

Canadian Legal Developments

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I. Canadian Communications Law

The following is a brief look at the more prominent 1999 decisions, announcements, and policies of the Canadian Radio-television and Telecommunications Commission (CRTC).

On February 22, 1999, the CRTC approved an application by Television Northern Canada Incorporated (TVNC) to operate the Aboriginal Peoples Television Network (APTN). As of September 1, 1999, in order to meet the objectives of the Broadcasting Act and to further the public interest, APTN was to be distributed nationally. The CRTC directed that this service form part of the mandated basic service package offered by large and mid-size cable companies (i.e., those with more than 2,000 subscribers), Direct-to-Home (DTH) satellite broadcasting systems, as well as Multipoint Distribution Systems (MDS). The CRTC expects the distribution of APTN to help preserve the cultural identity of Aboriginal peoples in Canada and offer a cultural bridge between Aboriginal and non-Aboriginal communities. APTN is authorized to charge a maximum monthly fee of fifteen cents per subscriber.

With the arrival of competition in the programming distribution market, consumers now have a choice in who provides their programming services, for example, conventional cable operators, or other companies such as DTH operators Bell ExpressVu and Star Choice and, in certain areas, wireless broadband operators Look Communications Inc. and Sky Cable. As of April 1, 1999, customers who cancel their cable service or have given another company the authorization to do so on their behalf are not to be contacted by their original cable distributor for a period of ninety days following the cancellation. CRTC issued a letter to the cable companies setting out marketing rules to be complied with in those cases where a customer has chosen to subscribe to services provided by a competitor. Also, the cable company may not offer discounts or other so-called win-back inducements to customers who contact them to cancel their basic service.

In a landmark decision, the CRTC announced on May 17, 1999, that it will not regulate new media services provided on the Internet, neither now nor in the future, even where

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such audio or video services are very similar or identical to services regulated under the Broadcasting Act. After conducting an in-depth review under the Broadcasting Act and the Telecommunications Act beginning last July, the CRTC concluded that the news media on the Internet are achieving the goals of the Broadcasting Act and are vibrant, highly competitive, and successful without regulation. The CRTC was concerned that any attempt to regulate Canadian news media might put the industry at a competitive disadvantage in the global marketplace. CRTC noted that many services on the Internet, such as alphanumeric text or services uniquely tailored or customized by the individual user, do not fall within the definition of "broadcasting." Those services constituting "broadcasting" will be exempted from the Broadcasting Act. The CRTC expressed the view that generally applicable Canadian laws (such as criminal law), as well as increased media awareness, are the appropriate tools to deal with the offensive and illegal content on the Internet.

On May 25, 1999, the CRTC approved an application by Telesat Canada to partially deregulate its Fixed Satellite Services (FSS) as of March 1, 2000. It adopted this transitional regulatory approach in anticipation of full competition and complete deregulation. Accordingly, Telesat Canada is no longer required to file tariffs with the CRTC for FSS services provided after March 1, 2000. To protect the interests of broadcasters and telecommunications providers who may not have access to adequate competitive choice, the CRTC has implemented a price ceiling. Key elements of Telesat's proposal, approved by CRTC, stated that Anik E satellite rates will remain in effect until December 31, 2000. After December 31, 2000, there will also be a fixed price ceiling for full-period, unprotected, preemptible RF Channel service for lease terms of at least five years, at \$170,000 per month per channel.

