Journal of Arbitration Studies, Vol. 26 No. 3
September 1, 2016, pp. 3~26
http://dx.doi.org/10.16998/jas.2016.26.3.3

Received : August 9, 2016
Revised : August 23, 2016
Accepted : August 28, 2016

A Study on the Dispute Settlement Procedure for the Preferential Rules of Origin

Ji-Soo Yi*

The preferential Rules of Origin (RoO) govern tariff preferences that are given in accordance with the FTA. However, relatively few studies have been devoted to the procedures in settling disputes that are relevant to RoO under the FTA. This study is a first attempt at analyzing the applicability and the potential improvement in dispute settlement procedures in FTAs targeted at the preferential RoO. By exploring three dispute cases involving the preferential RoO, it is suggested that restrictiveness, complexity, and uncertainty that are inherent in the preferential RoO may trigger political tension and dispute. Forming a panel that is capable of mitigating political tension, facilitating participation and early cooperation of experts and stakeholders, and establishing a well-structured enforcement procedure are essential in dispute settlement procedures to resolve disputes involving cases on RoO. Furthermore, the current dispute settlement procedure that hinders the private sector's access should be changed to one that is more open to private sector entities, such as companies, to facilitate the enforcement of the decision. Given that more improved FTA dispute settlement procedure may guarantee the enforcement and application of the FTA preferential treatment in relation with more politically powerful states and foster genuine free trades, more in-depth studies must be conducted on this topic.

Key Words : Rules of Origin, FTA, Disputes on the Country of Origin, Preferential Rules of Origin

〈 Contents 〉

Ⅰ. Introduction
Ⅱ. Preferential RoO and disputes
Ⅲ. Analyzing the disputes over RoO
Ⅳ. The procedure settling disputes over the preferential RoO
Ⅴ. Conclusion
References

* Ph.D. in International Trade. University of Canberra.
Licensed Customs Consultant. AOne Customs & Trade Service (email: jisooyi@aonecustoms.com)

Ⅰ. Introduction

The preferential Rules of Origin (henceforth 'RoO') govern tariff preferences that are given in accordance with the Free Trade Agreement (henceforth 'FTA'). Since the global expansion of the FTA that began in the mid 1990s, Korea has been able to enjoy preferential tariff in trading with 52 countries under 15 independent free trade agreements. Since the preferential tariff pursuant to the FTA are applied only to items originating from contracting parties, countries that wish to enjoy the benefit of preferential tariff should follow a series of procedures that are designed to verify the origin of the specific product. The preferential RoO contain such rules and procedures that specify the origin of a given product and are designed to grant preferential tariff (WTO, 2016).

Though the preferential RoO is the core rule for merchandise trade pursuant to the preference agreement, it contains rules that can potentially trigger a dispute, owing to its complex and cryptic rules, and vagueness in defining responsibility and risk. Efforts have been made to establish unified rules to resolve issues associated with the preferential RoO, but parties stopped at specifying a model of preferential RoO[1], leaving contracting parties of FTAs to come up with their respective preferential RoO each time they sign a preference agreement[2]. As a result of such grueling procedure, the global spread of FTA made export/import procedure pursuant to the preferential RoO as complicated and cryptic as a spaghetti bowl (Bhagwati, 1995), thereby sparking endless disputes with regard to the interpretation and application of the rule. It is unclear who must be held culpable among exporter and importer, or the custom authorities of the exporter and the importer regarding associated risk and responsibility, since the certificate of manufacture for a given product is issued by the manufacturing country of the product, whereas provision of preferential tariff or associated punishment are executed by the importing country on importers, thereby making it a cause of extreme uncertainty. Such uncertainty is the main reason why FTA preferential tariff is not actively utilized by companies (Yi, 2015).

1) Annex D.1 and D.3 of, the International Convention on the Simplification and Harmonization of Customs procedures (Kyoto Convention).

2) In this paper, a preferential agreement includes bilateral or plurilateral FTAs

The international dispute over the country of origin rule is feared to increase even more with the growing international trade volume driven by preferential treatment. However, relatively few studies have been devoted to the dispute settlement procedures concerning RoO under FTAs. Since no member nation would apply or implement the preferential tariff specified in the FTA, given the absence of an effective and fair dispute settlement system, the dispute settlement system is the key to proper compliance of the preference treatment specified in the FTA, as well as to the desirable enforcement of FTA rules. Furthermore, many cases generated in the course of settling dispute cases would further provide a basis to improve the preferential RoO. Since the number of complaints filed with the panel of FTA arbitration is extremely low due to esoteric country of origin rules and technical complexity, and related official records are disclosed only on a limited basis, an in-depth study on the dispute settlement procedure under FTA has not been performed sufficiently to date [3](Azrieli, 1993). It is therefore urgently required to perform studies on the dispute settlement procedure with an understanding of the predominant characteristics of disputes that are associated with the preferential RoO in order to apply the preference treatment of the FTA and improve its enforcement procedure.

Based on the aforementioned understanding, the author poses following the research questions: What are the types and characteristics of disputes that are stemming from the preferential RoO? What improvements should be made on the FTA rules on dispute settlement to obtain a dispute settlement procedure that ensures enforcement and application of the preferential RoO?

