the policy formulation and implementation context within which that trade will occur. We will first outline briefly the current nature and dimensions of the overall Canada/U.S. trade relationship in part II and of the bilateral energy trade and its policy implications in part III. Part IV provides a skeletal outline of domestic energy regulation in each country and a capsule history of policy and regulatory developments affecting energy trade in the 1970s and 1980s. It is not to analyze domestic regulation or these policy developments but to give the reader the context necessary to appreciate fully some of the changes the FTA will make. Part V describes briefly the basic general elements of the FTA that most affect energy and, in particular, the energy provisions of chapter 9 of the FTA and their implications for energy trade. Finally, in part VI we will focus on specific FTA provisions that, while not part of chapter 9, have special significance for the energy area (i.e., investments; dispute resolution and enforcement; subsidies and countervailing duties; and the harmonization of antitrust policies).

II. THE CONTEXT: THE CANADA/U.S. TRADE RELATIONSHIP

The extensive economic integration of the Canada/U.S. market has not evolved through foreign policy efforts of either country; rather, it has evolved as a matter of geography and economics. Because of the unique relationship between Canada and the U.S., the GATT has not proven all that effective when applied to the current context of economic relations between Canada and the U.S. While the U.S. has traditionally used the GATT in reference to its trading relations with third countries, Canada has used it primarily for

19. Federal Power Act, 16 U.S.C. §§ 824-824K (1985 & Supp. 1988) and Natural Gas Act, 15 U.S.C. §§ 717-717Z (1976 & Supp. 1988) both as amended by the Department of Energy Organization Act of 1977, 42 U.S.C. §§ 7101-7375 (1982).

20. Puerto Rico Dep't of Consumer Affairs v. Isla Petroleum, 108 S. Ct. 1350 (1988).

21. *See infra* pt. IV.

22. *See infra* pt. V.

managing relations with the U.S. To date, the GATT has essentially dealt with trade relations and trade issues within the traditional meaning of the word "trade," rather than with other international economic relations as well. However, the Canada/U.S. relationship is far more extensive and pervasive. Sharing the world's largest undefended border, business interaction is a daily matter. In fact, it is estimated that approximately two-thirds of Canada/U.S. trade is intra-company, resulting from American investment in Canada.

The GATT does not cover many Canada/U.S. issues which have a direct impact on the trading relationship, such as investment and services. Moreover, Canadian imports have often been seriously affected by U.S. trade measures aimed at third countries, not easily dealt with under the GATT.

Together, Canada and the U.S. have forged the greatest trading relationship in the world. The two countries are each other's largest trading partner and key sources of investment in each other's economy. In 1987, two-way trade totalled approximately $130 billion in merchandise alone.[23] Approximately 24% of the U.S. world exports are to Canada, with a comparative percentage of its imports originating there.[24] This is more than two-times the value of the U.S. trade with Japan. Indeed, U.S. trade with the Province of Ontario alone exceeds that with Japan. In 1987, 76% of Canada's exports were to the U.S. marketplace, with approximately 68% of its imports coming from the U.S.[25] Two million jobs in *each* country depend on the two-way trade between the U.S. and Canada. Canada is the United States' fastest growing market. In the years 1982-1986, when U.S. overseas market sales grew by less than 2%, U.S. sales to Canada grew by 45%.[26]

On January 2, 1988, President Reagan and Prime Minister Mulroney signed the FTA.[27] The Canada/U.S. free-trade regime will regulate and, ideally, eliminate economic barriers to trade, including tariffs, non-tariff barriers and other economic irritants in the trade relationship.

The provisions of the FTA applicable to each country are not necessarily mirror images of the other. A significant aspect of the negotiations was the inequality of the two nations in their respective market sizes and economic strengths. A guaranteed open market between the two nations without other concessions from Canada would not have been acceptable to the U.S. Congress, since Canada is effectively gaining access to a market ten-times the size of its own and the U.S. to one of only one-tenth the size of its domestic market. In exchange for assuring continued open access to the larger American market to Canada, the U.S. obtained concessions in other areas such as American access to Canadian investment and financial markets, automotive policy, trade in services and energy policy.

23. Information from U.S. Dept. of Commerce.

24. *Id.*

25. Information from Statistics Canada.

26. Government of Canada, *Partners in Prosperity* (1987).

27. FTA, *supra* note 7.

III. The Nature, Dimensions and Policy Considerations of Canada/U.S. Energy Trade

The principal components of the energy trade relationship today comprise major Canadian exports to the U.S. of crude oil ($4.8 billion),[28] petroleum products ($1.4 billion), natural gas ($2.53 billion), electricity ($1.25 billion), sizable U.S. exports to Canada of coal and coal products ($803 million), comprising virtually all Canadian coal imports, and of petroleum products ($748 million).[29] Canada also has significant exports to the U.S. of liquified petroleum gas ($663 million) and uranium ($578 million).

Total Canadian energy export values to the U.S. for 1987 were $11.2 billion (up from $9.9 billion in 1986). U.S. energy exports to Canada totalled $1.9 billion for a total trade of $13.1 billion. The total energy trade has fluctuated between $10 billion and $14 billion in the mid-1980s. This comprises approximately 10% of the total bilateral trade in goods. Perhaps more significant, Canada's energy trade surplus accounted for 61% of its total merchandise trade surplus in 1987 (49.5% in 1986).

Fluctuations in the total value of energy trade have been attributable more to dramatic changes in world oil prices and some related volatility in domestic natural gas markets than to changes in volumes traded; however, price changes have, in turn, influenced significant changes in volume. For instance, the 13.7% increase in Canadian exports between 1986 and 1987 was largely the product of oil price increases and of a 32.6% increase in natural gas volumes (now 27.7 billion cubic meters), which kept the total value of natural gas exports around the $2.5 billion mark in an era of softening natural gas prices. There has been a discernible trend in the 1980s of increasing volumes in Canadian natural gas and electricity imports into the U.S., both of which reached record levels in 1987.

Perhaps the most telling statistic of all is that the U.S. now takes 84.2% of all Canadian energy exports (81.4% in 1986). This, as noted, contributes more than all other sectors combined to Canada's merchandise trade surplus. Canada exports well over a third of its total crude oil production to the U.S. Energy imports from the U.S. comprise 36% of Canada's more modest energy import bill. Hence, energy trade with the U.S. is critical to Canada's trade balance and important to its Gross Domestic Product. Imports from Canada contribute significantly to U.S. total consumption of crude oil (5%), natural gas (5.9%) and petroleum products (12.8%).

The potential for growth in the bilateral energy trade is also very significant. Canada is already by far the world's largest producer of uranium, the third largest producer of natural gas, fifth in electricity generation (second in hydropower generation), ninth in crude oil production and eleventh in coal

28. All figures herein, unless otherwise stated, are for 1987 provided by Canadian and U.S. government sources, based on data provided by Statistics Canada, External Trade Division and by the Energy Information Agency, U.S. Dept. of Energy. *See also The Canada-U.S. Free Trade Agreement and Energy: An Assessment*, Energy Strategy Branch, Dept. of Energy, Mines and Resources, Government of Canada [hereinafter Canadian Assessment].

29. The U.S. also exports to Canada modest amounts of crude oil ($139 million) and liquified petroleum gas ($162 million).

production.[30] Its untapped production potential in crude oil, natural gas and electricity is vast.

Most of the controversy and policy issues in the 1970s and early 1980s have arisen around trade in crude oil, natural gas and their related products; and, more recently, around natural gas, electricity and uranium.

The issues in crude oil and related products, and to some extent in natural gas, have centered on "energy security" concerns in both countries emanating from the perceived oil crisis and price shocks of 1973-74 and 1979. In response to these concerns, the U.S. imposed oil import quotas and fees, domestic oil price controls and an extensive oil allocation program,[31] building on a longer standing tendency to intervene in the oil import market to protect the domestic market.[32] The underlying rationale for much of this intervention was the notion that protection of the domestic infrastructure for oil and natural gas exploration and production (E&P) was necessary to ensure the health of these industries, viewed as critical to U.S. "energy security," which is a type of "national security" concern.[33] Often, more explicit defense-related reasons were cited. Energy security remains the principal rationale advanced for recent proposals to impose an oil import fee.

The U.S. natural gas markets, already tightly regulated, were subjected to further governmental intervention by various National Energy Act provisions enacted in 1978, which were designed to constrain consumption and encourage production.[34] While some of these changes set the stage for partial deregulation, they also exacerbated regulatory complexity and pricing distortions. This contributed, and perhaps led to inflated demand and shortages. The perception of natural gas as a scarce and "clean" fossil fuel, which could in many cases act as a substitute for crude oil, also infected natural gas policy with a significant "energy security" component.

In the early 1970s and 1980s, Canada also moved to both tax and directly restrict oil exports, especially those of light crude, and price both crude and natural gas exports well above Canadian domestic prices. Canada's policies were driven by a desire to protect its own E&P infrastructure and to preserve for posterity and its long-term economic health[35] reserves of two perceivedly scarce and wasting high priority fossil fuels, oil and natural gas. Fears of premature exhaustion by U.S. consumption led to export restrictions and the imposition of substantial price differentials between exports and

30. Information from U.S. Dept. of Energy, *International Energy Statistical Review*; British Petroleum, *Statistical Review of World Energy* (June 1988).

31. *See, e.g.*, Remarks of William F. Martin, Deputy Secretary, U.S. Dept. of Energy, Montreal Conference Proceedings, *supra* note 14, at 27-28.

32. Remarks of William F. Martin, U.S. Deputy Secretary of Energy, at American Bar Association National Institute on U.S. Canada Free Trade Agreement: The Economic and Legal Implications, Washington, D.C., at 529-30, (January 28-29, 1988).

33. Other goals included conservation, which was also driven by a basic energy security goal of reducing reliance on foreign oil imports, and "fairness" in the allocation of scarce resources.

34. *See, e.g.*, Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1978); Powerplant and Industrial Fuel Use Act of 1978, 42 U.S.C. §§ 8301-8484 (1978).

35. While apparently replete with natural reserves of these fuels, Canada is also the most energy-intensive of the world's major industrialized economies.

domestic consumption. Canadians' concerns over their ability to control their energy future, coupled with a rising tide of economic nationalism in the 1970s, also focused on increasing Canadian ownership and control of the oil and natural gas E&P industry, which had traditionally relied heavily on U.S. investment.[36] The result was a far more restrictive regime for U.S. investment in Canadian energy production,[37] the legacy of which is still strong and would not likely disappear quickly upon ratification of the FTA.[38]

Most of these policy concerns, and the governmental responses detailed below, arose in the post 1973-1974 "oil crisis" era in which "national energy policy" had assumed a central role in national policy, foreign policy, and national security debates in each country.[39] The trade rules and domestic regulation of energy, especially the former, were subjected to seemingly clear, overriding energy policy goals concerning the production and usage of oil and natural gas. These masked the complexity of their regulatory impact and the distortions they created in both the domestic and bilateral trade markets. The economic, technical, and market realities of the trade relationship were largely ignored. As we will see, this tendency suffered a rather dramatic reversal in the mid-1980s as two generally pro-market governments embarked upon ambitious and seemingly parallel efforts to reduce government intervention in both the domestic and bilateral trade markets and to permit market forces to operate to the fullest extent possible. Today, most calls for government intervention in these sectors, still usually couched in energy security terms, are for measures to slow down or mitigate the impact of market forces that are perceived as too strong or too volatile, rather than calls for a return to the targeted, heavily bureaucratic policies of the preceding decade.

In electricity, the trade relationship, while affected by security concerns, has not been dominated by these influences. Because the industry is so capital-intensive and because its reliance on the "scarce" fossil fuels as a feedstock is limited in most regions, the central policy issues have been different. They have focussed on whether Canadian producers have sufficient assurance of long-term access to U.S. markets to justify financing large capital expansions to serve U.S. markets on a long-term basis, i.e., to build for export purposes; and on whether U.S. utilities have sufficient assurance in the long-term availability and price of such supplies to include them as a component of their long-term supply plans, perhaps justifying foregoing building their own generation facilities with long gestation periods.[40] While security of long-term supply in an industry so important to the U.S. economic infrastructure has also raised "energy security" and "national security" concerns,[41] the U.S. focus has been more upon whether Canadian regulatory pricing or contracting practices pose

36. *See infra* pt. VI on foreign investments.

37. *Id.*

38. *Id.*

39. Interview with Alan Gotlieb, Canadian Ambassador to the United States (July 1988). Mr. Gottlieb reflected that, when he assumed the office in 1981, negative tensions over energy trade issues dominated the diplomatic relationship to a degree far out of proportion to their actual importance.

40. See U.S. Dept. of Energy, *Energy Security*, May 1987, DOE/S-0057; *Northern Lights: The Economic and Practical Potential of Imported Power from Canada*, December 1987, DOE/PE-0079.

41. Considerable attention was paid to concerns expressed by U.S. Secretary of Energy, Donald

threats to the sanctity of long-term contracts than upon the influences of broad national energy policies. The Canadian focus, in turn, has been less upon electricity exports as depleting scarce natural resources and more upon whether they have access to sufficiently secure long-term markets to justify the allocation of scarce capital resources. Canadian concerns relate primarily to fears that U.S. economic protectionism (which, in the energy area, is often cloaked in "energy security" rhetoric)[42] will interfere with long-term market stability.

To a considerable extent, in the new era of limited government intervention, there has been a similar shift in the focus of policy issues in natural gas trade. More focus is on investment and secure, competitive markets than on broader "energy security" concerns.

Because of a perceived abundance of coal in the U.S., and in parts of Canada, that trade has been less affected by the vicissitudes of national energy policies. Trade in coal today presents few distinctive "energy policy" issues that might affect the trade rules or domestic laws under which it operates.

Trade in uranium, essentially a world market commodity now that various production cartels have dissipated, has been potentially influenced by the fragility of the U.S. uranium-producing industry in the face of stiff international competition and flagging demand.[43] The main focus has been on whether the U.S. Department of Energy (DOE) is legally required to limit or exclude its uranium purchases for enrichment purposes from foreign suppliers in order to protect the viability of domestic suppliers.[44] The U.S. Supreme Court recently upheld the DOE's refusal to do so,[45] probably putting the issue to rest.

IV. Import/Export and Domestic Regulation of Energy Trade

A. *The Regulatory Structure*

The purpose of this section is to briefly describe the regulatory framework within which Canada/U.S. energy trade currently operates, which will critically interact with the FTA, if ratified. With even greater brevity, we will outline the recent regulatory history of that trade relationship, which we believe is necessary to fully appreciate the potential impact of the FTA. A thorough analysis of neither area is possible within the confines of this article.

The FERC has responsibility for a wide range of domestic regulatory

Hodel, in 1984 and by John Dingell, Chairman of the Comm. on Energy and Commerce, U.S. House of Representatives, in 1987.

42. One example has been the strident attack on Canadian electricity imports by advocates for certain U.S. mid-west coal-producing interests, who apparently fear that Canadian imports will limit the ability of mid-west coal burning utilities to sell into lucrative northeast and mid-Atlantic markets. These interests have even asserted that Canadian pressure for an expedited U.S. solution to the "acid rain" problem is pt. of a "conspiracy" to limit the competitive ability of the mid-west coal-burning utilities, who contribute significantly to the acid rain problem.

43. The apparent demise of the U.S. domestic nuclear industry as a growth industry has seriously upset future demand projects and has depressed prices.

44. *See infra* pt. V.

45. Huffman v. Western Nuclear, 108 S. Ct. 2087 (1988).

functions which are shared, in the electricity and natural gas areas, with state PUCs and state certification and siting authorities. The Commission's broadest responsibilities lie in the natural gas area and include:

(a) administration of prices and price ceilings for "old" (pre-April 20, 1977) natural gas production and the decontrol status of gas wells;
(b) setting rates that interstate pipelines may charge for the transmission and sale of natural gas;
(c) approval of proposals for construction of interstate pipeline facilities, including review of the sources and adequacy of the supply and markets for the gas, and the adequacy, and environmental and safety impacts of facilities; and approval of facilities for receiving and exporting liquified natural gas (LNG);
(d) review of pipeline proposals to serve new customers or to modify or abandon existing service; and
(e) approval of curtailment plans to allocate reductions in gas supply during shortages.[46]

The FERC regulation does not extend to the purchase and resale to end-users of natural gas by local distribution companies (LDCs), which is typically regulated by state PUCs.[47]

In the electricity area, the FERC's jurisdiction is limited to regulation of rates and terms for wholesale sales of power for resale. Such sales are typically by investor-owned utilities (IOUs) either to other IOUs (usually these are "coordination" sales), or to municipal or rural electric cooperative utilities (usually "requirements" sales) whose activities, with a single exception, are not regulated by the FERC.[48] The FERC also regulates the rates and terms of agreements to transmit electricity. The bulk of electricity sales still comprise direct sales by IOUs to end-users (retail sales), which are typically regulated by state PUCs, whose retail jurisdiction is preserved by section 201(a) of the Federal Power Act (FPA). However, the portion of sales regulated at the FERC has been growing rapidly and now comprises about 30% of all kilowatt hour sales regulated in the U.S. The FERC's authority extends to approval of interconnection and "power pool" agreements between utilities;[49] and it has discrete and quite constrained authorities to order interconnections and to order "wheeling" (transmission of power for another party) in certain circumstances.[50] Under various sections of the FPA, the FERC also regulates certain corporate and financial activities of jurisdictional utilities.[51] Finally, it has limited review authority over rates of the federal power marketing agencies.[52]

46. 1987 FERC ANN. REP. at 3.

47. The authority of PUCs to review the prudence of LDC purchasing practices, as well as rates for their sales to end users, was recently upheld in Kentucky W.Va. Gas Co. v. Pennsylvania Pub. Serv. Comm'n, 837 F.2d 600 (3rd Cir. 1988).