With its new television policy released June 11, 1999, the CRTC aims to strengthen the programming industry, increase the visibility of Canadian talent both in Canada and abroad, and promote the growth of Canadian broadcasters in an increasingly competitive global market. The CRTC decided to maintain the existing rule, which requires broadcasters to air at least sixty percent Canadian programming during a broadcast day, and at least fifty percent Canadian programming during evening hours. The CRTC divided Canadian broadcasters into two groups: those that reach over seventy percent of the audience in one of the two official languages, such as CTV, Global, WIC, and TVA, and those that reach less than seventy percent of the audience, such as CHUM, Craig, and TQS. One of the major changes for the first group is the broadening of the definition of prime time priority programming. From now on, documentaries of thirty minutes or more, regional programs (other than news and sports), and programs that promote Canadian talent are included in the definition, in addition to drama, comedy, music, and variety programs. As well, CTV, Global, WIC, and TVA will be required to broadcast at least eight hours per week of priority programming during prime time. As of September 2000, prime time will run from 7:00 P.M. to 11:00 P.M., seven days a week, instead of being limited to 8:00 P.M. to 11:00 P.M. on weekdays, and 7:00 P.M. to 11:00 P.M. on weekends. CRTC also gave broadcasters an incentive to broadcast more dramas, which is the most expensive genre to produce, by giving a 150 percent credit to dramas that meet 100 percent of the Canadian content criteria, and a 125 percent credit to those that meet sixty percent of the criteria. These changes will extend prime time by five hours per week and are expected to provide the flexibility and incentive necessary for the production and broadcasting of a wider choice of programs. As well, CRTC decided to stop regulating local newscasts and stated that the English language broadcasters are no longer required to spend a minimum amount on news programming.

On July 7, 1999, the CRTC issued a new rule requiring large cable companies (those with more than 6,000 subscribers) to obtain prior approval before increasing their basic monthly fees linked to the addition of specialty services. This change was brought about by consumer complaints. Under the new rules, cable subscribers will have a thirty-day period to voice their comments to the CRTC about any such proposed increases. Under the amended Broadcasting Distribution Regulations, the CRTC will be able to suspend or disallow a proposed fee increase if it determines that such an increase is not justified.

In a significant decision released on September 14, 1999, the CRTC directed cable companies to offer their higher-speed Internet services to independent Internet providers at a discounted rate, twenty-five percent lower than their lowest retail rate. This mandatory commercial access service for ISPs was in response to an application for access to cable carriers' higher speed Internet service by the independent members of the Canadian Association of Internet Providers (CAIP). In keeping with its previous decisions, which determined that cable carriers must provide other ISPs with access to their underlying facilities, CRTC will maintain these terms until competing Internet service providers are able to connect their facilities with those of the cable carriers.

On October 19, 1999, the CRTC issued a decision designed to extend and improve telephone service for Canadians living in high-cost telephone areas. Even though Canada is considered to be the best-connected country in the world, there are pockets in remote or rural regions and the far north where no telephone service exists or where it needs to be upgraded. The decision defined "basic service" as including: single-line Touch-Tone service with local access to the Internet; enhanced calling features; access to emergency services; Voice Message Relay service; and access to operator and directory assistance services, long distance service, and a recent local telephone directory. The CRTC ordered the small, independent telephone companies across Canada to file service improvement and tracking plans by March 1, 2000. The large, regional telephone service providers must file service improvement and tracking plans in 2001. Special measures were ordered in the case of Northwestel (NWTel). This company serves a large and sparsely populated area of the far north, mostly located in the Yukon, Nunavut, and the Northwest Territories. It has the lowest telephone density in the country. The CRTC is concerned that NWTel may not be able to fund the service improvement plan by itself and has started a proceeding to determine that question.

On another regulatory front, a long-awaited decision by the Copyright Board of Canada on the scope of copyright protection for musical works communicated over the Internet was released on October 27, 1999. The decision concerns a statement of proposed royalties filed by Canada's performing rights society, SOCAN, for the use of its musical works as part of Internet transmissions. In the first phase of ongoing proceedings, the Copyright Board was required to determine if section 3(1)(f) of the Canadian Copyright Act, which gives copyright owners the right to communicate their works to the public by telecommunication, was applicable in the particular context of the Internet.

The Copyright Board concluded that Internet transmissions intended to be received by members of the public are communications by telecommunication to the public within the meaning of the Canadian Copyright Act. However, in order to occur in Canada, a communication must originate from a server located in Canada on which content has been posted. The Copyright Board also held that a work is communicated not when it is made available (e.g., by storing it on a host server where it can be accessed by members of the public), but when it is transmitted (i.e., each time a member of the public uses a browser

to access the work from the source computer). When a work is transmitted in this fashion, it is the person who posted the work who communicates it. However, by making a work available to the public on a server, a person authorizes its communication and thus attracts liability, whether or not a communication occurs.