To answer these research questions, the author analyzed preceding studies on core FTA rules on dispute settlement, as well as essential judicial precedents associated with the preferential RoO. Based on this research, the author intends to define the types and characteristics of trade disputes, and analyze potential improvement methods for the preferential RoO. This study is significant because it is a first attempt at analyzing the applicability and potential improvement of the rules on dispute settlement in the preferential trade agreement targeted at the preferential RoO, and that it is aimed at providing detailed policy levers that would ensure the enforcement of the intended goal of the preferential treatment by improving the trade dispute settlement procedure in the preferential RoO.

3) Almost every FTA has its own provisions for dispute settlement, mostly based on ADR procedures.

To achieve the aforementioned research goals, the author will analyze the existing rules on dispute settlement as well as study the trends on this issue through an overview of the preferential RoO as well as of the existing agreement and preceding studies. Based on the preceding studies and judicial precedents, the author will explore the functions and limitations of the trade dispute settlement procedure of FTA as a tool in ensuring procedural and practical rationality in the resolution of trade disputes stemming from the preferential RoO. Next, the author will explore possible policy alternatives that would overcome the limitations of the dispute settlement procedure of FTA, and test its enforcement direction at the theoretical level. Lastly, the author will come up with the policy implication on the operation and improvement of the dispute settlement procedure of FTA in accordance with the preferential RoO on the basis of the results of the analysis.

Ⅱ. Preferential RoO and disputes

1. Overview of the preferential RoO

The World Customs Organization classifies the rules on the country of origin into two groups: the preferential RoO aimed at providing tariff preference in accordance with regional trade agreement or preferential trade agreement; and the non-preferential RoO aimed at applying non-preferences, such as anti-dumping duty and countervailing duty (WTO, 2016). The preferential RoO is being used widely across diverse regional trade agreements, such as FTA or the customs union that warrant mutual preferential duties for more than two different countries or economic zones, or across multiple preferential trade agreements, such as the general system of preference (GSP) that guarantees unilateral preferential duties. Each country specifies its own rules on the country of origin in accordance with the General Agreement on Tariffs and Trade (GATT, 1947), which is the reason why rules governing the country of origin vary, depending on the nation or the FTA (Brenton P. and Imaga H., 2005). The complex procedure that deals with arcane rules on the country of origin put immense burden on companies and customs authorities as to cancel out the benefit they can enjoy from the preferential tariff. The WTO and WCO have taken action to unify and simplify the

rules of origin. However, they had to stop at coming up with a unified agreement only on the non-preferential rules of origin. Annexes D.1 and D.3 of the International Convention on the Simplification and Harmonization of Customs Procedures that took effect in 1974 are being used by many nations as a model for preferential rules of origin, but it has since failed to evolve as a unified rule.

In the majority of agreements, preferential rules of origin were established by following the aforementioned model rule, and for this reason they share core provisions. According to the rule, the country of origin is the one where the product in question was [4]*wholly obtained* or the final one where [5]*substantial transformation* on the product in question was performed. Since the RoO determine the country of origin for a given product based on the production and manufacturing procedure of the product, volumes of documents are required to be prepared and archived, including documents on raw materials, production cost, manufacturing procedure, classification of raw material, and suppliers of raw materials. Basically, each manufacturer is held responsible for determining the country of origin in accordance with the preferential RoO based on the information on manufacturing procedure and raw materials. Importers or exporters who have no such information on manufacturing or production procedure of a given product should demand the manufacturer of the product to submit related documents on the country of origin.

Manufacturers, exporters, or even importers (in the case of the Korea-U.S. FTA) can issue a certificate of origin. The certificate of origin is prepared by filling in a specified form or by adding to the invoice in the form of a specified phrase before being delivered to importers. Then, the importer can apply for FTA preferential tariff to the customs authority in the importing country based on the certificate of origin he/she has received. The types of certificate of origin is classified into authority-issuing in which the certificate is issued by a customs authority or by other governing authorities, and self-issuing, in which the certificate is issued voluntarily by exporters or by importers.

Post origin verification, where the customs authority of the importing country verifies whether or not preferential tariff was awarded legitimately, has been a direct cause of

4) Wholly-obtained method (WO) is a type of RoOs that determines the country of a product's origin as the country where a product is wholly produced.

5) Substantial transformation method is a type of RoOs that is applied in cases where more than one country is involved in the production of a product. The rule is satisfied by proving that a particular product has undergone sufficient work or processing in countries party to FTAs.

trade dispute between the customs authority and the companies or between exporting companies and importing companies. The post origin verification is classified into direct verification where the customs authority of the importing country verifies the exporter or the manufacturer of the exporting country directly, or indirect verification where the exporter or the manufacturer of the exporting country is verified via the customs authority of the exporting country before the verification result is notified to the importing country. To perform post origin verification, the customs authority of the importing country verifies information related to the raw materials or manufacturing that was prepared by the exporter or the manufacturer of the exporting country either directly or indirectly before it can conclude whether the country of origin rule was satisfied or not. Due to the nature of the verification procedure where two independent nations with different legal and cultural backgrounds are involved, there is a large room for dispute in understanding and in the application of the country of origin rule. Some of the main issues experienced in applying post origin verification include: 1. The customs authority should spend substantial amounts to visit the other party for verification (Izam, 2003); 2. There are potential differences in the interpretation and understanding of the RoO of the exporting and importing country (Cantin and Lowenfeld, 1993); and 3. The effectiveness of the verification is not ensured if there is no smooth cooperation between the customs authorities in the case of indirect verification (Commission of the European Communities, 2003). Table 1 shows different country of origin verification and post origin verification procedures according to various FTAs Korea has signed so far.