48. FPA, § 205, 16 U.S.C. § 824d (1982).

49. *Id.*

50. *Id.*

51. FPA, §§ 202, 210-12, 16 U.S.C. §§ 824a, 824i, 824j, 824k (1982).

52. *E.g.*, FPA, §§ 203-04, 16 U.S.C. §§ 824b, 824c (1982).

It should be noted that the FERC has no certification and siting authority as to electric transmission or generation facilities, although it does have authority to qualify certain generating facilities for the benefits of section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA).[53]

In addition to these general authorities in electricity and natural gas, the FERC has exclusive authority to license and oversee most non-federally-owned hydropower facilities and projects under part I of the FPA;[54] to regulate the rates and practices of pipeline companies transporting oil in interstate commerce;[55] and to act as an appeals court for the DOE "remedial orders" issued pursuant to the petroleum allocation and pricing regulations of the late 1970s and early 1980s.

Regulation of electricity and natural gas imports and exports has been divided since 1977[56] between the FERC and the ERA, pursuant to various delegations of authority. The ERA has the authority both to grant presidential permits to construct facilities for the import or export of electricity on the basis of review for environmental impact and effect upon reliability of service;[57] and to authorize such electricity exports as do not impair sufficiency of supply or coordination of facilities in the U.S.[58] No similar authorization is required for electricity imports.

For natural gas trade, the presidential permit authority for import/export facilities resides in the FERC under delegation. The ERA has the principal authority over natural gas import and export policy and is required under section 3 of the Natural Gas Act (NGA) to grant such applications for imports and exports of natural gas which are not inconsistent with the "public interest."[59] However, a complex bifurcation exists between the ERA and the FERC as to the policy and pricing decisions over imports.

The importance to the bilateral trade relationship of the FERC's authority to price Canadian gas as it enters the stream of U.S. interstate commerce through U.S. pipelines was vividly illustrated by the FERC's "as billed" decision in 1986 and 1987. In that case, the FERC recognized a two-part rate for a Canadian pipeline selling gas into the U.S. market but refused to permit inclusion of certain production and gathering costs in the U.S. pipeline's demand charge; this action was in accordance with the FERC pricing or rate design practices but not consistent with the NEB's pricing practices for Canadian pipelines.[60] The FERC refused to apply the "as billed" principle normally applied in intra-U.S. pipeline rates because the FERC had not reviewed the reasonableness of the upstream allocation of the production and gathering

53. Public Utility Regulatory Policies Act of 1978, § 210, 16 U.S.C. § 824a-3 (1982).

54. 16 U.S.C. §§ 791a-828c (1982).

55. Interstate Commerce Act, 49 U.S.C. §§ 10101-11916 (1982).

56. Dept. of Energy Organizations Act of 1977, 42 U.S.C. §§ 7101-7375 (1982).

57. This authority is derived not from statute but from two Executive Orders of the President emanating from his constitutional powers to conduct foreign policy and protect the territorial integrity of the U.S. Exec. Order No. 10,485, 3 C.F.R. 970 (1949-1953); Exec. Order No. 12,038, 3 C.F.R. 136 (1978).

58. FPA, § 202(e), 16 U.S.C. § 824a(e) (1982).

59. 15 U.S.C. § 717b (1976).

60. Opinion No. 256, Natural Gas Pipeline Co. of Am., 37 F.E.R.C. ¶ 61,215 (1986); *clarified*, Opinion No. 256A, Natural Gas Pipeline Co. of America, 39 F.E.R.C. ¶ 61,218 (1987).

costs with regard to the demand charge.[61] The FERC's decision focused on the relative ability of the U.S. pipeline to shift to consumers the risk of purchases of Canadian gas as opposed to U.S. gas. However, the decision's perceived upstream effect on Canadian gas contracts and regulatory decisions caused a storm of protest from Canada.

The FERC's "as billed" decision was driven by an underlying concern that Canadian practices of including more costs in demand charges than the FERC permitted of U.S. pipelines might give the purveyors of Canadian gas an unfair advantage to price discriminate in U.S. markets. However, the decision drew strong criticism from Canadian government sources who described the action as an undue extension of the FERC regulation into Canada, an undue interference with free-trade and a thinly veiled form of protectionism.[62] Subsequent consultations have eased tensions, but the underlying potential for conflict remains.

Canada's NEB has both a regulatory function, similar in some respects to that of the FERC, and also a broad responsibility to advise the government on the use of energy resources.[63] In the regulatory area, the NEB's authority includes quite detailed regulation of oil, gas and electricity exports, and some regulation of imports, and various aspects of domestic regulation, though probably less extensive than those of the FERC.[64]

On the export side, the NEB issues long-term licenses for exports of oil, natural gas and electricity, usually following a public hearing process on the record in which intervention and opposition may occur.[65] The NEB also issues orders for short-term exports of energy, subject to its part VI regulations, and licenses imports of natural gas.[66] Space prohibits examining in detail the substance of this regulation and the standards under which it operates.

The NEB export standards have been in a state of metamorphosis in the mid-1980s as the Canadian government has moved quite decisively toward a freer trade regime and a less regulated pricing approach toward exports. Indeed, oil exports have essentially been deregulated. The rules for natural gas exports have been considerably liberalized and a more market-based test of review applied. The previous rather restrictive "surplus" test (requiring proof of various ratios of reserves to production) was replaced by the NEB in September 1987 by a three-part test for review of the market-negotiated price.[67] The new "Market-Based Procedure" has three components:

(1) The export proposal may be subject to complaint by Canadian users asserting they cannot obtain gas supplies under terms and prices similar to the export.

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61. *Id.*

62. *See, e.g.*, comments of Minister Marcel Masse, Canadian Ministry of Energy, Mines and Resources New Release No. 87/131 (May 27, 1987); Second Annual Conference on Canada-U.S. Trade in Energy, American Bar Association, New York (June 4, 1987).

63. 1987 National Energy Board ANN. REP. at 53 [hereinafter NEB REPORT].

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.* at 17-18.

(2) An export impact assessment must be filed for an NEB determination whether the export will "cause Canadians difficulty in meeting their energy requirements at fair market prices."
(3) The NEB must still make its broad, statutory "national public interest" determination.[68]

It is also worth briefly noting the basic regime and standards under which electricity exports are regulated. For electricity exports, the NEB must satisfy itself in three broad areas that:
(1) the energy to be exported is surplus to reasonably foreseeable requirements for use in Canada ("the surplus test");
(2) the export price is "just and reasonable" ("the pricing test"); and
(3) there are no adverse environmental effects.[69]

The "just and reasonable" pricing test has been elaborated in the NEB's part VI regulations to require demonstration that the export price would:
(1) recover the appropriate share of costs incurred in Canada;
(2) be not less than the price to Canadians for equivalent service in related areas; and
(3) not produce a price "materially less than the least cost alternative" at the same location in the importing country.[70]

The second of these tests has evolved into a "first-offer" requirement to neighboring Canadian utilities to ensure lower cost sources of power are utilized first in Canada before export. The seriousness of the test was illustrated in May 1987 when a Hydro-Quebec application for a long-term export to New England was denied for failure to meet this requirement,[71] but subsequent compliance with the "first-offer" requirement led to granting the application. The third pricing requirement would be eliminated under the FTA.[72] The federal Cabinet has some ultimate review authority over the NEB's export decisions. While its role today is constrained by statute, court decisions and tradition, it may be enhanced by the FTA.

Most electricity exports emanate from provincially-owned utilities. Their governing statutes typically require provincial cabinet approval for all extra-provincial sales. There is also ongoing informal political scrutiny of export decisions. Electricity was not subject to the 1985 Western Accord between the federal government and the western provinces over deregulation or liberalization of oil and gas pricing and export rules. Hence, it remains more regulated than oil and gas and was, predictably, one of the areas that required specific modification in the FTA. However, after a two year review of its electricity export regulations, the Canadian government in September 1988 announced a new policy to liberalize its electricity export rules.[73]

The principal focus of the new policy is on the NEB's procedures for

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68. *Id.*
69. National Energy Board Act (NEBA), pt. VI, R.S.C. ch. N-6, as amended, § 83(a) (1970).
70. NEB, pt. VI Regulations, ¶ 6(2)(z).
71. NEB, Reasons for Decision In Re Hydro-Quebec, May 1987.
72. *See infra* pt. V(*F*)(9)(1).
73. Ministry of Energy, Mines and Resources, Canada: News Release No 88/185; and Statement by

issuance of export licenses and for certification of international power lines, both of which have to date required public hearings on "all relevant considerations" and the Governor-in-Council (i.e., the Cabinet) approval. Henceforth, approval of both will normally be by NEB permit, without the need for public hearing or Cabinet review. However, the Governor-in-Council may, on the advice of the NEB, impose the public hearing process if serious concerns exist that the proposal is not in the Canadian public interest. Cited examples of situations raising such concerns include a province ignoring federal environmental standards; a proposal with negative extra-provincial environmental effects; an exporter not giving fair access to potential Canadian domestic puchasers; and deficient provincial regulation that may effect a subsidy of an export. The last of these reservations is particularly significiant in light of the absence of a comprehensive FTA regime to deal with subsidies.

A significant part of the rationale for relaxing and expediting the NEB's review procedures is based upon the Canadian government's conclusion that most Canadian electricity production and export arrangements are now subject to "extensive provincial oversight" and hence do not also require intense federal regulation in normal cases. This rationale also supports another of the major reforms announced—that the NEB will no longer determine the detailed routes of international power lines, except where a line passes through more than one province and the sponsoring province requests detailed NEB route review. Otherwise, detailed routing and land acquisition are left to provincial jurisidiction.

These reforms reflect recognition not only of the advent of pervasive provincial oversight but also of changing realities in the electricity export market since the last major review of the NEB's export rules in 1963, when long-term electricity imports were first permitted. Today, most provinces view themselves as exporters into a potentially sizeable U.S. market, and several are pursuing long-term contract arrangements. To accommodate the latter, the current twenty-five year duration limit on export contracts in the NEB Act will be extended to thirty years by the September 1988 reforms.

These reforms are also consistent with the Canadian government's 1986 "regulatory reform strategy," which seeks to simplify and streamline regulation, ensure that its benefits exceed its costs, and increase regulatory cooperation with the provinces. They should serve to reduce regulatory uncertainty and delay at the federal level for Canadian utilities seeking to compete in the U.S. electricity markets. While these reforms have come later than in oil and gas, they appear consistent with the general direction of the Mulroney government toward more competititive domestic and bilateral energy trade. The timing of their announcement, in the middle of the U.S. ratification process, is a significant signal by the Canadian government that it intends its electricity export rules to comport more closely with a free-trade regime.

In the domestic area, the NEB's regulatory authorities are more limited than the FERC's. The NEB's principal jurisdiction lies in regulating the traf-

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and Notes for an Address by the Hon. Marcel Masse, Minister, all of September 6, 1988. The ensuing description of this policy is derived from these documents.

fic, tolls, and tariffs of interprovincial oil and natural gas pipelines under "just and reasonable" and "no unjust discrimination" standards; and in certificating the construction and operation of both interprovincial and international oil, gas, and petroleum products pipelines and electricity transmission lines.[74]

The authority of the provinces is considerable, especially in the area of pricing services. In order to move toward deregulation in the oil and natural gas areas, the power of the provinces has required a series of "accords" between the federal government and relevant provinces. Most notable is the Western Accord, concluded to permit the movement toward deregulation of production prices to be effective. The provinces also typically regulate the prices and activities of privately-owned natural gas LDCs much as states typically regulate gas LDCs in the United States.

Today, most electricity production and distribution is carried out on an integrated basis by provincially-owned utilities, although a few small investor-owned utilities still exist in Alberta and in some of the maritime provinces. The rates and activities of the provincial utilities are subject to direct administrative control, ultimately accountable to the provincial cabinets, although some provincial regulatory agencies fulfill advisory review functions in the area. Because of the pervasive direct political control by provincial governments over domestic electricity production, an Eastern Accord, similar in effect to the Western Accord for oil and natural gas, may be required if the electricity markets in the eastern provinces are to be deregulated or rendered more competitive. Issues such as transmission access have already come to the fore in the NEB and provincial proceedings.

B. Recent Trade and Regulatory History

While a detailed, recent history of the Canada/U.S. energy trade relationship would be revealing and underscore the significance of the FTA to energy trade, this article cannot accommodate such an exercise. However, Illustration 1 demonstrates poignantly, if cryptically, some of the intensity and volatility of government intervention by both countries in the trade relationship in the 1970s and 1980s.[75] Most cases consisted of large scale, direct interventions in the trade itself and were driven by broad national energy policy concerns.[76] Most raised strong objections from the other country and were the cause of considerable diplomatic tension. They served to undermine confidence in both countries in the viability of a long-term energy trade relationship. This lack of confidence underlies some of the lingering policy concerns that exist today over that trade.

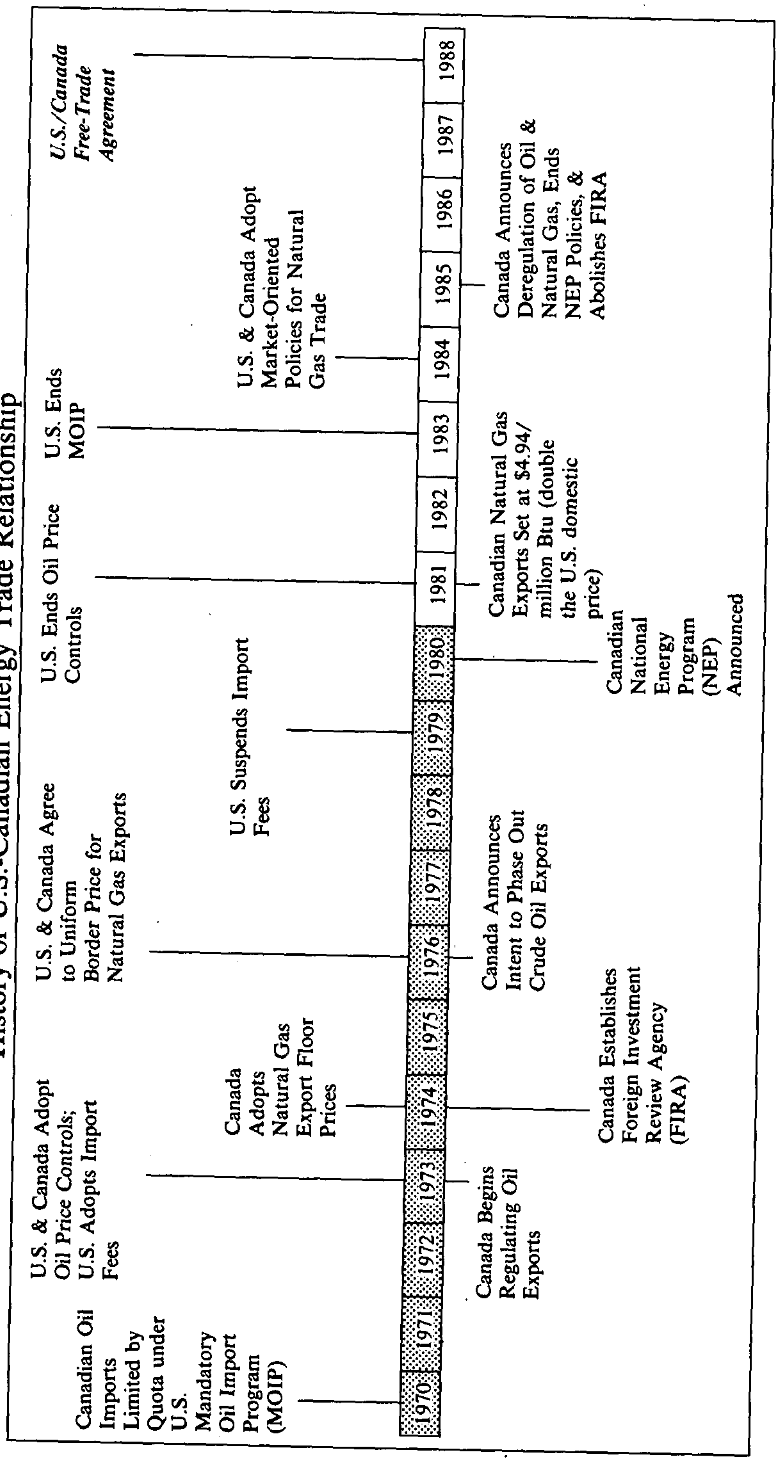
The Canadian measures that permeated the U.S. consciousness perhaps most of all were the Canadian minimum export-price and other export restrictions, especially the 1976 announcement of Canada's intent (never fully effectuated) to phase out crude oil imports. The latter raised major concerns over

74. NEB REPORT, *supra* note 63.

75. Statement by William F. Martin, U.S. Deputy Secretary of Energy, before the Subcomm. on Energy and Power, Comm. on Energy and Commerce and the Subcomm. on Mining and Natural Resources, Comm. on Interior and Insular Affairs, U.S. House of Representatives (March 9-10, 1988).

76. *See supra* pt. III.

ILLUSTRATION 1



potential regional crude oil shortfalls in the U.S. "northern tier" states that led, inter alia, to the enactment of title V of the PURPA, designed to expedite approval of two major oil pipelines into the region.[77] Tightening Canadian restrictions on U.S. investments in the Canadian oil and gas industry reached their zenith in explicit Canadianization measures in the National Energy Programme (NEP), announced in 1980. The NEP comprised a complex of price regulations, tax incentives, and investment restrictions designed to strengthen and increase Canadian participation in these industries.