The Copyright Board went on to conclude that, by virtue of section 2.4(1)(b) of the Canadian Copyright Act, entities acting as Internet intermediaries, such as ISPs, generally do not communicate works. However, such entities will not be entitled to claim the benefit of section 2.4(1)(b) if, as a result of business relationships or other factors, they do not limit themselves to acting as mere intermediaries (e.g., by posting content, associating themselves with others to offer content, moderating news groups, etc.).

The decision confirmed that a statutory basis does exist for SOCAN's tariff and that the Copyright Board has jurisdiction to proceed to the next phase of the proceedings in which it will address issues relating to the structure of the tariff and the quantum of royalties to which SOCAN will be entitled. That phase of the Copyright Board's proceedings may very well be delayed, however, in light of Federal Court applications seeking judicial review of the Board's decision.

On November 22, 1999, Industry Minister John Manley announced the provisional license winners of Canada's first spectrum auction. Of the thirteen original bidders, twelve were declared eligible to receive licenses in the twenty-four and thirty-eight GHz frequency bands. Access to this spectrum will allow these companies to provide broadband services in all areas of Canada and accommodate the increasing demand for high-capacity local access infrastructure required for high-speed Internet and electronic commerce applications. The auction process allowed Industry Canada to assign the largest number of licenses ever awarded in a single process, with 260 licenses going to the twelve companies who bid more than \$171 million for the right to offer broadband services to Canadians. The auction was conducted securely over the Internet by employing Canadian public key infrastructure (PKI) encryption and digital signature technologies to ensure the bids' confidentiality and authenticity.

The top bidding company was Wispra Networks Inc., with six top-standing high bids totaling \$74,020,000. Other provisional licensees include Stream Intelligent Networks Corp., AT&T Canada Telecom Services, BCTel Mobility Cellular Inc., WaveCom Electronics Inc., Gateway Telephone Limited, ABC Allen Business, Northwestel Mobility Inc., and Skycable Inc.

II. Canadian Environmental Law Update

The year 1999 was a relatively active year for environmental law in Canada. The constitutional overlap between the federal and provincial/territorial governments (as well as delegated environmental responsibilities to municipalities) led to considerable duplication, as both levels of government tackled issues that are local and national in scope.

After much controversy, the federal government passed a new Canadian Environmental Protection Act, 1999 (Bill C-32) in September 1999. The preamble indicates the government's priorities: pollution prevention; the control and management of pollutants and wastes; the "precautionary principle"; cooperation; and the integral role of science and the "polluter pays" principle. The most significant regulations that will implement the Act are currently being drafted.

The issue of bulk water exports received much attention in 1999, in both the provincial/territorial and federal governments. A summit meeting was held between the govern-

ments in an attempt to get an agreement on prohibiting the bulk export of water. The federal government, five of the ten provinces, and all three territories agreed to the accord. Five provinces reserved their position pending further consideration. A majority of the provinces have now enacted legislation that attempts to ban the bulk export of water. Constitutional jurisdiction and the North American Free Trade Agreement (NAFTA) will complicate the efforts of the governments from banning the export of water outright.

Endangered species legislation (in Canada, it will likely be called "Protection for Species at Risk") was set as a priority by the federal government. An accord was signed with the provinces and territories on setting priorities for action and protection of plant and animal species. At present, Canada has no such legislation.

The new federal Environment Minister David Anderson (who has considerable background in the environmental arena) has stated his priorities for the upcoming year include climate change, air quality, species at risk, water, the five-year review of the Canadian Environmental Assessment Act, and contaminated sites.

In regard to other provincial/territorial initiatives, voluntary initiatives continue to be popular as evidenced by the Alberta Memorandum of Understanding with chemical producers, and British Columbia's collaboration with Alcan on a voluntary pollution prevention plan. In 1999, much controversy was generated by Ontario's environmental deregulation, downsizing of environmental departments, and lack of enforcement. The newly elected government has promised to get tough on polluters and there are some indications that they will keep their promise.

Toronto, Canada's largest city, has published a proposed new sewer use bylaw that places strict limits on discharges of specific contaminants and requires industry to prepare pollution prevention plans. The bylaw is expected to set the precedent for other major cities in Canada.