<Table 1> Certificate and Verification under Korean FTAs

FTA (Effective Year)	Issuance of the Certificate of Origin	Post Origin Verification
Korea-Chile FTA (2004)	Self-certification	Direct Verification
Korea-Singapore FTA (2006)	Authority Issuing	Indirect/Direct Verification1)
Korea-EFTA FTA (2006)	Self-certification	Indirect Verification
Korea-ASESAN FTA (2007)	Authority Issuing	Indirect Verification
Korea-India CEPA (2010)	Authority Issuing	Indirect Verification
Korea-EU FTA (2011)	Self-certification (Authorized Exporter)	Indirect Verification

FTA (Effective Year)	Issuance of the Certificate of Origin	Post Origin Verification
Korea-Peru FTA (2011)	Self-certification	Direct Verification
Korea-U.S. FTA (2012) Korea-Turkey FTA (2013)	Self-certification Self-certification	Direct Verification Indirect Verification
Korea-Australia FTA (2014)	Self-certification/ Authority Issuing	Direct Verification
Korea-Canada FTA (2015)	Self-certification	Indirect Verification
Korea-New Zealand FTA (2015)	Self-certification	Direct Verification
Korea-China FTA (2015)	Authority Issuing	Indirect/Direct Verification1)
Korea-Vietnam FTA (2015)	Authority Issuing	Indirect/Direct Verification1)
Korea-Columbia FTA (2016)	Self-certification	Indirect/Direct Verification1)

1) The post verification under these FTAs is performed first indirectly by the customs authority of the exporting country, and then in exceptional cases, by the customs authority of the importing country.

2) Source: Korea Customs Service FTA Portal, http://www.fta.customs.go.kr retrieved on July 1, 2016.

2. Restrictiveness, Complexity, and Uncertainty of the RoO

Preceding studies on the preferential RoO singled out diverse factors that FTA may not be utilized and cause trade disputes. The issue posed most frequently by preceding studies is that RoOs can be applied very strictly as tacit tools to foster protective trade in FTA. Arguments have emanated from debates on the restrictive nature of preferential RoOs. Ju and Krishna (1998) argued that the trade creation effect of FTAs for member countries is frequently hampered by RoOs that require firms to use ineffective local inputs for their production of finished goods. Ju and Krishna warned that restrictive RoOs undermine trade of both finished goods and the inputs among member countries. Krishna and Krueger (1995) and Krueger (1993) have urged that countries use RoOs as trade policy instruments, substituting tariffs.

Estevadeordal et al. (2007) suggested that complex RoOs raise costs and uncertainty for both the public and private sectors. The complexity of RoOs increases: first, when the rules for a product vary across regimes and, second, when the rules are applied under a complex pattern of trade among the parties under the FTAs. In their investigation of the complexity of product specific rules of origin (PSR) applied to

PANEURO, NAFTA, and E.U.'s preferential trade agreements, Cadot, Carrère, et al. (2006) contended that the higher administrative costs for PANEURO are consistent with the more cumbersome procedures required for the certification in the PANEURO system.

When analysed from the perspective of dispute settlement, the verification procedures under RoOs have considerable issues (Izam, 2003). Since customs authorities in two parties under an FTA are involved in the verification procedure, an interpretation of the origin made by one party may not be always consistent with that of the other party. As suggested by Harris and Staples (2009), another dilemma in this procedure is "balancing the rights and obligations of the producer and the importer". While the producer is knowledgeable on the origin of his/her product, the importer is responsible for the payment of tariffs. Therefore, if the producer, either by fraud or negligence, provides a faulty statement of origin in relation to his/her product, the importer is liable for unpaid tariffs and penalties. If self-certification methods are introduced to allow the importer to issue the certificate for the purpose of protecting importers, the importer's liability becomes more onerous, as higher costs are required for importers to certify the origin. The uncertainty in verification procedure increases the operating costs of FTAs, thus discouraging companies from using FTAs.

Studies have suggested that these factors of preferential RoOs have caused disputes, however, dispute settlement procedures under FTAs are neither predictable, nor transparent in the context of politically sensitive disputes (Cantin and Lowenfeld, 1993). Furthermore, the verification procedure, which requires the Customs authority of the importing country to obtain the required information directly or indirectly from the exporting country, entails a considerable financial cost. The verification procedure has often been rendered ineffective by such budgetary restrictions in verification visits. To compensate for this weakness in the post-verification procedure, countries tend to increase the stringency of the pre-export inspection in the certification procedure (Commission of the European Communities, 2003). However, by doing so, exporters are frequently subject to a stringent pre-export inspection and, sometimes, also to a post-audit check (Manchin and Pelkmans-Balaoing, 2007). This increases the uncertainty of companies on their liability under RoOs and reduces the use of FTAs, which often ends up in disputes.