Canadian concerns over U.S. intervention focused on a long tradition of multilateral U.S. measures in oil trade that were insensitive to the impact on the bilateral relationship. Canadians also feared that growing protectionism would increasingly drive U.S. trade policy in all the major energy trade areas.

Much of this intervention was reversed in the mid-1980s under the quite rapid movement toward deregulation and freer trade of the two governments in power, the Reagan Administration and the Mulroney Government which took office in 1984. In entering into the FTA negotiations, both governments were very conscious of the deleterious effect these interventions had had on developing efficient trans-border energy markets and, in turn, efficient and more viable energy production. Hence, the two overriding objectives in entering into the energy negotiations were: Canada's desire for increased and assured access to U.S. markets; and the United States' desire for assured access to reliable supplies of Canadian energy, which was viewed as a potentially significant contributor to U.S. "energy security".[78] We will now examine the degree to which the FTA will, if implemented, serve these principal objectives and how it might affect the nature and direction of energy trade.

V. THE CANADA/U.S. FREE-TRADE AGREEMENT

A. *The Negotiations*[79]

Canada's "broad objectives" in negotiating a free-trade agreement with the U.S. included securing and enhancing Canadian access to the U.S. market by enshrining a better set of rules by which Canada/U.S. trade is conducted.[80] In particular, the Canadian government indicated that the negotiations should address the following:

(1) the manner in which Canadian companies' access to the U.S. market can be frustrated by the use of trade remedy laws;

77. 43 U.S.C. §§ 2001-2012 (1982 & Supp. 1985).

78. *Analysis of Chapter 9 of the U.S./Canada Free Trade Agreement Concerning Trade in Energy*, May 24, 1988 at 14, 15, 24-25 [hereinafter *DOE/USTR Memorandum*]. The memorandum was prepared by the staff of the U.S. Dept. of Energy (DOE) and of the U.S. Trade Representative (USTR). The memorandum was principally authored by Craig S. Bamberger of the DOE and Robert Reinstein of the USTR at the request of Senator J. Bennett Johnston, Chairman of the U.S. Senate Comm. on Energy and Natural Resources; *See also Canadian Assessment, supra* note 28, at 37, 47.

79. For a comprehensive background and analysis of issues in the negotiations, see Battram, *Canada-United States Trade Negotiations: Continental Accord or a Continent Apart?*, 22 INT'L LAW. 345 (1988).

80. Report by the Honourable J. Kelleher, Minister for International Trade, to the Prime Minister (Sept. 17, 1985) (reprinted in CANADIAN TRADE, NEGOTIATIONS, SELECTED DOCUMENTS 65, at 65 (1985)).

(2) the ease with which imports from Canada are swept up in measures aimed at other countries;
(3) the continual threat of unilateral changes in the rules of the game; and
(4) the inadequacy of current mechanisms to resolve trade disputes.[81]

The U.S. Trade Representative identified six broad areas of interest that would be pursued in the negotiations:

(1) *Tariffs*: Canadian tariffs average between 9 to 10% as compared to the U.S. tariffs that average 4 to 5%;
(2) *Non-Tariff Barriers*: Extensive non-tariff barriers exist at both the provincial and federal level in Canada;
(3) *Foreign Investment in Canada*: While the present government has significantly improved Canada's investment climate by repealing the Foreign Investment Review Act and replacing it with the Investment Canada Act, concern still exists over Canadian investment policy. The stated U.S. objective would be to "produce a Canadian policy environment as open to inflows of foreign direct investment" as its own;
(4) *Trade in Services*: Several sectors stated to have an interest in enhanced trade relations were transportation services, information, communications, professional services and advertising;
(5) *Government Assistance*: American industry and Congress have questioned various forms of Canadian government assistance; and
(6) *Intellectual Property*: There was concern in the American business community relating to the protection of intellectual property in Canada.[82]

The U.S. essentially achieved its major stated objectives in the FTA. Canada also obtained a stated goal in securing access to the U.S. marketplace. Neither country achieved 100% of its objectives. However, the result is perceived by both governments as fair, well balanced and, most importantly, workable.

B. Relationship to the GATT

While the FTA is bilateral, the parties resolve to use it to "*build* on their mutual rights and obligations under the [GATT] and other multilateral and bilateral instruments of cooperation."[83] The FTA, building on the GATT and its ancillary agreements, provides for the bilateral elimination of tariffs at three different rates depending on the goods involved, over a period of ten years (the Transition Period).[84] Both parties will continue to apply their existing tariffs to imports from third countries. Since each country has different rates of

81. *Id.* at 67.
82. Testimony by Ambassador Clayton Yeutter, U.S. Trade Representative, to the Senate Finance Comm. (April 1986) [hereinafter Yeutter Testimony].
83. FTA, *supra* note 7, Preamble (emphasis in original).
84. *Id.* art. 401.

duties on similar or identical goods, the FTA attempts to prevent third country exporters from entering the Canada/U.S. marketplace via the country with the lower external tariff through "rules of origin".[85]

C. Rules of Origin

The "rules of origin" for goods define those goods which are entitled to receive duty-free treatment when being imported into the territory of one party from the other under the FTA.[86] In essence, the FTA provides that goods which originate in Canada, the U.S. or have a combined Canada/U.S. origin are entitled to duty-free treatment on entry to the other country, subject to the Transition Period.[87] Goods will be considered to originate in the territory of Canada or the U.S. if they are wholly obtained or produced in the territory of either country or both countries.[88] Goods which originate outside Canada and the U.S. will require Canadian or American content value-added to qualify under the rules of origin.[89] The basic test is whether there has been such substantial transformation, through processing or assembly, to result in a change in tariff classification as set out in the annex to chapter 3 of the FTA. Products such as chemicals, machinery, electronics and automobiles will be required to satisfy a 50% Canadian or American value-added test.[90] Goods which originate in Canada or the U.S. and subsequently undergo transhipment, processing or assembly in third countries will not qualify for duty-free status.[91]

D. Elimination of Tariff Barriers

Tariff elimination is the cornerstone of any free-trade agreement. The FTA, building on the GATT, provides for the elimination of tariffs at three different rates (depending on the goods invoked) over a course of ten years.[92] Logically, each party is prohibited from increasing any existing tariff or introducing any new tariff on goods originating in the territory of the other party, except where expressly permitted by the FTA.[93] Additionally, certain goods currently receiving duty-free treatment will continue to do so. The FTA also provides for consultations between the parties in order to accelerate the Transition Period for the elimination of tariffs on specified goods.[94]

Approximately 75% of Canada/U.S. bilateral merchandise trade is currently exempt from tariffs. This does not mean, however, that the elimination of the remaining tariffs will have only minimal or marginal effect on U.S. exports to Canada: Trade tends to flow through duty-free holes and the

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85. *Id.* ch. 3.
86. *Id.*
87. *Id.* art. 401, annex 401.2.
88. *Id.* art. 301, para. 1.
89. *Id.* art. 301, para. 2, annex 301.2.
90. *Id.* annex 301.2.
91. *Id.* art. 302.
92. *Id.* art. 401, para. 2, annex 401.2.
93. *Id.* art. 401.
94. *Id.* art. 401, para. 5.

potential benefits of further tariff reductions should not be underestimated. Canadian tariffs are still high in many sectors. Their elimination will encourage an increase in U.S. exports to Canada by small and mid-size manufacturers that may have been reluctant to market outside the U.S. to date.

The FTA, in the Border Measures chapter, also imposes important constraints on the use of non-tariff barriers to trade, including: elimination of customs user fees,[95] elimination of duty drawback[96] (subject to certain exceptions), elimination of waiver of customs duties which are conditioned on fulfillment of performance criteria,[97] and significant advances over the GATT provisions in the areas of minimum export-price and import-price requirements.[98] These are discussed in the context of the energy chapter.[99]

E. Reduction of Barriers to Trade in Services

The FTA establishes the first comprehensive international understanding concerning trade in services between nations.[100] In essence, the FTA provides for the right of "national treatment" for most commercial service industries (with certain exceptions for transportation, basic telecommunications, lawyers, doctors, dentists, child-care and government-provided services). Additionally, separate annexes relating to enhanced telecommunications and computer services, tourism and architectural services are included. Sufficient latitude is provided for the two governments to negotiate additional sectoral annexes.[101]

F. The Energy Provisions of the Free-Trade Agreement: The Implications for Energy Trade[102]

1. Significance of General FTA Provisions for Energy

Because most trade in energy comprises trade in goods, many of the general provisions of the FTA relating to the trade in goods also apply to energy trade. The FTA incorporates the GATT article III rule and related interpretations, requiring that each party shall accord "national treatment" to the goods of the other party.[103] This means treatment no less favorable under laws affecting their sale, distribution or use than accorded to like domestic goods. In the energy area, the "national treatment" rule, which applies to "like, directly competitive or substitutable goods," amounts essentially to a

95. *Id.* art. 403.
96. *Id.* art. 404.
97. *Id.* 405.
98. *Id.* art. 407-409.
99. *Id.* ch. 9.
100. *Id.* ch. 14.
101. *Id.* art. 1405, para. 1(b).
102. The authors are indebted to, and grateful for, the outstanding cooperation and assistance they received with respect to the energy provisions of the FTA from Craig S. Bamberger, Assistant General Counsel for International Affairs, U.S. Dept. of Energy; from Mr. Robert Reinstein, Director, Energy and Natural Resource Trade Policy, Office of the U.S. Trade Representative; and from Mr. Ronald Wall, First Secretary, Canadian Embassy, Washington, D.C. Their readiness to share their fine expertise and insights has greatly assisted the preparation of this article.
103. FTA, *supra* note 7, art. 501, 502.

non-discrimination provision.[104]

In addition to trade in services, two areas where the FTA makes significant free-trade advances over the GATT are financial services[105] and business travel.[106] The financial services chapter is "standalone" and does not, for example, incorporate the article 502 non-discrimination requirement for state or provincial laws.[107] It contains a series of commitments by each party to exempt the bilateral trade in financial services from specific provisions of domestic federal law and regulation but leaves other federal laws, and state and provincial laws, in the financial services area unaffected by the FTA. However, the liberalization achieved, especially as to commercial and investment banking, should assist in financing major, capital intensive energy developments, especially "megaprojects" in Canada. It is not yet clear, with sophisticated financial institutions in both countries, whether the remaining restrictions will present a serious barrier to effective energy investments.

Business travel would be facilitated under the FTA through a series of reciprocal undertakings regarding temporary entry for business purposes. Most of these broaden eligibility for entry under each party's immigration laws and for exemption from labor certification requirements.[108] The positive implications for energy trade are obvious.

Perhaps more significant to energy, than any general free-trade advances the FTA makes in relation to the GATT, is that the FTA does not resolve what may be the most difficult of all the major trade problems—the impact of domestic subsidies on international trade. That impact becomes especially important where the domestic economies of the two countries are closely linked. It may suggest unique approaches where the dimensions of that interlinkage are as great as in the Canada/U.S. relationship.

It is apparent that the negotiators made a strenuous effort to deal with the subsidy issue.[109] Failing that achievement (which would have been remarkable in the negotiating time-frame permitted), the FTA requires the parties to establish a Working Group "to develop more effective rules and disciplines" for government subsidies and a "substitute system of rules for dealing with unfair pricing and government subsidization."[110] The FTA recognizes the close nexus between the problem of government subsidies and the domestic antidumping (AD) and countervailing duty (CVD) laws of each country by dealing with subsidies in the context of those laws.[111] The FTA tasks the

104. *Accord DOE/USTR Memorandum*, *supra* note 78, at 5-6. *See infra* pt. V(*F*)(3).

105. FTA, *supra* note 7, ch. 17. For an analysis of the financial services aspect of the negotiations see Battram & Levitt, *Canada/United States Trade in Financial Services*, 3 J. INT'L BANKING L. 159 (1987).

106. FTA, *supra* note 7, ch. 15.

107. *Id.* art. 1701, para. 1.

108. *Id.* ch. 15.

109. *See infra* pt. VI(B)(2).

110. FTA, *supra* note 7, art. 1907, para. 1(a),(b).

111. *Id.* ch. 19. The true nexus is between government subsidies to exporting producers and countervailing duties imposed by the importing country to offset competitive advantages created by those subsidies vis-a-vis domestic producers. *Accord*, K. Dam, THE GATT, LAW AND INTERNATIONAL ECONOMIC ORGANIZATION at 177-78 (1970). Dam notes that there has been a tendency for antidumping issues to take the lead in developing the legal regime, both international and domestic, for both sets of

Group to develop a new regime for restraining both subsidies and the domestic AD and CVD laws. The Working Group is also to police implementation of the dispute settlement mechanisms under chapter 19. The Working Group's success on these issues in a five to seven year time frame could be critical to the survival of the FTA if the AD or CVD issues are viewed by either party as sufficiently serious to warrant exercising a right of termination of the entire FTA.[112]

Because of the purported prevalence of various types of government subsidies in the major energy sectors of both countries, and because some of these sectors are importing or exporting in increasingly competitive transborder markets, the dispute settlement provisions and the efforts of the Working Group may have special significance for the energy area.

A second area in which the FTA may be more noted for non-coverage than coverage is the role and responsibilities of state enterprises under the FTA. Broad questions of whether and how state enterprises, such as Canadian Crown Corporations or provincial utilities and U.S. municipal utilities or federal power marketing agencies, are subject to the same constraints under the FTA as the governments themselves remain essentially unanswered. The only notable specific constraints on state enterprises are those applying to "monopolies."[113] Each party is to notify the other and provide opportunity for "consultations" when "designating"[114] a state monopoly and to introduce such conditions on its operation "as will minimize and eliminate any nullification or impairment of benefits" under the FTA.[115] Moreover, the designating party is required to ensure, through "regulatory supervision, administrative control . . . or other measures," that the monopoly not discriminate in the monopolized market against persons or goods of the other party or use its monopoly power to engage in anticompetitive practices, through price discrimination or cross-subsidization, in other markets.[116]

Hence, while certain broad antitrust standards are to be applied to a designated monopoly, the FTA does not elaborate how that monopoly's actions will in fact be disciplined by regulatory agencies and governments that currently exercise little authority or practical administrative control over state enterprises, such as those energy enterprises mentioned above. As we will see, the specific constraints imposed on the Bonneville Power Administration may do more to insulate it from these general constraints than to limit its freedom of action.[117] Generally, the lack of guidance in the FTA may prove especially significant in some parts of the energy trade, such as electricity, where state enterprises with broad and largely unconstrained discretion are prevalent. For instance, an assertedly discriminatory denial of transmission access to an

problems, despite their significant differences; and that a clear distinction is not always maintained with the GATT itself. *Id.* at 177-79.

112. *See infra* pt. VI(*B*)(2) concerning dispute settlement mechanisms in AD/CVD cases.

113. FTA, *supra* note 7, art. 2010.

114. "Designate" is defined to mean "establish, designate, or authorize or to expand the scope of a monopoly, franchise. . . ." *Id.* art. 2012.

115. *Id.* art. 2010, para. 2.

116. *Id.* art. 2010, para. 3.

117. See discussion, *infra*, following note 202.

entity of the other country may be difficult to effectively discipline to the standards of article 2010.

It should be noted that the problem of state enterprises is treated similarly in the GATT and, in the opinion of at least one commentator, does not satisfactorily address same major questions.[118]

2. The Scope of the Energy Trade Chapter

Chapter 9 of the FTA establishes the principles applicable to trade in energy goods between the U.S. and Canada. The FTA states that the energy chapter applies to "measures related to energy goods originating in the territories of either party."[119] "Measure" includes "any law, regulation, procedure, requirement or practice."[120] "Originating" means "qualifying under the rules of origin set out in Chapter Three."[121] The territorial coverage of the FTA is defined to apply to the territory of Canada in which its customs laws apply and to those parts of the seabed as to which Canada may exercise rights under current international law.[122] The definition is essentially the same for the U.S., including the District of Columbia and Puerto Rico.

The energy goods covered are defined in terms of the international "harmonized system" of classification set forth in detailed provisions in what are essentially appendices to the FTA. The energy goods referred to include solid fuels (coal, coke, peat, etc.), liquid fuels (including crude oil, refinery products and liquified petroleum gas (LPG)), gaseous fuels (including natural gas, ethane, propane in gas form, coal gas, etc.), electricity and nuclear fuels (uranium in all forms, heavy water, etc.).[123] The inclusion of electricity as a "good" in the FTA is significant in that it removes any uncertainty for FTA purposes as to that status. Such uncertainty may still exist under the GATT; and may emanate from U.S. customs tariff schedules (where electricity is treated as an "intangible") or the views of some in the industry that electricity is an integrated service rather than a good. The status of electricity as a good under U.S. AD or CVD laws is also uncertain, even in an FTA-governed Canada/ U.S. trade regime.[124]

The FTA itself, however, is comprehensive in coverage as to all significant existing forms of energy trade between the two countries.

118. *See generally* Dam, *supra* note 111, at 316-22.

119. FTA, *supra* note 7, art. 901.

120. *Id.* art. 201.

121. *Id.*

122. *Id.* Under the Law of the Seas Convention of 1982 (which Canada has signed and whose territorial provisions the U.S. recognizes as customary international law), nations may exploit the resources of the seabed within an "economic zone" that extends to the further of 200 miles from the shoreline or to a certain distance from the shoreline on that nation's continental shelf, determined by a combination of geological factors. THIRD U.N. CONVENTION ON THE LAW OF THE SEA, U.N. Sales No. E. 83. V.5 (1982).

123. Statement of Administrative Action to accompany the U.S. implementing legislation for the FTA, pursuant to § 102 of the Trade Act of 1974, at 48 [hereinafter Statement of Administrative Action].

124. The domestic antidumping and countervailing duty laws of each country, including their definitions, are left intact by the FTA. FTA, *supra* note 7, art. 1902, para. 1.