For 2000, the federal and provincial/territorial governments will continue to work on harmonization initiatives, especially with respect to standards. Climate change, bulk water exports, and air pollution (PM10 and smog) will also continue to be high on the agenda.

III. Canadian Antitrust

A. AMENDMENTS TO THE COMPETITION ACT

One of the most significant developments in Canadian competition law in 1999 was the long-awaited passage of Bill C-20, which represented the first major change to the Competition Act since 1986. On March 18, 1999, most, but not all, of the amendments contained in Bill C-20 became law. Some of the changes now in place include:

- adding protection for "whistle-blowers" who alert the authorities about Competition Act violations by their employers;
- creating a new offense of "deceptive telemarketing";
- creating a new noncriminal track for misleading advertising (while retaining the criminal track for the most serious cases);
- allowing the Competition Bureau to use wiretapping to obtain evidence in deceptive telemarketing, bid-rigging, and conspiracy cases;
- changing the title of the head of the Competition Bureau from the "Director of Investigation and Research" to the "Commissioner of Competition"; and
- creating a much less onerous test the Commissioner must meet when obtaining an interim injunction preventing a merger.

Amendments to the premerger notification process were held back and are expected to be in place by the end of 1999. These changes would, most importantly, double the no-close waiting periods from seven to fourteen days and twenty-one to forty-two days, depending on whether a short-form or long-form filing is used. The changes will also significantly increase the amount of information that must be contained in a long-form filing.

B. MERGER REVIEW

The Competition Bureau's Mergers Branch appears to have had a less busy year in 1999 than in 1998 when it was preoccupied with two proposed mergers of four of Canada's five largest banks. The most significant publicly disclosed case in 1999 involved the airline industry, an area well known to the Competition Bureau from prior deals examined in the early 1990s.

This year's round of airline transactions began in August when the federal cabinet took the unprecedented step of suspending the application of the Competition Act for ninety days with respect to Canada's two national air carriers: Air Canada and Canadian Airlines. The stated purpose of the order was to enable discussion of possible transactions that might stabilize the national transportation system in light of the severe financial difficulty faced by Canadian Airlines. The process ultimately resulted in a bid for both airlines by Onex Corporation (a holding company with investments in a number of industries), who sought to merge the two airlines, as well as a bid by Air Canada to acquire Canadian Airlines, with Air Canada promising to continue to operate Canadian Airlines as a separate subsidiary. Onex later dropped out after a court declared its bid illegal, leaving Air Canada as the only bidder for Canadian Airlines. Air Canada's bid (which is still outstanding as of the time of this writing) appears to be subject to a full Competition Bureau review, the ninety-day suspension of the Competition Act having expired in November. The case promises to be an interesting one, given both the lack of existing domestic competition and restrictions on new entry by foreign carriers.

C. CONSPIRACY CASES AND CLASS ACTIONS

The Competition Bureau had another extremely successful year in terms of the value of conspiracy fines it obtained. In March, the Bureau obtained a record-breaking \$11 million fine against UCAR Inc. (along with \$19 million paid by UCAR in restitution to victims of the conspiracy) following an investigation into a price-fixing conspiracy in the graphite electrode industry. The fine against UCAR was obtained for implementing a foreign-directed conspiracy, rather than under the conspiracy provisions of the Competition Act, which is significant as the latter offense provides for a maximum fine of only \$10 million.

The most significant fines were obtained in September, when five companies involved in an international conspiracy to fix prices and allocate shares in Canadian vitamins and food additives markets were collectively fined \$88.4 million. This fine, which followed guilty pleas by the defendants, is the largest ever imposed in any antitrust or criminal matter in Canada. These fines marked a continuation of a trend towards soaring fines in international conspiracy cases—until 1995 the largest fine levied in any Canadian antitrust case was only \$2.5 million.

This year also saw the beginning of Canadian antitrust class actions when in July a court certified a class action in an antitrust case for the first time. Indirect purchasers alleging a price-fixing conspiracy among manufacturers of iron oxide pigments brought the action in

Ontario. Class actions are also expected against the participants of the vitamins conspiracy. Unlike the United States, Canadians have not tended to seek civil damages for criminal violations of the Competition Act, although the Act specifically allows such actions (the reluctance being due at least in part to the availability of only single as opposed to treble damages).