Azrieli (1993) compared different dispute settlement procedures that are employed to settle trade disputes in the form of arbitration under FTA, including those by the Canada-US FTA, Bilateral Investment Treaties, the ICSID, UNCITRAL, International Chambers of Commerce, and the American Arbitration Association. The author stresses the following core issues in the design of FTA provisions on dispute settlement: arbitration institution that mitigates political tension; procedural rules well equipped with necessary procedures from the initiation of dispute until the derivation of a binding resolution; openness that provides dispute filing opportunity for private sector entities and individuals; and the publication of the panel's final and binding decisions that enforce the final resolution by arousing public opinion. In particular, the author stresses the importance of granting the private sector an access to the forum, while reminding readers that companies, manufacturers, and exporters are the real parties or the real beneficiaries of an FTA.

Schrombges and Wenzlaff (2011) weighed the respective responsibility of the exporter, importer, and customs authorities in the exporting and importing country, respectively, in the post origin verification when determining the preferential RoO in EU. While introducing the dispute settlement cases between the customs authority and importers in EU, the authors explain that the verification of the certificate of origin issued by exporters should be performed by the customs authority in the exporting country at the request of the importing country, while the judgment on the accuracy and authenticity of the certificate of origin shall be left to the discretion of the customs authority of the exporting country, and the customs authority of the importing country must simply accept such decision. The author points out that such ambiguity in determining the respective responsibility in the preferential RoO is forcing relative parties to waste time in determining who to blame in terms of responsibility and forcing them to spend more time in getting into the core of the substantive issues. The author also points out that private sector entities should settle their respective responsibility via a separate dispute settlement procedure since they cannot file a claim on origin verification through the dispute settlement procedure recommended by the FTA.

Park and Lee (2012) argued in their analysis of FTAs Korea has signed to date that FTA has expanded its reach, but it has failed to consider varying relationships with

particular countries. The authors therefore proposed potential models for the resolution of trade disputes stemming from FTAs Korea signed by comparing provisions on the trade dispute settlement in FTAs between advanced nations, those between advanced and developing nations, and those between developing nations. The authors analyzed if different FTAs stipulated provisions designed to prevent forum shopping when the parties could utilize different dispute settlement rules specified in the FTA and WTO, respectively, if they stipulated the installation of the standing institution for trade dispute settlement, and finally whether or not the decision of the arbitration panel has a binding force on the parties, concluding that trade dispute settlement procedures that are different by respective FTAs should be unified and improved to one that is more efficient.

Do (2008) analyzed the FTA dispute settlement system based on the precedents of the NAFTA. The author pointed out the vulnerability of those provisions on reports and monitoring that are related with the enforcement of panel decisions, arguing that NAFTA should raise/train an expert panel on trade laws and that it should run resolution procedure faster and more conveniently than what the WTO is doing.

Choi (2014) proposed conciliatory trade dispute settlement procedures, while discussing related provisions in the Korea-China FTA in which the panel decisions have a binding power on the disputing parties via an agreement between them. With regard to the resolution of confrontation over jurisdiction, the author proposed to apply only FTA dispute settlement procedure to specific types of disputes between the two countries by considering their unique relationship. The author also stressed that parties should be encouraged to use filing rights more proactively and that such move may improve democratic and procedural legitimacy associated with the enforcement of the FTA. Given that there is a high probability of trade dispute occurring among private entities associated with FTA, the author proposed to stipulate encouragement of the use of arbitration as in the case of the NAFTA or of other alternative dispute resolution (ADR) procedures while stressing there can be unexpected delay or uncertainty in the dispute settlement via a domestic court in China due to the Chinese culture of avoiding litigation and its status as a socialist nation.

In conclusion, preceding studies singled out uncertainty stemming from stringent provisions in the preferential RoO, complex and cryptic provisions, and post

verification of origin as the potential cause of those disputes associated with the rule. The dispute settlement provision designed to handle such trade disputes should be treated as one of the core provisions that are enforced beginning at the FTA signing phase. The issues associated with the preferential RoO include: establishment of arbitration institution that can mitigate political tension; efficient and sophisticated procedures of dispute settlement; openness to private-sector entities; and publication of the panel decisions. In the following segment, the theoretical framework required to apply various theories through preceding studies to real-life cases shall be established. First, a theoretical framework designed to analyze real-life cases associated with the FTA preferential RoO and then possible room for improvement in the dispute settlement rules shall be constructed, followed by the design of the research method based on this analysis.