3. Import and Export Restrictions

Article 902 contains some of the core provisions of the energy chapter. It essentially affirms for the bilateral energy trade in goods the terms of the GATT with respect to "prohibitions or restrictions on bilateral trade in energy goods."[125] Hence, the principal substantive obligations of the GATT are brought very centrally into the covenants of energy trade between the two countries. Without elaborating in detail, these substantive provisions can be grouped into four types:

(1) tariff commitments;
(2) "most favored nation" treatment with respect to border measures;
(3) "national treatment" for internal measures; and
(4) a series of commitments regarding other non-tariff barriers, including prohibitions against quantitative import and export restrictions or the imposition of protective taxes.[126]

These basic provisions of the GATT theoretically already cover international trade in energy goods between the two countries, and would be incorporated under the general trade-in-goods provisions of the FTA. However, the fact that they are specifically emphasized in the energy chapter underscores the seriousness of the two governments that the bilateral energy trade should hereafter be governed by a GATT-type regime, with some modifications. Moreover, the FTA gives a broad definition to the word "restriction" as "any limitation, whether made effective through quotas, licenses, permits, minimum price requirements or any other means."[127] It is clear that the drafters were sensitive to the many complex and not necessarily obvious contexts of industry practice and its regulation within which potential GATT violations might arise.

Of the four types of GATT substantive obligations identified, that relating to tariff commitments is essentially subsumed in and advanced by the phased elimination of tariffs under the FTA.[128] The GATT obligation to provide general "most favored nation" treatment[129] may also, in the context of the Canada/U.S. energy relationship, be largely academic should the FTA become effective. This is because it would be improbable that either party will be concluding trade arrangements with other countries "more favorable" than

125. *Id.* art. 902, para. 1.

126. *DOE/USTR Memorandum*, *supra* note 78, at 5.

127. FTA, *supra* note 7, art. 909.

128. *Id.* art. 410.

129. GATT, *supra* note 1. The GATT provides that:

> With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports and exports, and with, respect to the method of levying such duties and charges, and . . . all rules and formalities in connection with importation and exportation . . . any advantage, favor, 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.

In essence, this provision provides that there shall be like treatment for like products in the import and export rules between all the contracting parties of the GATT.

those contained in the FTA. Nevertheless, a clear confirmation of the GATT's obligations covers the potential for tariff commitments that the FTA may not specifically address, or for favorable trade relationships with other nations that the FTA may not achieve.

As indicated, "national treatment" in the energy context essentially means that each country's domestic energy laws and regulations should not discriminate between domestic and foreign energy goods on the basis of nationality.[130] Hence, imports should be accorded treatment no less favorable than like domestic products with respect to all laws or regulations relating to their sale, distribution or use. The most obvious practice proscribed by the "national treatment" provision is that of creating requirements that a specified portion of a product be supplied from domestic resources, a provision of most relevance to the manufacturing sector but potentially applicable to domestic natural gas or electricity needs. Other examples more pertinent to the energy area might include discriminatory internal taxes or requirements that no foreign coal or oil be marketed to domestic buyers.[131]

There is no special guidance in the FTA on the meaning of "national treatment" in the energy context or as to what discrimination means. However, the intent of the parties is that energy goods from one country should be able to compete in the other's markets without facing regulatory barriers that discriminate on the basis of national origin.[132] That, of course, does not impose a responsibility on the FERC or the NEB to assure the competitive success of the imported goods in the domestic market.[133] The essence is to create a "level playing field" for competition. The U.S. government apparently views both of FERC's major actions in the natural gas area that most affect Canadian imports, Order 500[134] (which restructures major elements of the FERC's natural gas regulation), and Opinion 256[135] (the "as billed" decision), as consistent with the FTA because neither discriminates on the basis of nationality.[136] Hence, in the U.S. view, the FTA does not require the FERC to change either action.[137] "Nor does the FTA 'lock-in' either action in its current form" or prevent the FERC from revising them.[138]

In practice the "national treatment" obligation is likely to be applied in the same vein as discrimination in the domestic regulatory context.[139] For instance, different prices for like products that are based on legitimate differences in transportation costs would probably not amount to discrimination.[140]

130. Statement of Administrative Action, *supra* note 123, at 48.

131. Statement of Administrative Action, *supra* note 123, at 49.

132. *Id.*

133. *Id.*

134. Order No. 500, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, III F.E.R.C. Stats. & Regs. ¶ 30,761, 52 Fed. Reg. 30,334 (1987) (to be codified at 18 C.F.R. pts. 2, 284).

135. Opinion No. 256, *Natural Gas Pipeline Co. of America*, 37 F.E.R.C. ¶ 61,215 (1986).

136. Statement of Administrative Action, *supra* note 123, at 56.

137. *Id.* That view is apparently shared by Canada.

138. *Id.*

139. For instance, the no "undue discrimination" standards developed under the FPA and NGA will likely be invoked as yardsticks for what is discrimination in the "national treatment" context.

140. *DOE/USTR Memorandum*, *supra* note 78, at 5-6.

However, precedent developed in interpreting and implementing the GATT will also be important.

The "national treatment" obligation, it should be noted, is limited by the specific exemptions for government procurement and subsidies under the FTA and by other applicable general exceptions under the GATT and the FTA, such as health and safety.

Of special importance to the energy area, particularly in those industries subject to comprehensive state or provincial regulation, is article 502 of the FTA. It applies the "national treatment" standard at the state/provincial level by providing that states and provinces shall accord imports from the other country "treatment no less favorable than the most favorable treatment accorded by such province or state to any like, directly competitive or substitutable goods" of the importing country.[141] The requirement of *most* favorable treatment means that the state or province cannot discriminate in favor of its own goods over the goods of the other country, even if it does so discriminate against goods of other states or provinces.

Of course, in the U.S., the potential for interstate discrimination is greatly constrained by the commerce clause of the Constitution. However, the FTA makes clear that any existing potential for interstate or interprovincial discrimination, likely a very fact-specific issue, may not be used to limit trade between the two countries. This constraint is not viewed as limiting states or provinces from taking into account, "in a non-discriminatory manner," the "greater reliability of proximately located natural gas or electricity supplies" where transportation systems "may limit potential deliverability from more distant sources."[142]

As to the non-tariff barriers covered by the GATT, and the incorporation of the GATT rights and obligations with respect to these into the FTA, article 902 makes clear that both minimum export-price and minimum import-price requirements are covered in the same fashion as other non-tariff barriers covered by the GATT. The only exception occurs where minimum import-price requirements are imposed in enforcement of AD and CVD orders and undertakings under the domestic laws of each country. Although both parties view article XI of the GATT as currently prohibiting in general terms minimum export-price requirements, they felt it important specifically to confirm this interpretation in the FTA.[143] The important extension of the GATT coverage in article 902 is to apply the same principle to minimum *import* pricing. Paragraph 2 of article 902 refers to circumstances in which other forms of quantitative restrictions may be allowed, such as those required for balance of payment reasons.[144]

4. "Third Party" and Multilateral Restrictions

Paragraphs 3 and 4 of article 902 make clear that the rights and obliga-

141. FTA, *supra* note 7, art. 502.

142. Statement of Administrative Action, *supra* note 123, at 56.

143. *DOE/USTR Memorandum, supra* note 78, at 6.

144. *Id.*; *see, e.g.*, FTA, *supra* note 7, at 2002; *see generally* GATT, *supra* note 1, art. VII.

tions generally applicable to import and export restrictions are directed at restrictions on direct energy trade between the two parties, and do not limit the ability of the signatories to impose restrictions on importation from or exportation to a third country. Hence, goods which do not originate in the exporting signatory (subject to the rules of origin in article 301), but which are imported from a third country, do not receive the protection of the FTA. Hence, the U.S. could implement current prohibitions against the importation of Libyan or Iranian crude oil or South African uranium transhipped through Canada.[145] Only if the import was "substantially transformed in Canada" into a refined product would it qualify as being of Canadian origin and be subject to the FTA.[146] The special significance of this provision is that it would permit the U.S. to enforce import restrictions against third countries, possibly including imposition of an oil import fee, without violating the FTA as such.[147]

The FTA also permits the enforcement of export restrictions against third countries by requiring that the goods exported be consumed within the territory of the other party.[148] "Consumed" is defined to mean either "transform so as to qualify under the rules of origin" to become a good originating in the importing country, or to be "actually consumed" in the importing country (e.g., by a combustion engine).[149] Hence, transformation of crude oil into gasoline would be viewed as consumption. This seemingly far-reaching right to impose export restrictions on third countries by imposing a domestic consumption requirement on the importing party to the FTA, in fact, reflects the current reality with respect to U.S. exports of crude oil to Canada.[150] However, such means of enforcing export restrictions are certainly not required, nor apparently encouraged by the parties.[151]

While the FTA preserves the ability to enforce the import and export restrictions on third countries in cases of transhipment through the other party,[152] the FTA realistically recognizes the potential of such restrictions for affecting the domestic markets of the two countries and their interrelationship.[153] The most obvious scenario would be the U.S. imposition of an oil import fee applicable to third countries without Canada adopting a similar restriction. The FTA would require an exemption for Canada from such a fee. However, the proximity of the U.S. market may draw increased quantities of Canadian crude and refined product into the U.S. market because of the impact an oil import fee would have upon the general price level of oil and oil products in the U.S. The increased relative profitability of the U.S. market might draw increased Canadian imports, might force Canadian prices up, and

145. *DOE/USTR Memorandum, supra* note 78, at 7.

146. *Id.*

147. Such restrictions or fees might, however, be constrained by the obligations of the GATT.

148. FTA, *supra* note 7, art. 902, para. 3(b).

149. *Id.* art. 909.

150. *DOE/USTR Memorandum, supra* note 78, at 7-8; *see* Exports of Crude Oil to Canada for Consumption or Use Therein, 50 Fed. Reg. 26,145 (1985).

151. *See DOE/USTR Memorandum, supra* note 78, at 8.

152. FTA, *supra* note 7, art. 902, para. 3.

153. *Id.* art. 902, para. 4.

might create some of the same competitive pressure on U.S. suppliers that the oil import fee was intended to mitigate.[154]

The FTA provides no specific mechanism to deal with such a problem, but simply requires that the two countries shall "upon request of either Party . . . consult with a view to avoiding undue interference with or distortion of pricing, marketing and distribution arrangements in the other Party."[155] This provision therefore embodies a clear recognition, perhaps unique in the FTA, of the complex interrelationship between international trade measures and domestic markets. However, because of that very complexity and the inability to predict the nature and dimensions of such distortions, or even how they might arise, the negotiators were not able to identify mutually acceptable mechanisms to deal with the problem. Rather, they deferred resolution to future ad hoc negotiations.[156] How effective this general obligation to consult will be may depend very much on timing, i.e., how rapidly market distortions develop and how quickly the consultative process is invoked to meet the problem. The need for expedited resolution was apparently recognized in the negotiations.[157] The U.S. government, for instance, hopes to resolve the problem in thirty days.[158] Failing such resolution, unilateral actions could be taken "to avoid distortions and protect and enhance competition" or the formal dispute resolution mechanisms[159] could be used.[160]

While most current "third-party" or multilateral energy trade restrictions comprise U.S. measures to serve both broader foreign-policy purposes, through country-specific embargoes on oil and uranium imports, and perceived energy security goals by continuing to restrict exports of crude oil, the provisions of paragraphs 3 and 4 of article 902 could potentially apply in a wide variety of situations. However, because so much of Canada's energy exports are to the U.S., and because few of its energy imports from the U.S. are subject to volatile world markets, the U.S. government is more likely to rely on the provisions of article 902, paragraph 3 than is the Canadian government.

In the course of the negotiations, three specific restrictions currently in force, one imposed by Canada and two by the U.S., were identified as problems and singled out for special curative treatment designed to conform them in full or in part with the obligations of the energy chapter.[161] Briefly, the three special provisions are:

(1) The U.S. is required to exempt Canada from any restriction on the enrichment of foreign uranium under section 161v of the Atomic Energy Act.[162] The proviso to section 161v requires the DOE, as successor to the Atomic Energy Commission, to restrict its enrichment of uranium of "foreign

154. *See DOE/USTR Memorandum, supra* note 78, at 8.
155. FTA, *supra* note 7, art. 902, para. 4.
156. *See DOE/USTR Memorandum, supra* note 78, at 8-9.
157. *Id.* at 9.
158. Statement of Administrative Action, *supra* note 123, at 54-55.
159. FTA, *supra* note 7, ch. 18.
160. Statement of Administrative Action, *supra* note 123, at 54-55.
161. FTA, *supra* note 7, annex 902.5.
162. 42 U.S.C. § 2201(v) (1982).

origin" to the extent necessary to assure the maintenance of a "viable domestic uranium industry."[163] The issue may be moot in light of a recent U.S. Supreme Court decision[164] upholding the DOE's determination not to impose any restriction on the enrichment of foreign uranium so long as that restriction cannot attain the statutory goal of maintaining a viable, domestic uranium industry.[165] The DOE's determination, based essentially on a finding that the restriction would not aid the domestic industry,[166] doomed by foreign competition in any case, was successfully contested by the industry in the lower federal courts but the U.S. Supreme Court reversed. The FTA essentially requires that the U.S. amend section 161v to assure that it would not be applied to uranium mines in Canada, regardless of restrictions the DOE determines are necessary to protect the U.S. industry.[167]

(2) Canada is required to exempt the U.S. from the Canadian Uranium Upgrading Policy as announced by the Minister of State for Mines on October 18, 1985. This policy essentially requires that Canadian uranium exports be upgraded to the maximum extent possible prior to export, thus favoring the sole Canadian converter of uranium oxide to uranium hexafluoride over two competing U.S. converters.[168] Implementation of this provision would resolve the currently pending GATT case between the U.S. and Canada on that issue.[169]

(3) Canada is to be given a partial exemption from the U.S. prohibition on the exportation of Alaskan oil imposed by section 7(d) of the Export Administration Act of 1979.[170] Under the FTA, up to 50,000 barrels per day, on an annual average basis, may be exported from Alaska to Canada, subject to the condition that the oil must be transported to Canada from "a suitable location within the lower 48 states."[171] This condition triggers the "Jones Act" requirement that U.S.-flagged vessels, to be used in all U.S. coastwise trade, must be used in this export trade.[172] From Canada's perspective, the concession may be chiefly a matter of principle in light of the glaring contrast between the longstanding U.S. prohibition on exportation of Alaskan crude and the absence of any comparable Canadian restriction.

163. *Id.*

164. Huffman v. Western Nuclear, Inc., 108 S. Ct. 2087 (1988).

165. *Id.* at 2093.

166. *See* 10 C.F.R. § 762 (1988).

167. The term "[s]ource or special nuclear material originating in Canada" is interpreted by the U.S. to include only uranium mined in Canada. Statement of Administrative Action, *supra* note 123, at 53.

168. *See DOE/USTR Memorandum, supra* note 78, at 10-11.

169. *Id.* The case was filed by the U.S. on November 1986 and has been the subject of consultation between the two governments under article XXIII(l) of the GATT.

170. 50 U.S.C. § 2406(d) (1982).

171. FTA, *supra* note 7, annex 902.5(3).

172. 46 U.S.C. § 883 (1982). Apparently, the condition was acceptable to the Canadian government because of a present lack of capability in Vancouver to directly handle the oil shipments. *See DOE/USTR Memorandum, supra* note 78, at 11. Implementation of this provision will require the Dept. of Commerce to amend its Export Administration Regulations, 15 C.F.R. § 377.6 (1988), and a "national interest" finding by the President similar to that made in the case of other, discrete, oil-export authorizations. *See* Statement of Administrative Action, *supra* note 123, at 51-52.

5. Export Taxes

The FTA provides: "Neither Party shall maintain or introduce any tax, duty, or charge on the export of any energy good to the territory of the other Party, unless such tax, duty, or charge is also maintained or introduced on such energy good when destined for domestic consumption."[173]

This provision prohibits export taxes, i.e., taxes on energy goods which are exported but not consumed domestically. This type of prohibition is not contained in the GATT; thus, this provision, specifically directed at the history of the Canada/U.S. energy trade relationship, represents a significant addition to the GATT. One of the more controversial forms of restrictions imposed in the 1970s by Canada was export taxes on crude oil exports to the U.S., which had an effect on the importer equivalent to minimum export-price requirements. Both measures, in fact, were part of the array of Canadian crude oil export restrictions to which the U.S. objected and which led to considerable tension in their energy relationship. This provision of the FTA is, in effect, a unilateral concession from Canada because the U.S. Constitution prohibits the U.S. government from imposing export taxes.[174]

6. Domestic Supply Shortfalls: The FTA Limitations on the GATT Exceptions

Article XX of the GATT contains a wide range of general exceptions to the rights and obligations contained in the GATT relating to subjects as diverse as "public morals," "life or health," and the gold and silver trade. These general exceptions are replicated by or expanded upon in the FTA in recognition that the governments "must retain some freedom . . . to protect their legitimate national interests."[175]

The energy chapter of the FTA departs from this approach in two critical respects. First, it curtails more severely than does the GATT the circumstances in which the domestic supply shortfall situations encompassed in the GATT exceptions will justify restrictions otherwise not permitted by the FTA.[176] Second, it considerably narrows the "national security" exception of article XXI of the GATT.[177]

What we have broadly characterized as the GATT "domestic supply shortfall" exceptions in fact comprise three of the GATT general exceptions and one exception to the elimination of quantitative restrictions.[178] These GATT exceptions cover a variety of situations, all loosely related to concerns over potential supply shortfalls in the short or long term. They permit otherwise proscribed (1) restrictions to conserve "exhaustible natural resources . . . in conjunction with restrictions on domestic production or consumption;"[179] (2) "restrictions on exports of domestic materials," held below world prices by

173. FTA, *supra* note 7, art. 903.
174. U.S. Const. art. I, § 9, cl. 5.
175. FTA, *supra* note 7, ch. 12.
176. *Id.* art. 904.
177. *Id.* art. 907.
178. GATT, *supra* note 1, art. XI.
179. *Id.* art. XX(g).

government action, in order to assure their availability for a domestic processing industry (if not used to increase the exports of or to protect that industry);[180] (3) restrictions on acquiring or distributing products "in general or local short supply," as long as the GATT parties are not denied "an equitable share of the international supply;"[181] and (4) temporary restrictions "to prevent or relieve critical shortages of foodstuffs *or other products essential* to the exporting" country.[182]

While article XX of the GATT does require that the general exceptions not be applied "in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries . . . or a disguised restriction on international trade," the breadth and generality of the GATT exceptions were viewed as too permissive for the purposes of the FTA.[183] The overall effect of article 904 is to greatly narrow the GATT exceptions by requiring that they may be exercised with respect to the export of an energy good to the other party only if three specific conditions are met. These conditions will apply wherever the domestic supply shortfall GATT exceptions are invoked to restrain energy exports in a manner that would otherwise be inconsistent with the FTA. Typically, this might occur where there is a situation of short supply in the exporting country, a domestic price control program in effect, or some perceived longer-term threat of the exhaustion of a finite natural resource. All three influences played a major role in how the energy policies of the 1970s and early 1980s, especially those of Canada, affected the energy trade relationship.