D. COMPETITION BUREAU GUIDELINES

In 1999, the Competition Bureau released guidelines covering several areas including pre-merger notification, the Bureau's immunity program for cooperating parties, and some of the recently introduced sections of the Competition Act such as deceptive telemarketing and wire-tapping. Most notable were the Intellectual Property Enforcement Guidelines (IPEG), which were released in draft form in June. The IPEGs outline the Bureau's approach to intellectual property matters in an attempt to provide certainty to businesspeople and thereby reduce any "chill" on the use of intellectual property that might otherwise arise. The IPEGs reject the view that intellectual property laws and competition laws must be at odds with one another and instead adopt the approach that both laws can enhance consumer welfare, albeit in differing ways. The IPEGs attempt to provide fairly specific guidance on the application of intellectual property to particular sections of the Competition Act and also provide a number of hypothetical examples. However, the draft IPEGs have been subject to some criticism and the Bureau intends to enter into a second consultative round on a revised version of the IPEGs sometime in the new year.

IV. Canadian Income Tax Law

The past year has been an eventful one in Canadian income tax law, through both court decisions and legislative initiatives.

The Supreme Court of Canada released its eagerly anticipated decision in *Shell Canada v. The Queen*. The case arose out of a Kiwi loan transaction in which Shell Canada borrowed New Zealand dollars at a market interest rate applicable to loans in that currency and concurrently entered into a series of forward contracts with a foreign bank that resulted in a conversion in its risk to U.S. dollars, creating a synthesized loan in U.S. dollars. The upshot of this transaction was an increased interest expense and a "locked-in" net foreign exchange gain to Shell Canada. Revenue Canada denied a portion of the interest deduction and treated the foreign exchange gain as being on income rather than on capital account. In allowing Shell Canada's appeal, the Supreme Court of Canada firmly established that the legal form of a transaction governs its Canadian income tax treatment rather than its economic substance, unless the transaction is a sham. In addition, it was held that the characterization of a hedge transaction generally follows the characterization of the underlying transaction, which was on capital account in this case. This decision continues a trend of taxpayer-friendly Supreme Court of Canada decisions, such as *Duba Printers (Western) Ltd. v. The Queen*, *Continental Bank Leasing v. Canada*, *Newman v. MNR*, and *Canderel Ltd. v. R.*

Tax professionals are concerned about draft legislation that imposes civil penalties on third parties that participate in a misrepresentation to Revenue Canada. The draft legislation contains two penalty provisions: (1) a penalty for misrepresentations in tax planning arrangements equal to the greater of \$1,000 and the gross entitlements in respect of the tax planning or the determination of the value of a property or service, and (2) a penalty for participating in a misrepresentation that could be used for the purposes of the Income Tax Act equal to the greater of \$1,000 and the penalty to which the other person (i.e., the taxpayer) would

be liable. These penalties are to apply when the third party has acted in a grossly negligent manner. The initial draft of these provisions included a limited exemption where the third party had relied in good faith on information provided by another person except where the misrepresentation was made in the course of a planning activity or a valuation activity. The most recent draft expands this good faith exemption to apply in all cases, including misrepresentations made in the course of a planning activity or a valuation activity.

The Income Tax Act rules relating to loans to nonresidents have been significantly expanded. Previously, a corporation resident in Canada would be deemed to have received interest at a prescribed amount when it had lent money to a nonresident person and the loan remained outstanding for more than one year without a reasonable amount of interest being paid. These provisions have been expanded to apply to all amounts owing by nonresidents to Canadian resident corporations, trusts with corporate beneficiaries, and partnerships with corporate partners where interest is not paid at a reasonable amount.

Draft legislation was released that will affect Canadian trusts with nonresident beneficiaries and nonresident trusts with Canadian beneficiaries. Under the draft legislation, a Canadian trust that distributes property to a nonresident beneficiary in satisfaction of a capital interest in the trust will be deemed to have disposed of the property at its fair market value. This will result in either a gain or a loss to the trust subject to Canadian tax. The trust will be able to post security for any tax payable on the deemed disposition of taxable Canadian property in lieu of paying the tax. The nonresident beneficiary will be deemed to have disposed of the capital interest in the trust for the fair market value of the property received less any capital gain to the trust. In addition, draft legislation was introduced affecting the application of the twenty-one-year deemed disposition rule to nonresident trusts with Canadian resident beneficiaries.