Ⅲ. Analyzing the disputes over RoO

1. Theoretical framework

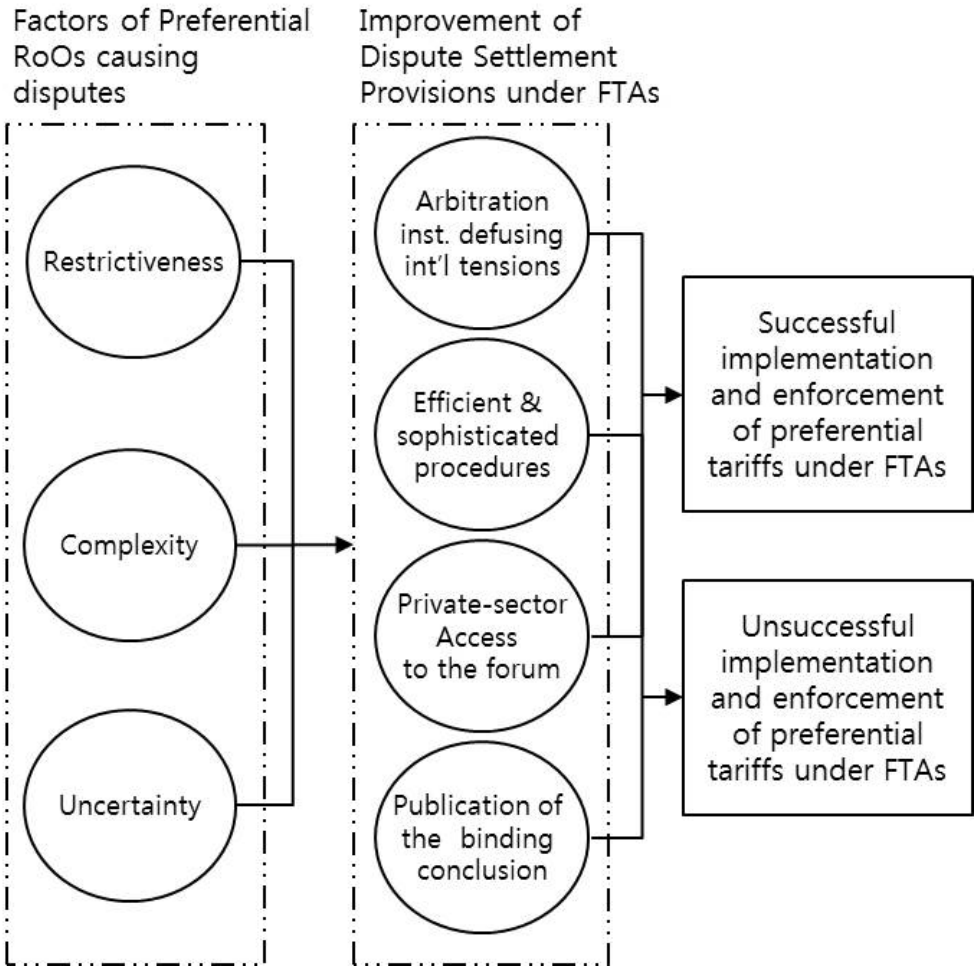
Park and Lee (2012), Azrieli (1993), and Do (2008) each confirmed in their respective discussion that the role of the FTA dispute settlement rule should be aimed at realizing a more effective dispute settlement procedure, reflecting conflicting interest of concerned parties than that of the WTO. In particular, they contended that the dispute settlement rule should guarantee enforcement and application of those preferential treatments befitting the intended goals of such preference among signing parties. Ju and Krishna (1998), Estevadeordal et al. (2007) and Harris and Staples (2009) each confirmed in their discussion that the preferential RoO still contain numerous problems that could ignite a dispute among the signing parties of the preferential agreement despite their best effort to simplify and unify the rules. The preferential RoO can be excessively stringent as a result of having accommodated conflicting political interests, understanding of and judgment on the rule can vary since the rule itself is technically cryptic, and, finally, there is no clear division of responsibility among exporters and customs authorities in the exporting and importing nations involved in the enforcement of the rules. It can be concluded from the

discussion of Azrieli (1993) that following issues would play an important role in ensuring enforcement and application of the preferential treatment by effectively handling such disputes: establishment of an arbitration institution that can mitigate political tension; efficient and sophisticated procedures of dispute settlement; openness to private-sector entities; and publication of the panel decisions. Figure 1 shows such theoretical proposition.

The analysis of real-life cases based on such theoretical proposition, including technical analysis of cases and analysis of improvement ideas, shall be performed in accordance with the following procedure:

First, disputing parties shall be identified along with the background and cause of the dispute, development procedure, and core issues and decisions as part of a technical analysis of those judicial precedents associated with the preferential RoO. In particular, it will be checked whether main issues in a particular case can be explained as a predominant dispute factor of the preferential RoO.

Second, it will be investigated whether the improvement ideas proposed by the preceding studies are useful in dealing with trade disputes and accomplishing intended goals of the preferential RoO. Specifically, it will be judged whether or not an establishment of an arbitration institution is necessary to mitigate political tension; efficient and sophisticated procedures of dispute settlement; openness to private-sector entities; and publication of the panel decisions can be accepted as effective means to ensure stringent running of the rule owing to political influence, resolve conflict of interest over cryptic rules, and clarify the respective responsibility of concerned parties without clashing with the customs authorities implementing and enforcing the preferential treatment and reality of export/import.