Article 904 of the FTA specifies that any restrictions exercised pursuant to the four GATT exceptions may not:

(a) Reduce the proportion of the good exported to the other party relative to the total supply of the exporting party, using the proportion prevailing in the most recent 36-month period for which data are available (or any other representative period agreed by the parties). In other words, if there is to be a reduction of supply, it must be shared in the same recent historic proportion by both the domestic and export markets.

(b) Impose a higher price for exports of an energy good than the price of comparable domestic sales, however the higher price is achieved (*e.g.*, through licenses, fees, taxation or minimum price requirements). However, a market-induced higher price resulting from an overall proportional restriction of supply permitted under 904(a) is not prohibited.

(c) ". . . require the disruption of normal channels of supply of or normal proportions among specific energy goods supplied to the other Party." Article 904(c) identifies specific examples of such "proportions"—between crude oil and refined products, or among different categories of crude oil and of refined

180. *Id.* art. XX(I)(i).
181. *Id.* art. XX(II)(a).
182. *Id.* art. XI(2)(a) (emphasis added).
183. *DOE/USTR Memorandum, supra* note 78, at 14.

products.[184]

These constraints upon the ability to use the GATT exceptions or restrictions that so pervaded the export policies of the two countries, in particular those of Canada, in the 1970s and the early 1980s must be viewed as a major achievement of the FTA. While most of those policies have been eliminated or ameliorated under the relatively free-trade philosophies of the Mulroney Government and the Reagan Administration in the mid-1980s, the importance of article 904 is that it will make a return to those policies a violation of the FTA unless they fall within the relatively narrow confines of the three conditions. In addition to the terms of article 904, the U.S. and Canadian energy negotiators informally agreed that, upon the request of either party, implementing provisions would be negotiated for the article 904(a) limitation on reducing exports in a manner not proportional to reductions in domestic supply.[185] Although no official commitment was made, the parties agreed, upon request, to establish more detailed procedures and criteria for applying this condition to particular goods.[186]

7. Article 907 Limitations on the GATT "National Security" Exception

Article XXI of the GATT, entitled "Security Exceptions," and article 2003 of the FTA, entitled "National Security," provide in essentially similar terms for a broad "national security" exception to the obligations of these agreements. They permit otherwise proscribed trade restrictions in a variety of situations "necessary for the protection of essential security interests," such as those relating to arms or to "other goods and materials . . . directly or indirectly for the purpose of supplying a military establishment," to prevent nuclear nonproliferation, or taken "in time of war or other emergency in international relations."[187]

In the energy area in particular, the GATT exceptions have long been viewed as a major escape mechanism or loop-hole from the requirements of the GATT. For instance, the U.S. cited the GATT national security exception as justification for the imposition of oil import quotas from 1959 until 1973 and of oil import fees from 1973 until 1979. These impositions were objected to by the Canadian government, although not officially challenged within the GATT process.[188] In light of this history, the energy negotiators were not prepared to let the general carryover of the GATT national security exception into the FTA be applied without modification to chapter 9. Accordingly, article 907 adopts an approach of limiting the applicability of general GATT exceptions similar to that of article 904. It limits the exercise of the "national security" exception in the energy area to four specified circumstances:

Neither Party shall maintain or introduce a measure restricting imports of an

184. FTA, *supra* note 7, art. 904.
185. *DOE/USTR Memorandum*, *supra* note 78, at 15.
186. *Id.*
187. FTA, *supra* note 7, art. 2003(b).
188. *See DOE/USTR Memorandum*, *supra* note 78, at 24.

energy good from, or exports of an energy good to, the other Party under article XXI of the GATT or under article 2003 (National Security) of this Agreement, except to the extent necessary to:

(a) supply a military establishment of a Party or enable fulfillment of a critical defense contract of a Party;
(b) respond to a situation of armed conflict involving the Party taking the measure;
(c) implement national policies or international agreements relating to the non-proliferation of nuclear weapons or other nuclear explosive devices; or
(d) respond to direct threats of disruption in the supply of nuclear materials for defense purposes.[189]

Outside the nuclear non-proliferation and nuclear materials area, then, the national security exception is confined to the actual provision of services to military establishments or to fulfill a "critical defense contract," and to situations of actual armed conflict. These limitations, particularly given the replication of the broad GATT exception in article 2003, may be viewed as another major achievement of the FTA in stabilizing the long-term energy trade relationship between the two countries. They should play a significant role in achieving the major objectives of the two countries in entering into the energy portion of the FTA, namely to assure Canada continued access to the U.S. markets and to assure the U.S. continued access to Canadian energy supplies, irrespective of domestic or world market conditions in either case.

Specifically, article 907 would seem effectively to preclude the application of future U.S. oil import fees or quotas to Canadian imports of crude oil or refined products or the more remote possibility of similar restrictions on natural gas and electricity imports. Combined with the limitations in article 904, article 907 gives the U.S. far greater assurance of security of supply from Canada, even in times of tight markets. If effective, these limitations will greatly constrain future exercises of domestic energy policy that affect the bilateral energy trade in periods of perceived energy crisis, such as the 1970s, and they will greatly narrow the ability of either country to use the "national security" exception as a thinly veiled cover for protectionism in the energy area.

8. Preserving the Status Quo

There are two discrete provisions of chapter 9 which are essentially designed to preserve the status quo in two quite different respects:

a. Government Incentives for Energy Resources Development

Although the FTA does not centrally deal with the issue of subsidies and does not require either country to eliminate incentives, such as those to be provided for new oil and gas exploration and development, the energy negotiators decided to make this ability explicit in article 906. "Both parties have agreed to allow existing or future incentives for oil and gas exploration, development and related activities in order to maintain the reserve base for these energy resources."[190]

189. FTA, *supra* note 7, art. 907.
190. *Id.* art. 906.

The probable reason for the specific identification of an ability already present in the FTA is that article 906 was drafted at a time when the two countries were still actively negotiating the possibility of disciplining their respective subsidy regimes. No agreement was reached on subsidies, although, as noted, article 1907 requires that the parties establish a working group to "develop more effective rules and disciplines concerning the use of government subsidies" and to "develop a substitute system of rules for dealing with unfair pricing in government subsidization."[191] In other words, the subsidy issue is yet to be negotiated. Hence, article 906, which was initially drafted as a specific exception for oil and gas energy and development to a potential FTA regime that constrained government subsidies, has become essentially a statement of policy by the two governments that they continue to support incentives for energy and development as important to enhance future energy supplies and security. It should also serve as a reminder to the working group that any future regime designed to restrict subsidies should not cover this area of enterprise.[192] However, this exclusion does not limit the availability of domestic countervailing duty and antidumping laws, which are explicitly preserved in article 1902.

b. International Allocation Requirements

Article 908 is a general savings provision which states that no "unavoidable" inconsistency is intended between the provisions of chapter 9, in particular the proportionality requirements for constraining supply in article 904, and the requirements of the agreement on an International Energy Program (IEP) administered by the International Energy Agency.[193] The IEP provides for oil sharing among the participants, including the U.S. and Canada, during emergencies in accordance with a prescribed formula.[194] While the energy officials of the two parties have not identified any consistency in advance,[195] should one occur, the provisions of the IEP would take precedence under article 908. Use of the adjective "unavoidable" would, however, appear to imply an obligation of the parties at least to manage national policies during an IEP oil sharing so as to avoid conflicts with the FTA. Article 908 is a departure from the general rule for the FTA that its provisions prevail over those of inconsistent provisions in other agreements.[196]

191. *Id.* art. 907.

192. *See DOE/USTR Memorandum*, *supra* note 78, at 23; Statement of Administrative Action, *supra* note 123, at 50.

193. Agreement on an International Energy Program, T.I.A.S. No. 8278.

194. *Id.*

195. *See DOE/USTR Memorandum*, *supra* note 78, at 26.

196. FTA, *supra* note 7, art. 104, para. 2.

9. Changes to the Status Quo: Correcting Existing Domestic Regulatory Inconsistencies

The principal focus of article 905 is to provide for a consultative mechanism for addressing future disputes over alleged inconsistences between domestic regulatory actions and the provisions of the FTA.[197] However, annex 905.2 to the FTA identifies three areas where existing domestic legislation or regulation was perceived by the negotiators to create inconsistencies with the FTA and where some action would be taken to correct or mitigate these inconsistencies:

(1) Canada has agreed to eliminate the "least cost alternative" pricing test currently required for a license to export electricity. The test requires that the export price "would not result in prices in the country to which the power is exported being materially less than the least cost alternative for power and energy at the same location within that country. . . ."[198] The U.S. has requested that this test be eliminated because, U.S. negotiators asserted, it provided unfair leverage to Canadian utilities in negotiating export contracts that might result in higher export prices than would be negotiated at arms length in a market free of government intervention.[199] This concession by Canada would eliminate one of the three major pricing tests for electricity imports. The other two pricing tests, namely that the exporter "recover its appropriate share of costs incurred in Canada," and that the export price "not be less than the price to Canadians for equivalent service in related areas"[200] are retained. However, they might be challenged if they were applied in a manner inconsistent with the FTA, for example, if they amounted to a minimum export-price requirement in violation of article 902, paragraph 2[201] as might any domestic or import/export regulation. The U.S. goal in negotiating the annex, and reserving this general right as to other price tests, was to preserve an ability to deal with price discrimination by Canadian suppliers, without defining price discrimination in advance.[202]

(2) Annex 905.2 contains a modest effort to resolve the longstanding dispute over the ability of British Columbia Hydro (BC Hydro) to use the transmission system and transmission interties of the Bonneville Power Administrative (BPA) to reach the California markets. The only major substantive requirement imposed upon BPA is that it modify its policy for access to the pacific Northwest-California Intertie (the Pacific Intertie) "so as to afford British Columbia Hydro treatment no less favorable than the most favorable treatment afforded to utilities located outside the Pacific Northwest."[203] Essentially, this provision would remove preferential access to transmission and intertie capacity for utilities outside the Pacific Northwest over BC Hydro power. However, it would not affect the far more significant pref-

197. *See infra* p. 374, pt. VI(*B*)(2).
198. NEB, pt. VI Regulations, ¶ 6(2)(z).
199. *DOE/USTR Memorandum*, *supra* note 78, at 19-20.
200. NEB, pt. VI Regulations, ¶ 6(2)(z).
201. Statement of Administrative Action, *supra* note 123, at 50.
202. *DOE/USTR Memorandum*, *supra* note 78, at 22.
203. FTA, *supra* note 7, annex 905.2.

erence to the Pacific Intertie for Pacific Northwest utilities. In effect, then, annex 905.2 requires nondiscriminatory treatment for BC Hydro only vis-a-vis non-Pacific Northwest entities. It does not adopt the article 502 approach of assuring the most favorable treatment offered to any national that is required of states and provinces. The issue of the Intertie Access Policy, and its effect on BC Hydro's ability to reach the California markets, has a complex history and is unique in nature.[204] We will not explore it here.

Annex 905.2 also contains a hortatory admonition to BPA and BC Hydro to "continue to negotiate mutually beneficial arrangements consistent with the . . . Agreement"[205] and, to that end, to seek any necessary statutory and regulatory changes independently of the FTA. There is no explicit obligation to negotiate or to create a new negotiating forum. Given BPA's views of its statutory mandates, the provision may constitute little more than wishful thinking over new negotiations to broaden BC Hydro's access to the California markets unless there is a dramatic change in the electricity situation in the Pacific Northwest.

(3) While facially consistent with the FTA, considerable concern has been expressed, particularly from the U.S., with regard to "surplus tests" for the export of energy goods to the other party,[206] meaning tests that would require that the export be surplus to domestic needs.[207] Unduly restrictive application of such tests by governments or regulatory agencies might unduly limit exports that might otherwise take place in a market free of intervention. A more pointed concern, which raises questions of "energy security," is whether these tests might be used as a basis for government intervention in long-term export arrangements which are likely to be particularly prevalent in electricity and, to a lesser extent, natural gas trade. For instance, if sudden changes in Canadian domestic demand created a Canadian domestic supply shortfall, a major U.S. concern would be whether previously concluded long-term export arrangements would be interdicted to make up that shortfall.

Annex 905.2 really does no more than apply a general principle, pervasive throughout the FTA, that any domestic or import/export regulation, however facially consistent with the FTA, may not be *applied or implemented* in a manner inconsistent with the FTA.[208] The point of the specific mention of "surplus tests" is presumably to highlight their perceivedly higher potential for "inconsistent" implementation and the perceived damage such implementation might do to the stability of long-term energy trade arrangements and their financing.

The fact that only three specific areas of existing law relating to energy were singled out in annex 905.2 apparently means, at least in the view of the U.S. government, that "further changes to existing federal energy laws and

204. *See, e.g., DOE/USTR Memorandum, supra* note 78, at 21.

205. FTA, *supra* note 7, annex 905.2.

206. *DOE/USTR Memoradum, supra* note 78, at 22.

207. See pt. IV, *supra*, for a description of the NEB's "surplus tests." Several Canadian provincial utilities have requirements that electricity exports must be surplus to the province's needs.

208. *DOE/USTR Memorandum, supra* note 78, at 22.

regulations" are not contemplated.[209] For instance, the U.S. government appears to believe that the FTA requires no changes, at least initially, in the basic federal laws regulating natural gas or electricity, such as the FPA,[210] NGA[211] and the major statutory additions to the regulatory scheme in the Natural Gas Policy Act of 1978 (NGPA).[212] Several reasons are cited:

(a) None of these laws requires a U.S. regulatory authority to discriminate on the basis of national origin;

(b) the basic standards that govern regulatory action under these statutes, such as "public interest" (which also governs issuance of presidential permits for transborder facilities) and "just and reasonable," can be implemented consistently with FTA principles; and

(c) the NGPA "embodies a basic policy of relying on free market forces and increased competition" to determine production, consumption and price, and the FTA "reinforces and expands that reliance and increases that competition."[213]

Presumably, the parties believe they have identified and addressed, at least on first examination, all facial inconsistencies in existing federal laws and regulations and are prepared to rely on the assurances of the other party that it can carry out its FTA obligations without further large changes. However, this does not immunize these laws and, of course, new laws, from further scrutiny or redress under the FTA if compliance is not, in fact, achieved. The status of state and provincial laws is less clear; presumably their subsequently discovered facial inconsistency with the FTA would require action under the constitutional processes of the pertinent country to bring them into conformity with the FTA. Moreover, implementation of any law, federal or state/provincial, in a manner inconsistent with the FTA, would create obligations to take corrective action.[214]

VI. SPECIFIC GENERIC PROVISIONS OF THE AGREEMENT CRITICAL TO ENERGY TRADE

A. *Investment*

1. Introduction[215]

The FTA contains significant provisions relating to foreign direct investment (FDI) for both countries[216] premised on a basic underlying principle: Canada and the U.S. will treat each other's investments and investors as they treat their own with respect to matters contained in the FTA. Canada and the

209. Statement of Administrative Action, *supra* note 123, at 51.

210. FPA, 16 U.S.C. §§ 791a-825u (1982).

211. NGA, 15 U.S.C. §§ 717-717w (1982).

212. NGPA, 15 U.S.C. §§ 3341-3348 (1982).

213. Statement of Administrative Action, *supra* note 123, at 55.

214. *DOE/USTR Memorandum, supra* note 78, at 22.

215. For a comprehensive analysis, see S. BATTRAM & J. KENNISH, *Investment Implications of the Canada/United States Free Trade Agreement* in THE CANADA/U.S. FREE TRADE AGREEMENT: THE IMPACT ON SERVICE INDUSTRIES 145 (E.H. Fry & L.H. Radebaugh 1988).

216. FTA, *supra* note 7, ch. 16.

U.S. are significant investment partners of each other. Canada is the fourth largest investor in the U.S.,[217] and the U.S. is the largest in Canada.[218]

While historically Canada has been an extremely hospitable country for American direct investment, its government has appeared indecisive on whether further FDI, and in particular American investment, should be encouraged. That ambivalence has been especially evident in several major energy sectors, such as crude oil and natural gas production.[219]

2. Background

The Foreign Investment Review Act[220] (FIRA) came about largely as a result of the analysis contained in a 1972 Canadian federal government report (the Gray Report)[221] which purported to address the problem of FDI in Canada. The Gray Report found that nearly 60% of the manufacturing in Canada was foreign controlled, with approximately 80% of that foreign control resting with U.S. ownership. In certain industries, such as petroleum, rubber products, and publishing, the Gray Report found that foreign control exceeded 90%. The stated purpose of the FIRA, in its preamble, was "to provide for the review and assessment of acquisition of control of Canadian business enterprises by certain persons and of the establishment of new businesses in Canada by certain persons."