V. U.S. Legal Developments

Long-term trade friction between the United States and Canada ripened into several U.S., NAFTA, and World Trade Organization (WTO) cases, and other notable developments in late 1998 and 1999.

A. AGRICULTURAL TRADE DISPUTES

1. *Live Cattle from Canada*

Highly contested U.S. trade cases involved concurrent antidumping and countervailing duty investigations of live cattle from Canada. Following a disputed determination that the U.S. petitioner, an ad hoc coalition of cattle producers, had standing to bring the cases, the U.S. Department of Commerce ultimately reached final affirmative antidumping and final negative countervailing duty determinations.¹ The International Trade Commission (ITC) then made a final negative injury determination in the dumping case.² Hence, both cases were terminated with no assessment of antidumping or countervailing duties against imports of Canadian cattle. The U.S. petitioner has appealed only the ITC's injury determination in the antidumping case.

1. See Notice of Final Determination of Sales at Less Than Fair Value: Live Cattle from Canada, 64 Fed. Reg. 56,739 (1999); Final Negative Countervailing Duty Determination: Live Cattle from Canada, 64 Fed. Reg. 57,040 (1999).

2. See *Live Cattle from Canada*, 64 Fed. Reg. 66,197 (1999).

The central allegation of the countervailing duty investigation involved a relatively novel theory that the Canadian Wheat Board (CWB), through its exclusive control of exports of Canadian feed barley, restrained the amount of feed barley actually exported from Canada, thereby inflating the amount and suppressing the price of feed barley sold in the domestic market to Canadian cattle producers. This, the petitioner argued, gave a countervailable benefit to Canadian cattle producers in the form of artificially low prices for feed barley. Feed barley is the primary feed ingredient for cattle in western Canada, where most Canadian cattle are produced. The Department of Commerce found that the feed barley prices paid by Canadian cattle producers were not low and, therefore, they received no countervailable benefit. It bypassed any lengthy examination of the economic and legal theories involved in the case, although expressing the view that export restraints could be countervailed. The overall level of benefits for all programs was below the one percent *de minimis* threshold set by U.S. countervailing duty law (as required by the WTO Agreement on Subsidies and Countervailing Measures).

2. *Live Swine from Canada*

The five-year "sunset" reviews mandated by the Agreement on Subsidies and Countervailing Measures have resulted in the Department of Commerce's decision to revoke the fourteen-year-old countervailing duty order on live swine from Canada. The decision, issued in November 1999,³ was based on the finding that the Canadian government and the provincial governments are not likely to provide more than a *de minimis* level of countervailable subsidies should the order be revoked. Revocation will take effect as of January 1, 2000.

The decision is the first sunset review in which the Department of Commerce has revoked a countervailing duty order over the opposition of a U.S. petitioner. It also ends a long history of litigation, including twelve active administrative reviews, three U.S.-Canada Free Trade Agreement (CFTA) or NAFTA chapter 19 panel reviews, one CFTA Extraordinary Challenge, and one appeal to the U.S. Court of International Trade (CIT).

3. *Softwood Lumber from Canada*

The most recent skirmish related to softwood lumber concerns predrilled wooden studs. This skirmish arose from the five-year Softwood Lumber Agreement (Agreement) that Canada and the United States entered in 1996. The Agreement placed a cap on Canadian lumber exports to the United States above which export fees would be assessed. In April 1998, the U.S. Customs Service announced its intent to review and perhaps reclassify the predrilled studs, which were not subject to the Agreement, into a classification that would subject those imports to the Agreement. Subsequently, the U.S. Customs Service ruled that this type of lumber would be reclassified and added to the list of products subject to the Agreement.