<Figure 1> Theoretical Framework of the Study

2. Research Design

This research shall be performed following the multiple case analysis method that is used to deal with many different judiciary precedents. As it is the first such study on the dispute settlement procedure associated with the preferential RoO, the multiple case analysis method was selected to ensure detailed and rich description, and an analysis of the situation and the context of each case. For any research inquiry with further implication, it would be possible to propose generalizations based on empirical studies.

In collecting necessary materials, the author strived to approach the given issue from a wider angle by ensuring an objective perspective through the use of multiple sources. First, the overall situation was explored by performing a basic literature review that was then followed by the collection of judiciary precedents highlighted by preceding studies. Considering there are only limited records available on the judiciary precedents that used the FTA dispute settlement procedure, the author collected cases of judicial rulings and litigations that dealt with the preferential RoO. Furthermore, articles, policy analyses, and policy reports published by concerned agreements, local enforcement laws, and news media and community newsletters were collected as well.

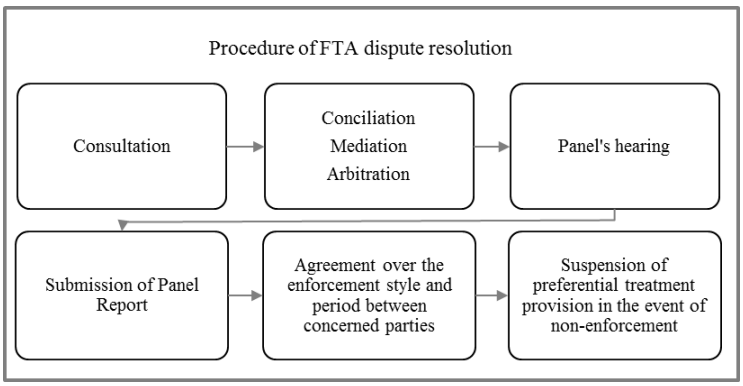
A technical analysis was performed over two different segments: analysis on related agreements and legal provisions, and analysis on the development of and decision on each real-life case. The analysis of those factors in need of improvement was performed in accordance with the 'pattern matching' method that verifies whether or not the pattern of those factors predicted by theoretical propositions and the empirically-observed pattern correspond with each other. In the case of the pattern matching method, it can be judged that the case study has secured internal feasibility if the pattern predicted by the theoretical proposition coincides with the empirically-observed pattern. This study was performed by focusing on verifying "why" and "how" a specific case could be handled by the dispute settlement procedure. For more on this, please consult the case study methodology by Yin (2008).

Told again, the author verified whether the improvement ideas for the dispute settlement procedure designed to ensure appropriate enforcement and application of the preferential RoO (which is the theoretical proposition backed by this study) would ensure effective handling of the root causes of disputes, and how such procedure could conspire. Furthermore, the author also explored the implications of running preferential RoO as well as improvement ideas for the existing resolution method based on the results of the analysis.

Ⅳ. The procedure of settling disputes over the preferential RoO

1. Dispute Settlement Provisions under FTA

In the segment on cases, real-life cases related with the preferential RoO specified in the Canada-US FTA, NAFTA, and EU shall be explored. According to a comparative study on the country of origin rules established by WCO (, the majority of preferential agreements have its respective dispute settlement provisions or institutions in place. In particular, the disputes associated with the interpretation and enforcement of the preferential RoO are supposed to be settled by the Commissions and Associations Council or committees that were established in accordance with the dispute settlement rule stipulated by the preferential agreement (World Customs Organization, 2007). Given that it is rational for the concerned parties to follow the dispute settlement procedure stipulated by the FTA if the main issue of the dispute was included in the FTA special concession, the dispute settlement procedure for the preferential RoO should follow the dispute settlement procedure established by the FTA. In reality, however, the FTA dispute settlement procedure was not used for settling disputes associated with the preferential RoO. Rather, litigation procedure was favored more frequently. The FTA dispute settlement provision is executed by employing the Alternative Dispute Resolution (ADR)procedure. Figure 2 below shows a brief procedure of the FTA dispute settlement.



<Figure 2> Procedure of FTA dispute settlement

There is a clear reason behind the introduction of the dispute settlement procedure on the basis of ADR by FTA. It was intended to settle political disputes over preferential treatment between the contracting parties via mediation and conciliation between them. Furthermore, the WTO dispute settlement rule or the FTA dispute settlement rule incorporates the ADR-type dispute settlement clause mainly in an attempt to establish a settlement procedure that would result in a resolution that can be agreed upon by the parties involved in a dispute, even in the presence of political and information imbalance between advanced and developing nations. There are many advantages in ADR: dispute settlement via ADR allows the parties to arrive at an amicable resolution via conciliation or mediation before the dispute escalates into a serious state, while the final decision is open to the public and stakeholders, thereby ensuring its enforcement is backed by public pressure amid the presence of the imbalance of power. Furthermore, related experts can be invited to participate in such dispute settlement procedure, thereby enabling rational settlement of dispute even in the presence of information imbalance.