In 1985, the FIRA was replaced by the Investment Canada Act (ICA).[222] The ICA, however, has a substantially different thrust from the FIRA. The changes brought about in the investment review regime by the ICA were an indication of the Mulroney Government's desire to reduce impediments to FDI in Canada. Despite its replacement by the ICA, the FIRA left a regulatory legacy in Canada not to be ignored. While under the ICA,[223] procedures for investment review were simplified, company size thresholds for acquisition review increased, and the burden of proof for justifying a covered transaction shifted from the foreign investor to the government, a bureaucratic screening mechanism remained in place, utilizing a "net benefit to Canada" test for all covered transactions. Again, that bureaucratic screening was particularly evident in the energy area. Additionally, a special focus remained on foreign investment in sensitive areas considered important to Canada's "cultural heritage" or "national identity." These included the cultural industries, government procurement, oil and gas production, uranium mining, communications and transportation.

217. Information from U.S. Dept. of Commerce (1987).

218. Information from Statistics Canada (1987).

219. See *infra* pt. IV(*B*)(4).

220. Foreign Investment Review Act, ch. 46, 1973-1974 Can. Stat. 619, *amended by* ch. 52, 1976-1977 Can. Stat. 1193 and ch. 107, 1980-1981-1982 Can. Stat. 3131, *repealed* June 30, 1985, by the Investment Canada Act, ch. 20, 1985 Can. Stat. 419.

221. Foreign Direct Investment in Canada (1972).

222. Investment Canada Act, ch. 20, 1985 Can. Stat.

223. *Id.*

3. The Canada/United States Free-Trade Agreement and Investment

a. Investment Issues and the Free-Trade Negotiations

The ICA, as now written, contains provisions to encourage FDI, and it eliminates many of the impediments to attracting FDI that existed under the FIRA. However, the ICA, despite the Canadian government's initial indications and the associated media reports, did not remove as many of the barriers or impediments under the FIRA as was originally anticipated by the public. From the U.S. viewpoint, the Canadian government, through the ICA, has to date adopted a more cautious approach than its "repeal" of the FIRA had suggested.

In the negotiations, the U.S. viewed blanket ICA restrictions on acquisitions and investments in certain sectors as an unreasonable impediment to investment in Canada. The U.S. had seen Canada impose stringent blanket controls through the FIRA and the National Energy Program[224] and was concerned that it might happen again.

In the negotiations, the U.S. identified the ICA as still imposing unreasonable restrictions on the entry of American investment in Canada and unreasonable denials of "national treatment" to American-owned investments in Canada.[225] U.S. Ambassador Yeutter testified that the stated objective of the free trade negotiations would be to "produce a Canadian policy environment as open to inflows of foreign direct investment as our own."[226]

b. The FTA

Canada and the U.S. have agreed, to the extent provided in the FTA, to accord "national treatment" with respect to investment as well as to trade in goods and services.[227] In particular, in chapter 16, each country has agreed to provide "national treatment" to investors from the other with respect to the establishment of new businesses, the acquisition of existing businesses (subject to certain monetary thresholds discussed below), and the conduct, operation and sale of established businesses.[228] The treatment accorded by a country under the "national treatment" article shall be, with respect to a province or state, no less favorable than the most favorable treatment accorded by that province or state in like circumstances to investors of the country of which it forms a part.[229] Moreover, neither country shall impose on an investor of the other country a requirement that a minimum level of equity be held by its nationals in a local business enterprise controlled by such investor.[230]

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224. A. MacEachan, Budget Speech. Before the House of Commons (Oct. 28, 1980).

225. Yeutter Testimony, *supra* note 82. *See also*, OFFICE OF THE U.S. TRADE REPRESENTATIVE, 1986 REPORT ON FOREIGN TRADE BARRIERS (1986) (annual report on the national trade estimates).

226. Yeutter Testimony, *supra* note 82.

227. FTA, *supra* note 7, art. 105.

228. *Id.* art. 1602, para. 1.

229. *Id.* art. 1602, para. 4.

230. *Id.* art. 1602, para. 2.

As an important exception to "national treatment," the FTA provides that any existing business or Crown corporation operated by the government of Canada, or by a provincial government, as of January 1, 1989, is exempted.[231] Consequently, "measures" can be imposed as to the privatization of these businesses even though they are on their face inconsistent with article 1602, paragraphs 1 and 2 relating to national treatment and minimum equity holdings. This exception is limited by a proviso which prohibits Canada, once it has introduced such a "new measure," from amending it or introducing any subsequent measure which renders the original "new measure" more inconsistent with the concept of national treatment.[232] The exception also extends to any new measure relating to the direct or indirect ownership at any time of the business enterprise. Similarly, Canada is not allowed, in the case of such a new measure, to later increase ownership restrictions contained in it.

Finally, in relation to business enterprises established or acquired after the entry into force of the FTA by Canada, or by a province or a Crown corporation, article 1602, paragraphs 1 and 2 shall not apply to the subsequent acquisition of these enterprises as a result of their disposition by Canada, by a province or a Crown corporation.[233] However, once the subsequent acquisition has been completed, the provisions of article 1602, paragraphs 1 and 2 apply.

Certain other further departures from "national treatment," relating to prudential, fiduciary, health and safety, or consumer protection reasons permit differential treatment to the other country's investors in prescribed circumstances.[234]

In response to some of the most notorious demands for undertakings made under the FIRA prior to 1985, the FTA directly rules out the imposition of significant trade-distorting performance requirements such as minimum export levels, import substitution, local sourcing and domestic content requirements.[235] Additionally, the FTA provides that neither country shall impose any of these performance requirements on an investor from a third country where meeting the requirements could have a significant impact on trade between the two countries.[236] This list of trade-distorting standards appears to be exhaustive in the legal text of the FTA. This suggests that other performance requirements are permissible. For example, Investment Canada could still negotiate undertakings relating to local employment, "product mandate" (for example, requirements that investors produce specific products in Canada), technology transfer, or research and development. Moreover,

231. *Id.* art. 1602, para. 5.
232. *Id.* art. 1602, para. 6.
233. *Id.* art. 1602, para. 7.
234. *Id.* art. 1602, para. 8.
235. *Id.* art. 1603, para. 1.
236. *Id.* art. 1603, para. 2.

there are no restrictions on the use of performance requirements where government subsidies or government procurement are involved.

A significant breakthrough for the U.S. is the requirement in the FTA that Canada increase review thresholds under the ICA for direct and indirect acquisitions and ultimately eliminate them for indirect acquisitions.[237] The current gross asset threshold for review under the ICA in acquiring a Canadian business is Can $5 million for direct acquisitions and Can $50 million for indirect acquisitions. These thresholds will be increased on FTA implementation to Can $25 million for direct acquisitions and to Can $100 million for indirect acquisitions, and thereafter annually for each category until the third anniversary, when the direct acquisition threshold will settle at Can $150 million in constant dollars in order to adjust for inflation, and when review of indirect acquisitions will be eliminated altogether.[238]

Canada has also agreed that these monetary thresholds will apply to acquisitions by third country investors in Canadian firms controlled by U.S. investors.[239] This provision will result in citizens of the U.S. having greater freedom than other foreign investors, and even Canadians, to dispose of their investments in Canada. This has attracted criticism in Canada as constituting an unfair preference for American investors.[240]

These amendments to the ICA restrictions, however, do not apply to the oil and gas and uranium mining industries.[241] These industries are to be subject to published policies that are to be implemented through the review process under the ICA, provided that such policies are not more restrictive than those in effect on October 4, 1987.[242] A pre-ratification exchange of letters between the two governments is to delineate fully these policies.

As a general matter, each country may require an investor of the other country who makes or has made an investment in its territory to submit routine information for informational and statistical purposes.[243]

The FTA provides that neither country "shall directly or indirectly nationalize or expropriate an investment in its territory by an investor of the other party . . . except for a public purpose, in accordance with due process of law, on a nondiscriminatory basis, and upon payment of prompt, adequate, and effective compensation at fair market value."[244] The FTA provides for the free transfer of profits and other remittances subject only to certain exceptions relating to bankruptcy, criminal offenses, reports of currency transfers,

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237. *Id.* annex 1607.3.

238. *Id.*

239. *Id.* annex 1607.3 para. 2(b).

240. HAYDEN, *Free Trade Unfair to Non-American Investors* in FOREIGN INVESTMENT IN CANADA 2317 (1987).

241. FTA, *supra* note 7, annex 1607.3, para. 4.

242. *Id.*

243. *Id.* art. 1605.

244. *Id.*

withholding taxes, issuing, trading or dealing in securities or ensuring the satisfaction of judgments.[245] While both these provisions are cornerstones of a stable environment for foreign investment, abuses in these areas have not historically been a major factor in Canada/U.S. economic relations.

It is important to note that the parties have also agreed that all existing laws, regulations and published policies and practices, or continuation or renewals thereof, not to be amended under the FTA are to be grandfathered in conformity with the investment chapter of the FTA.[246]

The investment chapter does not apply to any new taxation measures or any subsidy as long as these measures do not constitute a means of arbitrary or unjustifiable discrimination between investors of the two countries or a disguised restriction on the benefits accorded to investors under this chapter of the FTA.[247]

4. The Energy Investment Climate and the Free-Trade Agreement

The close relationship between energy trade and investment policy is made explicit in recent pronouncements of the Canadian government. Noting that energy has historically accounted for 15% to 20% of total Canadian investment, the Canadian government anticipates capital expenditures on oil, natural gas, and electricity projects "to equal at least Can $250 billion between now and the year 2000."[248]

Canada has tremendous reserves of oil and gas. Each of the three currently identified "frontier" basins—the Beaufort Sea, the Arctic, and the East Coast—have reserves about equal to its major currently producing field, which is located mostly in Alberta. Moreover, in the "oil sands," Canada has the world's largest deposit of oil, around two trillion barrels. If only 10% of that is recovered, that would amount to about ten times current U.S. reserves. Development of most of these resources will be very capital intensive, especially in the case of the oil sands. Lead times will be long and development risks great. Hence, Canadian government sources note, "the development of our energy resources will increasingly consist of megaprojects."[249]

Canada has enormous hydropower resources, also very capital intensive, which could be developed to serve U.S. markets. Hydro-Quebec alone has identified about 40,000 MW of developable hydro capacity in Northern and Central Quebec that would require huge capital investments, including Can $39 billion over the next decade to develop a relatively modest portion of this potential.

There are two principal reasons why development of these energy sources and the export trade are closely related:

(1) Development of many of these projects may not be possible

245. *Id.* art. 1606.

246. *Id.* art. 1607.

247. *Id.* art. 1609.

248. *See, e.g.*, Canadian Assessment, *supra* note 28, at 37-38; remarks of Minister Marcel Masse, Montreal Conference Proceedings, *supra* note 14, at 11.

249. Canadian Assessment, *supra* note 28, at 38.

without a significant "export component" to create the necessary market and the optimal economies of scale of many of these projects.[250]

(2) Foreign capital will probably be needed to supplement Canadian capital sources to develop some of these projects.

This recognition of the probable need for foreign investment in Canadian energy developments is counterbalanced in current Canadian government policy by an ongoing concern to assure substantial Canadian ownership and control of its energy sector. This is especially true of the oil and gas industries, which were dominated by foreign investment in their early years of development. In 1957, the Gordon Commission reported that at least 75% of Canada's oil reserves were under foreign control, and, despite measures taken under the FIRA to promote Canadian ownership and control, foreign control reached an estimated 80% in 1979.[251] Under the NEP, introduced by the Trudeau Government in 1980, Canadian ownership and control of these industries rose, but at a price to "Canada's reputation as a good place to invest" that the present government finds unacceptable.[252] Current Canadian government policy is to "preserve the Canadianization gains that had been made, while liberalizing the framework and giving the Canadian industry access to the additional capital it needs."[253] The government's target for Canadian control of the oil and gas industry, currently around 45-46%, is still the NEB target of 50%, now to be achieved by 1991.[254]

The current Canadian government policy, which cannot be viewed as unambivalent towards foreign investment in energy sources, is then the result of an effort to balance the recognition of the need for increased foreign investment with the deep-seated concerns that Canadians should be the primary beneficiaries, through ownership and control, of the exploitation of their own energy resources.[255]

As noted above, while the FTA makes significant advances in liberalizing the investment regime generally, many of the principal changes do not apply to the oil and gas and uranium sectors, including the schedule for raising the thresholds that trigger government review of foreign acquisitions of Canadian enterprises, the ban on imposing minimum equity level requirements of article 1602, paragraph 2, and the ban on imposing "performance requirements," such as domestic content percentages or requirements to export a given percentage or level of production, in article 1603.[256]

Essentially, most acquisitions of Canadian energy enterprises, outside of a fairly narrow list of exemptions under the ICA, are subject to the ICA review standards.[257] The most formidable of these is "compatibility of the investment

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250. *Id.*

251. M. Masse, Minister of Energy Mines and Resources, Government of Canada, Address Before the American Bar Association, Toronto, Ontario at 10-11 (Aug. 9, 1988) [hereinafter Masse Toronto Speech].

252. *Id.* at 11.

253. *Id.*

254. *Id.* (contained in answers to questions).

255. *See generally* R. Atkey, Remarks at the Montreal Conference Proceedings, *supra* note 14, at 301.

256. *Id.*

257. *Id.*

standards.[257] The most formidable of these is "compatibility of the investment with the national, industrial, economic and cultural policies of the country" as espoused in the case of energy by the Department of Mines, Energy and Resources.[258] Under current policies, this requirement imposes a "virtually absolute prohibition on the foreign acquisition of healthy Canadian controlled energy firms valued in excess of Can $5 million dollars [sic]."[259]

In conclusion, while the FTA would make significant advances in the area of investments generally, the advances are, because of the FTA's exclusions for the oil, gas and uranium areas, a good deal more modest in the energy area. However, the FTA does provide for such general safeguards as the constraint upon nationalization or expropriation without due process and adequate compensation, the prohibition on forced divestiture, and the removal of restrictions on the transfer of profits.[260] All are significant advances, at least in concept. However, it is clear that the prospect for unfettered U.S. investment in Canadian energy enterprises, at least in the oil and gas and uranium areas, will depend very much on the policy of the government of the day and, under current policy, how that government views itself as faring in its effort to maintain a balance between Canadian control of and adequate foreign investment in the energy sector.

Presumably, investment opportunities in the electricity sector, not constrained by the limitations in chapter 16 and not subject to the same national policies on ownership and control, may provide a freer investment climate. However, most investments in electricity, at least initially, are likely to be made at the initiative of provincial utilities or Crown corporations; and the degree to which they will feel it necessary to rely upon U.S. investment for future projects is unclear. Both national and provincial policy considerations are likely to play a major role in most electricity investment decisions as well.

How the investment regime for energy, which has been the source for much bilateral contention in the past, evolves in the next several years may well be a major determinant in how large and how buoyant Canada/U.S. energy trade becomes in the long term.

B. *Dispute Resolution and Its Impact On Energy and Domestic Regulatory Processes*

The FTA contains three distinct dispute resolution regimes applicable to the energy area—the general dispute resolution mechanisms relating to the FTA,[261] the alternative mechanisms to be followed in domestic antidumping and countervailing duty cases,[262] and consultation mechanism for disputes over "energy regulatory actions."[263] Each may prove important in the energy area. We will examine them and their relationship in some detail.

257. *Id.*
258. *Id.* at 314.
259. *Id.* at 308.
260. *Id.* at 321-22.
261. FTA, *supra* note 7, ch. 18.
262. *Id.* ch. 19.
263. *Id.* art. 905.