Canadian parties appealed to the CIT, which affirmed the U.S. Customs Service decision.⁴ The Court of Appeals for the Federal Circuit (CAFC) subsequently vacated that portion of the CIT decision, leaving intact the underlying U.S. Customs Service ruling.⁵ In May 1999, Canada turned to the World Customs Organization (WCO) and requested

3. Final Results of Full Sunset Review: Live Swine from Canada, 64 Fed. Reg. 60,301 (1999).

4. See *American Bayridge Corp. v. United States*, 35 F. Supp. 2d 922 (Ct. Int'l Trade 1999).

5. *American Bayridge Corp. v. United States*, 1999 WL 997303 (Fed. Cir. 1999) (unpublished disposition).

a ruling on the classification decision. The WCO made a decision in opposition to the U.S. Customs Service ruling and found the subject product to be outside the classifications of the Agreement. The United States has taken no steps to implement this decision, however, which it considers to be nonbinding. Thus, at present, Canadian predrilled wooden studs are treated by the United States as subject to the Softwood Lumber Agreement.

4. *Sugar Syrup from Canada*

Customs Service action also gave rise to the dispute this year over sugar syrup from Canada. In 1995, a Canadian company that imports sugar syrup from Canada and refines it into liquid sucrose obtained a ruling from the U.S. Customs Service that when imported, the sugar syrup would be classified under a Harmonized Tariff Schedules (HTS) subheading that carries a duty rate of 0.2 cent per liter for NAFTA-originating goods. In September 1998, a year after the company began operations, the Customs Service published a notice of revocation of that ruling to be effective on November 8, 1999. The revocation, which was based in part on the use of the syrup after its importation, would have subjected the imported sugar syrup to a prohibitive "tariff-rate quota" resulting in a duty increase of 7,000 percent. The company, Heartland, sought immediate judicial relief at the CIT.

Based on the principle that goods must be classified in their condition as imported, the CIT decided that the correct classification for the sugar syrup was as classified in 1995. The court observed that a manufacturer is free to fashion its processes to avoid the burden of high duties, and goods may be legitimately imported at any stage of manufacturing or processing, even if importation occurs after an interruption for the purpose of obtaining a lower rate of duty.⁶

5. *Canadian Milk Marketing System*

In March 1998, at the request of the United States and New Zealand, a WTO panel was established to examine whether Canada was violating its trade obligations under the WTO with respect to its pricing system for milk used to make dairy products for export. The two countries complained that Canada's system of providing cheaper milk to make products for export, through a complex system involving producer marketing boards and federal and provincial regulatory elements, amounted to an export subsidy under the WTO Agreement on Agriculture. They also complained that Canada had not complied with a Uruguay Round obligation to open a tariff-rate quota for fluid milk and cream.⁷ The U.S. action stemmed from the petition of three major U.S. dairy organizations to the U.S. Trade Representative under section 301 of the Trade Act of 1974.⁸

In May 1999, a WTO panel issued a report agreeing with the United States and New Zealand positions, and Canada appealed. A WTO Appellate Body report reversed in part the panel findings in September 1999, but upheld the panel on its finding that the Canadian milk marketing system constituted government action that resulted in an export subsidy inconsistent with the Agreement on Agriculture.⁹

6. *Heartland By-Products, Inc. v. United States*, 74 F. Supp. 2d 1324 (Ct. Int'l Trade 1999).

7. See *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Report of the Panel, WT/DS103/R, WT/DS113/R, 38 I.L.M. 1462 (May 17, 1999), available at <http://www.wto.org>.

8. 19 U.S.C. § 2411 *et seq.* (2000).

9. *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Report of the Appellate Body, WT/DS103/AB/R, WT/DS113/AB/R (Oct. 13, 1999), available at <http://www.wto.org>.

B. INVESTOR-STATE DISPUTES UNDER NAFTA

The last year has seen several U.S.-Canada disputes under the investor-state settlement provisions of chapter 11 of NAFTA.

1. *Ethyl Corp.*

In July 1998, Canada settled a \$251 million suit against it brought by Ethyl Corp. The Ethyl litigation began in 1997 after Canada placed a ban on the importation of a product that Ethyl made, methylclopentadienyl manganese tricarbonyl (MMT), due to its environmental and health dangers. Ethyl filed suit under chapter 11 of NAFTA, arguing that the ban on MMT would preclude its sales to Canada and therefore violate its investor's rights. Canada opted to eliminate the ban on MMT and pay \$13 million in damages to Ethyl.