However, the dispute settlement under the FTA is being implemented in an extremely closed manner compared to other general arbitration procedures. Historically, only a limited number of cases has been brought to the FTA arbitration panel (Avrieli, 1993). Even those cases brought to a few FTA arbitration panels took quite a long time until their final settlement, and such arbitration procedure has been performed secretly under the total control of government officials. Due to the nature of such procedure, the general public or stakeholders were not able to exert pressure on the defeated parties to abide by the panel's decision. Furthermore, many FTAs provide for the Panel to issue a non-binding Report, and do not provide sophisticated enforcement procedure. Accordingly, the FTA dispute settlement procedure has been criticized for its inefficiency and its detailed rules must be reviewed. With regard to those disputes resulting from an exclusion of the preferential treatment, a private-sector entity, such as companies, is the primary stakeholder. Since the FTA dispute settlement procedure does not allow private-sector access, however, numerous disputes and conflicts resulting from the preferential RoO are being settled via litigation. In the next sector, the main issues of trade dispute and the predominant elements of the dispute settlement procedure shall be explored by reviewing representative cases associated with the preferential RoO.

2. Disputes on the Preferential RoO

Case 1. The Honda Case under the Canada-US FTA

With the effectivity of the Canada-U.S FTA in 1989, Honda Civics made in Canada became eligible for the preferential treatment when its engines manufactured in the United Stated are imported back to Canada in accordance with the preferential RoO, while Honda Civics manufactured in Canada equipped with the imported engines became eligible for the preferential treatment as well when they are being imported by the United States. Honda Canada contended that imported engines are eligible for preferential treatment since the share of regional content exceeds 50% of the regional content value specified in the preferential RoO. The customs authority in Canada accepted the argument of Honda Canada for its engine parts. However, the U.S. Customs Service declined to do so for the Honda Civics manufactured in Canada with their engines and other components imported from Japan. Therefore, Honda Canada was excluded from the preferential treatment in the United States, and, instead, it was handed a retroactive bill of 17 million dollars.

The main issue in this dispute was the difference in the technical understanding on roll-ups and roll-downs of the cost of raw materials and reasonable allocation of direct and indirect costs (Lowenfeld and Cantin, 1993). Whatever its accurate judgment may be, the incident has pushed preferential RoO as the biggest stumbling block in the trade dispute between Canada and the United States. As the number of cases where foreign automobile manufacturers operating in Canada were not eligible for the preferential tariff in the United States began to increase, the fear that a growing number of companies would relocate their operations eventually to the neighboring country has increased as well, thereby making it a hot political issue between the two countries.

As the incident began to be highlighted by the public and various international governments in the course of NAFTA negotiation procedure, it prompted an introduction of more explicit rules to NAFTA through the introduction of net cost method and abolition of a roll-down clause.

Case 2. United States v. Ford Motor Company

Complying with the preferential RoO often demands an excessive amount of documents and records, thereby making the utilization of FTA impractical. Since the scope of the required record is not clear, the rule demands so many records that cover almost entire stages of the manufacturing and production procedure. In 2007, the U.S. Customs and Border Protection imposed on the Ford Motor Company a massive fine amounting to $42 million for the auto parts it imported from Mexico in 1996 on the ground that Ford refused to comply with the summons demanding the records related to the preferential treatment under NAFTA. The CBP requested for the manufacturing records associated with the auto parts Ford imported from Mexico. Ford argued that the records are from the foreign producer whose documentation must be maintained by the exporter. The Ford Motor Company countered such request, saying that these records are not required to be kept in accordance with the country of origin determination criteria that are applicable to the product, and added that CBP has not been consistent on this issue. In the lawsuit filed in Mexico, the Court denied Ford's motion to dismiss the complaint. The Court essentially ruled that the 'supporting records' specified in NAFTA certificate of origin include those records requested by the CBP. However, CBP dismissed the case permanently without imposing any fine on the Ford Motor Company on the date the motions for summary judgment were to be filed. The CBP explained that it dismissed the case after a reassessment of the NAFTA preferential RoO. The incident shows that the ambiguous rule on the scope of record-keeping is such that even customs officials failed to understand them consistently. It also shows immense potential cost that can be incurred by the preferential RoO that makes it compulsory tokeep massive records on manufacturing procedure. Therefore, it forces us to estimate how difficult it would be to comply with the record-keeping duty and receive resulting duty-free treatment for private sector entities in developing nations other than those in the United States, given the associated cost burden and information imbalance.

Case 3. Pascoal and Filhos Ld. v. Fazenda Pública

The preferential RoO specified in the FTA that was signed by the European Union applies the majority of the preferential RoO applicable to European Union Customs