1. The General Dispute Resolution Regime

a. The Commission

At the institutional heart of the FTA's dispute resolution regime is a Canada/United States Trade Commission (Commission) composed of representatives of both countries, each headed by the cabinet level officer or minister primarily responsible for international trade.[264] The Commission is to provide for the joint management of the FTA and for the avoidance or settlement of any disputes respecting the interpretation or application of the FTA, oversight of future elaboration of the FTA, and the effective management of any other matter which may affect the operation of the FTA.[265] The Commission may establish and delegate responsibilities to ad hoc standing committees or to working groups, and it may consult with non-governmental parties.[266] All decisions of the Commission will be made by consensus.[267]

b. The Decisional Process

The dispute resolution process consists of a series of steps and devices designed to maximize the prospect of "mutually satisfactory resolution" through consultation, at which the parties are to "make every attempt."[268] The key to this goal is the right of either party to obtain information as to any "actual or proposed measure"[269] of the other and to "request consultations" regarding it or any matter that might affect operation of the FTA[270] and a general obligation of the other party to provide notice to measures it thinks might affect operation of the FTA.[271]

If resolution is not achieved within thirty days of the request for consultations, either party may request a Commission meeting, which normally should convene within ten days and attempt, with the help of technical advisors and mediators, if necessary, to resolve the matter promptly.[272] Failing resolution within thirty days, the Commission may, and in cases of "emergency actions,"[273] must refer the dispute to binding arbitration.[274] Alternatively, the Commission may establish its own "panel of experts," also somewhat confusingly called the "arbitration panel."[275] This panel is to operate subject to

264. *Id.* art. 1802, para. 2.
265. *Id.* art. 1801, para. 1.
266. *Id.* art. 1802, para. 4.
267. *Id.* art. 1804, para. 1.
268. *Id.* art. 1806, para. 2.
269. *Id.* art. 1803, para. 3-4.
270. *Id.* art. 1804, para. 1.
271. *Id.* art. 1803, para. 1-2.
272. *Id.* art. 1805.
273. In chapter 11, entitled "Emergency Action," the FTA permits, under certain conditions and subject to stringent safeguards, restrictions "otherwise inconsistent with the Agreement to deal with surges in imports causing serious injury to domestic producers." *See* FTA, *supra* note 7, ch. 11, preamble.
274. *Id.* art. 1806, para. 1.
275. *Id.* art. 1806, para. 2.

detailed quasi-judicial, though confidential, procedures and its purpose is to ascertain for the Commission the facts and, if requested, "the degree of adverse trade effects" of the disputed measure.[276] Upon receipt of the arbitration panel's "final report," the Commission "shall agree on the resolution of the dispute, which normally shall conform to the recommendation of the panel,"[277] and the resolution "[w]henever possible . . . shall be non-implementation or removal" of the non-conforming measure, or, failing that, compensation, which is not specifically defined.[278]

The emphasis of the FTA is to get the parties to make every effort to resolve disputes through consultations and more formal mechanisms. Failing resolution the ultimate remedy is, as in the GATT, self-help. Hence, if the Commission has not achieved "a mutually satisfactory resolution" within thirty days of receiving the final panel report and if a party considers that the dispute measure would impair its "fundamental rights" or benefits anticipated under the FTA, it may suspend "the application to the other party of equivalent benefits until such time as the parties have reached agreement on resolution of the dispute."[279] Similarly, if the binding findings of the arbitration panel are not implemented "in a timely fashion" and if the parties are "unable to agree on appropriate compensation or remedial action," the right to suspend "equivalent benefits" is triggered.[280]

Although muted in its emphasis and clearly a last resort, the self-help remedy is essentially equivalent to that in the GATT.[281] The GATT provides a perhaps unique system of enforcement which relies on retaliation, a form of self-help, in the form of withdrawal of "substantially equivalent concessions" to those in effect denied by the transgressions of the offending party, but only after the deliberative process of dispute resolution and within the bounds of equivalency.[282] Unlike most domestic legal systems and many international systems, there is no body under the GATT to make ultimate determinations of violations and to impose sanctions or penalties.[283] The FTA, by providing for decisional mechanisms that produce findings of fact, at least, and perhaps findings as to adverse effects on trade, represents an important extension of the GATT dispute resolution mechanisms. However, as in the GATT, there is no final determination of "violations" or imposition of sanctions or penalties by the institutions created.

Also important is that the FTA adopts the GATT approach that trade measures which cause "nullification or impairment of any benefit reasonably

276. *Id.* art. 1807.
277. *Id.* art. 1807, para. 8.
278. *Id.*
279. *Id.* art. 1807, para. 9.
280. *Id.* art. 1806, para. 3.
281. *See, e.g.,* GATT, *supra* note 1, arts. XXII, XXVIII.
282. *See* DAM, *supra* note 111, at 79-81, 87, 356-68 (1970).
283. *Id.*

to accrue . . . directly or indirectly" under the FTA, whether or not they otherwise conflict with FTA provisions, also give the right to trigger the chapter 18 dispute resolution and self-help remedies.[284] An example cited in the FTA would be exercise of the right of governments to establish a monopoly or state enterprise with the "sole purpose" to "evade an obligation under the Agreement."[285]

c. Referral of Matters from Judicial or Administrative Proceedings

As the Treaty of Rome established the European Economic Community, likewise the FTA contains a method for addressing interpretation matters arising in any domestic judicial or administrative proceedings of one party which the other party believes would merit intervention, or where a court or administrative body itself solicits the views of either or both parties. In these cases, the parties shall endeavour to agree on the proper interpretation of the applicable provision of the FTA. If the parties are unable to agree upon such proper interpretation, either party may submit its own views to the court or administrative body.[286]

d. Scope of Chapter 18: Relationship to the GATT

The institutional provisions of chapter 18 apply to the avoidance or settlement of all disputes respecting the interpretation or application of the FTA, except for disputes arising under the chapter on financial services and dispute settlement in relation to AD and CVD cases.[287] Chapter 18 also applies to situations when a party considers an actual or proposed measure of the other party to be inconsistent with the FTA or to cause "nullification and impairment" of its benefits, unless the parties agree jointly to use another procedure in any particular case.[288] Surprisingly, disputes arising under both the FTA and the GATT, and agreements negotiated under the GATT, may be settled in either forum, under that forum's rules, and at the request of the complaining country.[289] However, once the dispute settlement provisions of either the FTA or GATT have been initiated, that procedure governs the matter to the exclusion of any other.[290]

284. FTA, *supra* note 7, art. 2011, para. 1.
285. *Id.* ch. 20, preamble.
286. *Id.* art. 1808.
287. *Id.* art. 1801, para. 1.
288. *Id.*
289. *Id.* art. 1801, para. 2.
290. *Id.* art. 1801, para. 3.

2. Dispute Settlement in Antidumping and Countervailing Duty Cases[291]

a. Introduction

The Canadian government's stated primary goal in entering into the negotiations was to secure and expand Canadian access to the U.S. marketplace. To this end, the Canadian government sought in the FTA to establish a more predictable framework and better rules for settling trade disputes. The need for a more predictable framework was highlighted, from the Canadian viewpoint, by perceptions of excessive administrative discretion in the American trade system and the susceptibility of U.S. trade legislation to be bent politically to accord with domestic protectionist pressures.

The Canadian government believed that security of access to the U.S. market was being continually impaired by the numerous AD and CVD actions launched by private industry in the U.S. To the Canadian government, these investigations were significant in that they affected important exported products such as lumber, fish and, recently, potash, and they appeared to challenge Canada's regional development programs and subsidies.

Chapter 19 of the FTA provides for a unique dispute resolution regime that "shall apply with respect to goods that the competent investigating authority of the importing party, applying [its] antidumping and countervailing duty law to the facts of a specific case, determines are goods of the other Party."[292] In such cases, the general dispute resolution mechanisms of chapter 18 do not apply.[293]

b. Purpose and Composition of Binational Panel

The FTA provides for the establishment of a "binational panel"[294] which will serve two functions. The FTA replaces judicial review by domestic courts of AD and CVD final determinations with review by a binational panel.[295] The binational panel is also designed to resolve disputes originating from changes to CVD and AD legislation.[296]

Panel candidates, the majority of which shall be lawyers, are to be selected from a roster of fifty candidates who are considered objective, reliable, of sound judgment and familiar with international trade law.[297] The binational panel shall establish its own rules of procedure (including at least one hearing and an opportunity to provide written submissions and rebuttal argu-

291. *See generally* S. BATTRAM & P. GLOSSOP: *Dispute Settlement under the Canada-United States Free Trade Agreement* in THE CANADA/U.S. FREE TRADE AGREEMENT: THE IMPACT OF SERVICE INDUSTRIES 104 (E.H. Fry & L.H. Radebaugh 1988).

292. FTA, *supra* note 7, art. 1901.

293. *Id.* art. 1902.

294. *Id.* art. 1901, para. 2; *id.* annex 1901.2.

295. *Id.* art. 1904, para. 1.

296. *Id.* art. 1903, para. 1.

297. *Id.* annex 1901.2.

ments) unless the parties agree otherwise prior to its establishment.[298]

The binational panel system will be in effect for a five to seven year period,[299] during which time Canada and the U.S. will attempt, through a working group to be established, to develop more effective rules and disciplines concerning use of subsidies and a substitute system of AD and CVD rules for dealing with unfair pricing and subsidization.[300] This could mean harmonization of U.S. and Canadian AD and CVD laws, development of a common administrative and judicial process, or an agreement to limit the application of the parties' respective AD and CVD laws. The seriousness of the commitment to develop new, mutually acceptable AD and CVD regimes in each country is underscored by the right of either country to terminate the entire FTA on six months' notice if a substitute system of rules for AD and CVD is not agreed to and implemented after seven years.[301]

c. Scope of the Panel's Jurisdiction

(1) Legislation

The FTA provides that each party shall continue to enforce its own AD and CVD laws against the other.[302] Each party reserves the right to amend its AD and CVD laws, provided that any such amendment:

(a) only applies to the other party if actually so specified in the amending statutes;
(b) the party amending its laws must notify the other party in advance of enacting the amendment;
(c) the other party, following notification, may require consultation with the amending party prior to enacting the amendment; and
(d) the amendment is not inconsistent with either the GATT or the "object and purpose" of the FTA "to establish fair predictable conditions for the progressive liberalization of trade . . . while maintaining effective disciplines on unfair trade practices."[303]

The binational panel is authorized to issue declaratory opinions on legislative changes to AD and CVD laws.[304] If the binational panel determines that any amendment is not in conformity with the principles stated above, or has the effect of overturning a prior decision of a binational panel and is not consistent with either the GATT or the FTA, the parties must consult for ninety days in an attempt to resolve the situation.[305] If remedial legislation is not enacted within nine months from the end of the sixty day consultation

298. *Id.* art. 1903; *id.* annex 1903.2.
299. *Id.* art. 1906.
300. *Id.* art. 1907, para. 1.
301. *Id.* art. 1906.
302. *Id.* art. 1902, para. 1.
303. *Id.* art. 1902, para. 2.
304. *Id.* art. 1903, para. 1.
305. *Id.* art. 1903, para. 3.

period, then the other party may retaliate with similar legislative or equivalent executive action or, more drastically, terminate the entire FTA with sixty days' notice.[306]

(2) Judicial Review

Currently, the U.S. Court of International Trade and the Canadian Federal Court conduct judicial review of administrative action and final orders in AD and CVD cases. Under the FTA, the binational panel is to determine:

> whether such determination was in accordance with the antidumping or countervailing duty law of the importing Party. For this purpose, the antidumping or countervailing duty law consists of the relevant statutes, legislative history, regulations, administrative practice, and judicial precedents to the extent that a court of the importing Party would rely on such materials in reviewing a final determination of the competent investigating authority.[307]

The binational panel process will apply to injury decisions and review of injury decisions made by the Canadian Import Tribunal or the International Trade Commission and to final determinations by the Department of Commerce after January 1, 1989.[308] In addition, the binational panel process will apply to final determinations of dumping and subsidization, administrative reviews as to whether particular goods are covered by an AD or CVD order, and for Canada only, undertakings to eliminate dumping or subsidization, for example, under the agreement where Canada undertook to eliminate subsidization of its softwood lumber industry.[309]

Under the FTA, the binational panel shall apply the standard of review defined in article 1911, which refers to certain U.S. and Canadian statutory provisions, and the general legal principles that a court of the importing party otherwise would apply to a review of a determination of the competent investigating authority.[310]

(3) Constitutional Issues

The dispute settlement provisions have been subject to legal controversy in the U.S. concerning two questions relating to the constitutionality of the replacement of domestic judicial review with the binational panel.

Firstly, it has been alleged that it will contravene article III of the U.S. Constitution by permitting non-article III judges to determine matters "arising under [the] Constitution, the Laws of the United States . . . between a State, or the Citizens thereof, and foreign States, Citizens or Subjects."[311] However, the U.S. implementing legislation obviates the concerns that constitutional claims must be heard by a U.S. Constitution article III court by

306. *Id.* art. 1903, para. 3(b)(ii).
307. *Id.* art. 1904, para. 2.
308. *Id.* art. 1904.
309. *Id.*
310. *Id.* art. 1904, para. 3.
311. Article III vests the power in these matters in the U.S. Supreme Court and in such inferior courts as the Congress may from time to time ordain and establish. U.S. CONST. art. III, § 1.

excluding constitutional claims arising in trade cases involving Canada from the binational panel process and additionally provides for a special procedure for constitutional challenges to the binational panel process.

Secondly, concern arose that the binational panel process may breach article II of the U.S. Constitution which provides:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint . . . all other Officers of the United States . . . but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.[312]

The U.S. Supreme Court has held that this applies to "any appointee exercising significant authority pursuant to the laws of the United States."[313] In dealing with this issue the FTA incorporates the relevant domestic laws into the FTA,[314] so that the authority is exercised pursuant to the FTA as well as U.S. law.

However, it is arguable that the power of the binational panel to make determinations that are binding on private persons as a matter of U.S. law, can only derive from U.S. law. Presumably for this reason, a compromise was reached with Congress, under which binational panel decisions are to be automatically binding unless a successful constitutional challenge to the provisions is made. In such instance, the President is given "discretion whether to accept a remand decision on behalf of the United States. . . ." The Administration has stated its intent to issue an executive order agreeing in advance to accept all panel decisions which, like any executive order, can be revoked.

d. Conclusions: Implications for Energy

The binational panel process does appear to have some advantages over the present system. First, Canadians and Americans will be able to present their cases to a body perceived to be more neutral than a U.S. or Canadian court. Second, the panel could serve to resolve apparent conflicts in domestic trade law which may be difficult to achieve in a national court system based on precedent. Third, the procedural timetable, which calls for a panel decision within 315 days after the date on which a request for a panel is made, is probably more expeditious than a GATT panel or than either party's domestic judicial system. The decision of the binational panel is, subject to possible gloss in the constitutional compromise discussed above, binding upon the parties and their investigating authorities. The binational panel's decision will state the time limits for remedial action by the investigating authority.

Chapter 19 deals with what is already one of the most sensitive and contentious areas in U.S. economic and trade relations with other countries. The notion that the AD and CVD laws are too easily used as an instrument of protectionism is widely held internationally and has significant support

312. U.S. CONST. art. II, § 2, cl. 2.

313. Buckley v. Valeo, 424 U.S. 1, 125-26 (1976).

314. FTA, *supra* note 7, art. 1904, para. 2.

domestically.[315] Chapter 19 represents a strong commitment to reduce or eliminate the destructive potential of AD and CVD disputes for the bilateral relationship. It provides for an ambitious mechanism to solve the underlying problem in a five to seven year period, and it provides for a speedy and presumptively more effective resolution mechanism for specific disputes in the interim. Each exercise is subject to the potentially draconian right of unilateral cancellation of the entire FTA in the event of failure. It would be pointless to speculate now as to the probabilities of such a right ever being exercised in light of the tremendous economic stakes that each country, especially Canada, has in a stable trade relationship. This must be balanced against the high feelings surrounding and the potentially high economic stakes involved in individual AD and CVD cases. Exercise of a right to cancel may be more indicative of that party's perception that the FTA has not met expectations than of frustration over the specific AD and CVD issue in dispute.

As to energy, the history of the Canada/U.S. energy relationship does not support a high probability that significant dumping will occur. Indeed, much of the past controversy has related to artificial overpricing of exports. Moreover, the capital intensity of most of the industries and the long-term contract regimes which tend to dominate reduce this possibility further. However, given that most energy industries on both sides of the border are perceived as receiving or having received significant subsidies, the possibility of serious CVD disputes appears much higher and could significantly affect energy trade. Hence, the chapter 19 dispute resolution mechanisms may develop greater significance for energy than first meets the eye.

3. Resolution of Inconsistencies Between the FTA and Domestic Energy Regulation

We have described, in some detail because of its obvious importance to any major area of bilateral trade in goods, the general dispute resolution mechanisms of the FTA (chapter 18) and the alternative dispute settlement mechanisms when AD and CVD duty cases are concerned (chapter 19). This dichotomous regime for dispute resolution also applies, of course, to trade in energy goods.

However, the negotiators recognized the special relationship between the energy trade rules and the domestic energy regulation of each party.[316] The complexity of the relationship is accentuated because of the independent or quasi-independent status of some of the principal regulatory agencies involved, such as the FERC. Their actions cannot as readily be forced into compliance with trade policy by their national governments. The energy chapter of the FTA therefore creates an additional procedure to deal with disputes emanating from future inconsistencies between decisions of the domestic regulatory

315. *See, e.g.*, R. REICH, THE NEXT AMERICAN FRONTIER (1983).

316. Statement of Administrative Action, *supra* note 123, at 50.

agencies and the provisions of the FTA.[317] It also identifies a number of existing inconsistencies that the parties agree to eliminate or ameliorate.[318] Article 905, paragraph 1 is sufficiently important to recite in full:

> If either Party considers that energy regulatory actions by the other Party would directly result in discrimination against its energy goods or its persons inconsistent with the principles of this Agreement, that Party may initiate direct consultations with the other Party. For purposes of this Article, an "energy regulatory action" shall include any action, in the case of Canada, by the National Energy Board, or its successor, and in the case of the United States of America, by either the Federal Energy Regulatory Commission or the Economic Regulatory Administration or their successors. Consultations with respect to the actions of these agencies shall include, in the case of Canada, the Department of Energy, Mines, and Resources and, in the case of the United States of America, the Department of Energy. With respect to a regulatory action of another agency, at any level of government, the Parties shall determine which agencies shall participate in the consultation.[319]

The essence of this provision is to provide for a direct consultative mechanism between the national energy departments of each country between the principal energy policymakers, rather than the regulatory agencies themselves. What is mandatory is that the two governments, including their energy departments, shall enter into consultation. It is left to each party's discretion whether to include the regulatory agencies within those consultations. Article 905 singles out all actions of the FERC, the NEB and the ERA, the three federal agencies primarily responsible for energy trade and domestic economic regulation of energy, as "energy regulatory actions" within its scope. However, it is not so limited. It could apply to regulatory actions of the states or provinces, such as public utility or facility certification and siting commissions which the government of the other party feels are discriminatory to its trade or otherwise inconsistent with the "principles" of the FTA. Nor does article 905 appear limited to economic regulation; actions of agencies concerned with the health and environmental effects of energy facilities, such as the U.S. Nuclear Regulatory Commission, are also potential candidates for article 905 consultation.