2. *Methanex*

A pending chapter 11 claim involves a suit against the United States by a Canadian company, Methanex. Methanex is suing the United States for \$970 million based on damages foreseen from U.S. implementation of a ban on methyl tertiary butyl ether (MTBE), one of the products that Methanex makes. Both California and the Environmental Protection Agency (EPA) have advocated the phase-out of MTBE as a gas additive due to environmental and health concerns, and in March 1999, the United States announced its intent to phase out MTBE by the end of 2002. Methanex argues that the proposed ban amounts to an expropriation of its market and potential profits.

3. *Loewen Group*

Another Canadian company, the Loewen Group Inc., has filed a \$725 million suit against the United States under chapter 11 of NAFTA, claiming unjust treatment in 1995 litigation with a U.S. company in Mississippi. The Loewen Group asserts that anti-Canadian bias in the jurists prompted them to make an extreme, overly punitive judgment of \$500 million. Loewen invokes article 105 of NAFTA, which calls for observance of NAFTA provisions by state and provincial governments, with the argument that the United States is liable for the actions within the state jurisdiction of Mississippi.

C. BILATERAL NEGOTIATIONS AND AGREEMENTS

1. *Agricultural Trade Monitoring*

In a cooperative approach to border disputes, Canada and the United States signed a Memorandum of Understanding (MOU) on December 4, 1998, covering seventeen different irritants in their bilateral agricultural trade. Principal issues covered included:

- increased access for U.S. hogs to the Canadian market by modifying Canadian testing and quarantine procedures (the required modifications finally came into force on October 7, 1999), and facilitated access to the Canadian market for U.S. feeder cattle from states free of certain diseases;
- an undertaking by Canada to review generally its phytosanitary regulations governing imports of animals and animal products, and an undertaking by the United States to eliminate inconsistencies between federal and certain state animal health requirements;
- an agreement to cooperate in the exchange of information related to the cattle trade;
- Canada's agreement to facilitate the rail transport in-transit within Canada of certain grains from certain states that are free of specified grain diseases, to improve access for

U.S. farmers to primary grain elevators in Canada, and to phase in reduced phytosanitary testing on importation into Canada of wheat and other grains originating in specified disease-free states;

- an agreement to meet at least quarterly to consult on global grain production and marketing, to include, among other things, an exchange of information on each country's projected quantity of certain grains likely to be exported to the other country in the current marketing year; and
- an agreement that country of origin labeling requirements for food products be consistent with NAFTA and WTO country of origin rules.

While the MOU did not resolve all of the parties' outstanding disputes, it established a process by which the two governments may be able to work together to advance their interests in these areas without the need to force some resolution through the mechanism of trade actions.

2. *Magazines*

The "cultural" battle between Canada and the United States over Canada's magazine policies also continued in 1999. The dispute stemmed from a 1997 U.S. complaint to the WTO regarding a Canadian ban on foreign split-run Canadian periodicals. The WTO found in the United States' favor that the Canadian policies were a violation of WTO rules. In response, in late 1998, Canada introduced an amended magazine policy, Bill C-55. The proposed law would prohibit foreign magazine publishers from selling advertising aimed primarily at the Canadian market and would inflict financial penalties on any offenders of the restriction.

While the bill was regarded in Canada as a legitimate attempt at cultural preservation, the United States questioned its adherence to WTO principles and threatened bilateral retaliation in the form of duties on imports from Canada. However, the dispute was resolved by bilateral negotiations. In May 1999, the United States and Canada reached a compromise under which U.S. publishers were granted a share of the Canadian advertising market, but the Canadian government maintained some rights, primarily through the Canadian Culture Ministry, to provide indirect assistance to the Canadian magazine sector.

3. *Salmon*

In June 1999, the United States and Canada reached an agreement on the fishing of salmon in the Pacific Northwest after five years of negotiations. The agreement aims to protect several dwindling species of salmon and ensure the continued maintenance of the U.S. and Canadian salmon industries in the shared waters of the Pacific. It requires U.S. and Canadian fisheries to divide their catches more evenly, and it earmarks a total of \$140 million for joint conservation efforts, including habitat restoration assistance. The agreement lasts until 2009.