In establishing this mechanism, the framers were clearly conscious of both the "independence" of some agencies, such as the FERC, and the procedural constraints under which regulatory agencies typically operate, such as ex parte rules.[320] That sensitivity is also pertinent, of course, to the considerable de facto independence of state and provincial regulators under both parties' federal systems notwithstanding, in the U.S., the ultimate supremacy of federal law.[321] Consultation may also serve to diminish head-on confrontations between the federal and state/provincial governments and use in the U.S. of the unpopular and not always effective doctrine of preemption. It is of note that both the Reagan Administration's October 1987 Executive Order on federalism and a 1988 ABA resolution on the use of federal preemption call for

317. FTA, *supra* note 7, art. 905, para. 1.
318. *Id.* art. 905, para. 2; *id.* annex 905.2.
319. *Id.* art. 905, para. 1.
320. *See DOE/USTR Memorandum, supra* note 78, at 16-17.
321. U.S. CONST. art. VI, cl. 2.

various mechanisms designed to identify potential preemption issues early in the federal legislative and regulatory process and to encourage early consultation with affected states to minimize conflicts.[322]

How this consultation process will work in situations such as the furor over Opinion 256[323] is one of several major uncharted areas that implementation of the FTA will navigate. It is clear that article 905 does not purport to give any right to overturn decisions of the regulatory agencies or impose any obligation to amend their regulations. Nor does it limit appeal rights from domestic regulatory proceedings, whether federal or state/provincial.[324] Moreover, the view of the negotiators was that article 905 should not create any expectation of overturning existing regulation that is not on its face inconsistent with the provisions of the FTA.[325]

The Canadian negotiators originally argued for a "sanctity of contract" provision that would limit the ability of domestic regulators to intervene in or overturn bilateral energy trade contracts. The U.S. negotiators responded that, as long as either country continued to regulate its energy markets, the potential for regulatory intervention could not be foreclosed and that to so "sanctify" only bilateral trade contracts and not other domestic contracts subject to the same regulatory regime would itself create a form of discrimination in the domestic market concerned.[326] The FTA does not purport to limit the actions of the regulatory energy agencies in this or any other respect.

Nor, it should be noted, does article 905 give any specific rights to the parties, such as a right of retaliation under chapter 18, should an inconsistency be identified.[327] Article 905 may best be viewed as offering a prophylactic consultation mechanism to deal with an alleged inconsistency between a domestic regulatory decision and the FTA *before* it turns into a fullblown dispute under chapter 18 or, potentially, under chapter 19.[328] Because disputes in the energy area so adversely affected the Canada/U.S. trade and diplomatic relationships in the recent past, article 905 offers an important, if at this point not well defined, mechanism for dealing with the complex and potentially troublesome relationship between domestic regulation, especially by "independent" agencies, and the bilateral trade rules.

While article 905 may best be viewed as preceding and hopefully heading off action under chapters 18 or 19, there are, on the face of the FTA, some ambiguities in the relationship between article 905 and those chapters. For instance, article 1804 also provides for "consultations" upon the request of either party regarding "any actual or proposed measure" or "any other matter that it considers affects the operation" of the FTA.[329] The parties must make "every attempt to arrive at a mutually satisfactory resolution of any matter

322. Exec. Order No. 12,612, 52 Fed. Reg. 41,685 (1987).

323. Opinion No. 256, Natural Gas Pipeline Co. of America, 37 F.E.R.C. ¶ 61,215, (1986).

324. Statement of Administrative Actión, *supra* note 123, at 57.

325. *DOE/USTR Memorandum, supra* note 78, at 17. The memorandum asserts that "the negotiating history simply does not support such a position." *Id.*

326. *Id.*

327. *Id.* at 18.

328. *See* Statement of Administrative Action, *supra* note 123, at 57.

329. FTA, *supra* note 7, art. 1804, para. I.

through consultations under this article or other consultative provisions in the FTA."[330] If the parties fail to resolve the matter "through consultations within 30 days of a request for consultations under [a]rticle 1804," either party may proceed to invoke the powers of the Commission.[331] It is not clear whether the words "through consultations" are limited to the article 1804 process or might also include the article 905 process. The above-quoted language in article 1804, paragraph 2 suggests the latter.

Moreover, in a parallel situation in the GATT, which also has a series of overlapping consultation provisions (the GATT has nineteen in all), it has been decided that requests for different consultation provisions may both trigger the same right to take the next step in dispute resolution.[332] In view of the seriousness of the energy consultation provisions, and the high profile energy disputes will be given by the two governments, a similar analogy would appear appropriate for triggering a meeting of the Commission for dispute resolution under article 1805.

C. Harmonization of Antitrust/Competition Laws and Policies

The FTA says little explicitly about how the antitrust or Competition laws of each country are to interact in an evolving bilateral free trade market, and there is no explicit effort to address the issue of harmonization of competition laws and policies. However, the FTA and some extra-FTA developments do provide a few subtle pointers as to how the issue might evolve.

In particular, several of the FTA's pervasive principles and provisions appear to militate toward harmonization:

(a) Among the five listed objectives of the FTA is to "facilitate conditions of fair competition within the free-trade area."[333]

(b) The "national treatment" requirement that pervades the agreement[334] and the requirement that states and provinces give the other countries treatment of "like, directly competitive or substitutable goods . . . no less favorable" than its own, essentially impose broad requirements of nondiscriminatory treatment.[335] Presumably, in reaching bilaterally acceptable definitions of "discrimination," some harmony will be achieved.

(c) The limitations in article 904 of the GATT exceptions relating to domestic supply shortfall situations, which include the historic proportions requirement, no discrimination against exports through higher prices, and no disruption of normal channels of supply, are characterized by one Canadian official as embodying the concept "one should not do to others what one would not do to oneself. It is a principle of fairness which, in the context of the evolving competitive energy markets on

330. *Id.* art. 1804, para. 2.
331. *Id.* art. 1805, para. 1.
332. *DOE/USTR Memorandum*, *supra* note 78, at 18.
333. FTA, *supra* note 7, art. 102(b).
334. *Id.* art. 501.
335. *Id.* art. 502. See discussion *supra* pt. V(*E*).

both sides of the international border, will contribute to the competitive trade in energy."[336]

Moreover, the probable direction of domestic antitrust enforcement in the regulated energy industries area should also lead to some harmonization. For instance, the Canadian *Competition Act* cites among its purposes not only the protection of domestic competition but also expanding "opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada."[337] Hence, "competition issues in the domestic market cannot be looked at in isolation from issues in the export market."[338] Moreover, among the criteria to be considered in the all-important process of review by Investment Canada under the ICA of foreign investments in Canadian energy companies is the effect of the proposed investment on competition in the industry or industries in Canada.[339]

While we have not found, in the laws governing U.S. energy regulation, references this explicit as to the interrelationship between domestic competition and international trade, an increased sensitivity of U.S. regulatory agencies, such as the FERC, to the impact of their decisions on the bilateral trade in energy is inevitable after the furor over Order No. 256, the "as billed" decision. That sensitivity should also be enhanced by the FTA's focus on the consultation provisions of article 905 relating to domestic regulatory measures. Much of the debate in that arena will be over whether specific measures, such as Order No. 256, are likely to enhance or derogate from a "level playing field" in the bilateral market, a concept probably similar to that of "fair competition" in article 102 of the FTA. Perhaps reflecting that sensitivity, the FERC Commissioners have publicly rejected any notion of the FERC permitting states, in implementing "all-source" competitive bidding schemes for future power acquisition under proposed FERC rules to amend the PURPA, to exclude Canadian entities as potential participants.[340]

In addition to these indicia in the FTA and in domestic law or practice, there has been a longstanding dialogue between the Canadian and U.S. antitrust authorities themselves. A Memorandum of Understanding on antitrust matters provides for notification, exchanges of information and consultations to reduce conflicts and differences in enforcement policy into the application of the antitrust laws of each country.[341] Recent meetings have focused on merger review and the implications of free trade.[342] Canadian Bureau of Competition officials do not view the number of conflicts over the years as "significant" in light of the volume of trade, and they note convergence "to a

336. H. Wetston, Senior Deputy Director of Investigation and Research, Canadian Bureau of Competition Policy, Remarks at the Montreal Conference Proceedings, *supra* note 14, at 253.

337. *Id.* at 256.

338. *Id.*

339. Atkey, Montreal Conference Proceedings, *supra* note 14, at 314.

340. Responses of Commissioners to Questions Submitted to the U.S. Sen. Comm. on Energy and Natural Resources Following Oversight Hearings on the PURPA, Washington, D.C. (February 1, 1988).

341. *See, e.g., Canada/U.S. Memorandum of Understanding as to Notification, Consultation and Cooperation with Respect to the Application of National Antitrust Laws* (March 1984), *reprinted in* 23 INTERN'L L. MATS 275 (1984).

342. Wetston, Montreal Conference Proceedings, *supra* note 14, at 264.

substantial degree" in the competition laws of the two countries in recent years.[343] For free trade, they view the "critical issue" to be whether differences that do exist "are likely to create trade distortions or prevent the establishment of a level playing field."[344] Generally, they note, competition laws do not discriminate on the basis of nationality; for instance, the Canadian merger review process is "identical" whether a Canadian or foreign acquirer is involved.[345] They conclude that while "differences in competition laws do exist between Canada and the United States, the potential for trade distortions, as a result of a lack of harmony, does not appear to be significant in the context of free trade."[346]

Without challenging this assessment, and its optimistic prognostication, it is worth noting two possible flashpoints in which significant differences could cause controversy in the energy area:

(a) divergent development of the U.S. "state action doctrine" and the Canadian equivalent, the "regulated conduct defence," both of which provide some level of protection from antitrust liability for state-sanctioned franchise monopolies, and

(b) excessive use of the private right of action under section 4 of the *Clayton Act* by U.S. energy firms against Canadian competitors.

The latter might lead to charges of disguised protectionism, similar to those made in the antidumping and countervailing duty areas. Canadian law provides only a very narrow, not comparable, private right of action. One significant distinction between this and the AD and CVD area is that the antitrust laws, which typically protected competition rather than competitors, are probably far less amenable to use for protectionist purposes.

VII. Conclusion

The FTA should provide a solid basis for achieving the principal goals of the two countries in entering into the energy negations—for Canada, achieving assured access to U.S. markets, free of "energy policy" interventions or protectionist distortions and for the U.S., the ability to procure Canadian energy supplies on a long-term, reliable basis, free of "energy policy" and nationalistic interventions in times of perceived shortage.

The principal achievement of the FTA would be to inject an essentially GATT regime with significant additions into the bilateral energy trade relationship. That should serve to stabilize that relationship around the existing relatively free trade principles achieved in the mid-1980s by the governments currently in power. The FTA would also make some significant immediate advances in that free-trade relationship and create the basis for further advances. Most importantly, it should help greatly to prevent a serious backslide into the interventionist policies of the 1970s and early 1980s. For this

343. *Id.*
344. *Id.* at 265.
345. *Id.*
346. *Id.*

last reason, those who assert that the FTA makes only a modest difference in the energy trade area miss the essential point—that the new set of GATT-type trade rules will serve to greatly constrain any energy policy of either government that seeks to retreat from the level of free-trade currently achieved.

Indeed, even if the FTA is not ratified, or were terminated, the new consciousness it has already created as to the applicability of the GATT to energy trade will likely similarly constrain government intervention in energy trade with Canada, Mexico and other major energy trading partners, though without some of the constraints the FTA adds to those in the GATT.

For the energy industry, the most significant of the FTA additions to the GATT is the explicit elaboration of the "national treatment" standard as applicable to state and provincial as well as federal governments, the considerable narrowing of the "domestic supply shortfall" and "national security" groups of GATT exceptions, and the advances in the non-tariff barrier area to encompass minimum export-price and import-price requirements. Ironically, from the U.S. viewpoint, the narrowing of the ability to use "national security" as a justification for trade restrictions may do far more to enhance long-term "energy security," and hence national security, in the broader sense often utilized under the GATT, than to damage it.

One immediate consequence of ratification will be an immediate focus on GATT precedent as a major source of guidance and analogy in interpretation and implementation of identical or similar, and even some of the unique, FTA provisions. This probable reliance on GATT law may be especially significant in light of the lack of guidance that a detailed negotiating history of the FTA would provide. Most of the negotiations, as is typical in negotiating international agreements, were not made public. Even before ratification, there are signs of increased reliance on GATT law to resolve bilateral energy trade disputes.

However, while GATT law may provide significant guidance, there are unique aspects of the Canada/U.S. energy trade relationship that will raise special implementation problems.

The most obvious, perhaps, is how the authority of the energy regulatory agencies (both federal and provincial/state) over domestic issues, not directly curtailed by the FTA, will interact with the new set of trade rules and how effectively the consultation process in article 905 will work in cases of perceived conflict. The major policy issues of the future are likely to focus more on the implications of domestic regulatory decisions, such as Order No. 256, than on the broader national energy policy or "energy security" issues, although the latter will doubtless continue to be asserted. If this change in focus occurs, the regulatory agencies themselves, especially the FERC and the NEB, will have to create some effective means for direct dialogue to develop a workable relationship and to minimize conflicts of the "as billed" ilk. Even in that case, the FERC's rehearing order showed considerable progress over its 1986 order in recognizing the NEB's area of jurisdiction. A serious need for close coordination would appear evident, for instance, in the area of the NEB and the FERC certification of gas pipelines to be built to service Canadian gas exports; no obvious mechanism exists in the FTA to directly deal with this area. If a reasonably clear jurisdictional division develops between the FERC and the NEB, the need for U.S. parties to intervene in NEB proceedings, and for Canadian parties to intervene in the FERC proceedings, may become more evident.

Although article 905 seems to look primarily to the two federal energy departments to lead the energy side of the "consultations" process, direct involvement of the pertinent regulatory agencies will probably be important to bring the necessary level of expertise and authority to bear on what may be complex issues of domestic regulation. That may be difficult insofar as regulatory agencies receive conservative legal advice as to how far they can interact with other agencies and as they retreat into an increasingly quasi-judicial mode.

The conclusion, then, for the agencies exercising domestic, as opposed to import/export, regulatory functions, such as the FERC, the NEB, or state or provincial agencies regulating electricity and natural gas, is that the FTA generally assumes these agencies will not produce decisions that impose direct bilateral trade restrictions proscribed by the FTA. Moreover, while recognizing that these decisions may *indirectly* affect bilateral trade, the FTA leaves the jurisdiction of these agencies essentially intact, except to the extent they are required to avoid discrimination based on nationality under the "national treatment" obligation.[347]

Avoiding overt discrimination should not prove to be problematical. However, where an indirect discriminatory effect is asserted, as with the FERC's "as billed" decision, the issue becomes far more difficult because it will likely involve the interaction of at least two complex regulatory systems and market structures. The "as billed" decision, it should be noted, did not overtly discriminate against Canadian gas, and on rehearing, the FERC took pains to stress that the decision did not purport to alter the NEB regulation.[348]

It is clear that the FTA negotiators recognized both the danger of and the difficulty of definitively resolving disputes in such cases. Hence, the FTA relies heavily on the article 905 "consultations" process to sensitize the energy policy and regulatory agencies in each country to the potential for indirect effects.[349] While the FTA does not require the regulatory agency to change its decision, the hope is that the process will at least clear up misconceptions as to its intent and the effect of its decision and perhaps generate an effort to mitigate the troublesome effect on trade or explore other decision options that reduce that effect. Informal consultations between the two governments over the FERC's "as billed" decision already appear to have achieved sufficient understanding on the Canadian side to allay most concerns and to permit the U.S. government to take a position in the sensitive pre-ratification climate that the decision is not inconsistent with the FTA.[350]

A second quite obvious flashpoint could be how the continued right of

347. *See, supra* text following note 130.

348. Opinion No. 256, Natural Gas Pipeline Co. of America, 39 F.E.R.C. ¶ 61,218, at 61,764-65 (1987).

349. *See, supra* text following note 316.

350. *See, supra* text following note 133.

Investment Canada and other Canadian government agencies to limit U.S. participation in the Canadian energy industry is administered, especially if large capital injections are needed to develop export-related Canadian energy projects. One immediate constraint of concern would be to permit continued focus on the gross amounts of U.S. vis-a-vis Canadian investment, rather than focus on eliminating or precluding certain types of U.S. investment action perceived as pernicious, such as hostile takeover bids.

Absent bilateral agreement on a subsidies control regime, another potential though less obvious problem area is the possibility of increased use of CVD cases to attack Canadian imports in particular. One major threshold question will be the degree to which electricity imports are subject to CVD actions. As noted, if conflict in the CVD area gets out of hand, it could trigger a right of unilateral termination of the entire FTA.

However, such an assertion would likely be symptomatic of a broader discontent with the entire FTA, as controversial as the CVD area is. It should never be forgotten, however, the degree to which the desire of both governments to avoid repeats of previous divisive conflicts in the energy area (with impacts on the diplomatic relationship far in excess of their portion of the dollar value of trade) drove much of the FTA negotiations. It is not pure coincidence that the FTA was negotiated in a time of energy over-supply by two free market-oriented governments, apparently both very conscious of a deleterious impact on trade and development of previous interventionist energy policies.

Perhaps the most strenuous test for the FTA, if ratified, and for its dispute resolution mechanisms, will occur, whatever the triggering events, in an era of perceived energy "crisis" or at least of serious shortage and when the policies of one or other government become more interventionist, driven by "energy policy" or, perhaps, by broader protectionist or nationalistic concerns. That, of course, is a test most multilateral trade agreements face periodically. Typically, the agreement survives through nonobservance rather than termination of the agreement. In a bilateral relationship as tightly knit as that of Canada and the U.S., tolerated nonobservance of clear bilateral obligations is a more vexed notion.