Union. Unlike the post verification system in the United States, the one in Europe is performed normally when the customs authority in the exporting country verifies the certificate of origin of the exporter via the customs authority of an importing nation. The post verification implies diverse potential issues. The first issue is on how the risks associated with the certification of origin can be distributed over, and how the issue of 'administrative cooperation' between the customs authorities of the concerned countries can be settled. Pascoal, a company operating in Portugal, which is an EU member state, submitted the certificate of origin certifying that the cods it was importing over four times originated from Greenland before it was permitted by the Portuguese customs authority to import them without any tariff. The Portuguese government then requested to perform a post verification of origin. Contrary to the content of the certificate of origin, Greenland notified the Portuguese authority that the exported item failed to satisfy the country of origin rule. Accordingly, the Portuguese government notified Pascoal that the company will be charged with an additional fee. Pascoal filed a complaint to the Customs Court but it was readily dismissed. The company then appealed to the Tribunal Tributario de Segunda Instância. Upon filing for the appeal, Pascoal claimed how the risks should be allocated rightly in the certification of origin and post verification procedures, and to what extent the cooperation should be made among the customs authorities that participated in the post verification. Responding to this claim, the court ruled that the exporter cannot be charged with an additional fee that is charged on the duty free treatment awarded by EC even if the onus of proof for erroneous certification of origin falls on the exporter, and, therefore, the importer may be allowed to request the exporter for repayment for any economic loss inflicted on the importer, which enjoyed duty free treatment based on good intention. It also ruled that the customs authority of the exporting country is not legally responsible for the explanation of the result of post verification of origin to the importer, since the notification of the post verification result is aimed at allowing the government of the importing country to make a judgment on the legality of the application of the preferential treatment.

As demonstrated by this case, importers cannot obtain accurate information on the result of the verification of origin, and may possibly get involved in an additional dispute settlement procedure with the exporter as a result of economic loss stemming

from the unclear boundary of cooperation among different customs authorities. According to the WCO origin irregularity typology study (WCO, 2013), the customs authority of the importing country would often experience difficulty in gaining necessary help from the exporting country, and 28% of the questioned said in the survey that administrative cooperation was not fully realized. In 2010, 330 out of 426 post verifications were appropriate in advanced countries, but 93 out of the remaining 96 failed to pass post verification, owing to the non-response of the exporting country. They were treated as having failed to pass the verification, regardless of the interpretation and the application of the country of origin rule or of an intention of fraud by the exporter. Such cases showed that the structural problem was inherent in the post verification of origin through conventional administrative cooperation.

3. Improving the dispute settlement procedure for the preferential RoO

The case of Honda Canada shows that the difficulty in the consistent interpretation of the preferential RoO may escalate into a trade dispute, and eventually to a political dispute among countries. The resulting refurbishment of the preferential RoO in NAFTA triggered by this case demonstrates that the parties should be able to receive expert opinions regarding the dispute settlement procedure stemming from the preferential RoO as well as the necessity of sophisticated dispute settlement procedures that may mitigate such political tension.

With this regard, Kim (2007) has suggested that Korean FTAs should specify further the arbitration procedures to include the place of arbitration, and the applicable conventions for the enforcement of arbitral award. In particular, Kim suggests establishing arbitration agency to settle the disputes under FTAs, which basically comprise of arbitration agencies of major parties to Koran FTAs such as China and other Asian countries.

The case of the Ford Motor Company shows that in the event of a difficulty in enforcing the preferential RoO, owing to information imbalance and power imbalance, it should be possible to arrive at an agreement on the process of improving the fundamental system and the difficulty in information provision in the dispute settlement procedure. It also

shows that the parties should be able to arbitrate conflicting interests on the rule, and arrive at an effective agreement through the involvement of an expert group.

The final case on the indirect post verification of origin shows that given the high probability of dispute among the importer and the exporter in the post verification of origin, ARD should be applied to the dispute settlement procedure since the dispute settlement in accordance with the aforementioned procedure may inevitably go through an extended litigation process, and that more open dispute settlement procedure may be necessary for those damages stemming from an unsatisfactory administrative cooperation among different customs authorities. Therefore, the dispute settlement rule for the preferential treatment resolution procedure should recognize the petition right of private-sector entity more broadly, and that the application of ARD should be recommended for the dispute settlement among private companies, thereby ensuring conciliation and mediation before the case escalates into a political dispute.

For all such lessons, it would be desirable to include a clause that would guarantee a binding enforcement of the conclusion of the FTA dispute settlement procedure in light of the fact that those cases associated with the preferential RoO still follow inefficient litigation processes due to the binding power of the judiciary ruling. Choi (2013) has highlighted that in reforming the dispute settlement procedures under FTAs, cultural differences in contracting parties should be taken into account. Especially, amid the national efforts of concluding mega FTAs with Asian countries under TPP and RCEP, it is essential that reflecting the Asian attitude on disputes in establishing more predictable as well as practicable ADR procedures under FTAs. Such procedures will attract more companies to utilize FTAs even under the situation where the preference margin has been marginalized with the overall reduction of MFN tariffs of the world.

Ⅴ. Conclusions

In this paper, three separate cases of trade dispute were explored to identify the predominant characteristics of these disputes involving the preferential RoO. Based on this review, it was confirmed that restrictiveness, complexity, and uncertainty inherent in the preferential RoO may trigger political tension and dispute. It was also reviewed that to settle such disputes within the FTA dispute settlement procedure, it is necessary

to form a panel that is capable of mitigating political tension, facilitate participation and early cooperation of experts and stakeholders, and establish a well-structured dispute settlement procedure capable of inducing conciliation and mediation to resolve these disputes that are teeming with such characteristics. Furthermore, the current dispute settlement procedure that hinders the participation of the private sector should be changed to one that is more open to the private sector entities to facilitate the enforcement of the decision as well as the participation of private businesses that are true concerned parties of the dispute. Likewise, the publication of the panel's final report is essential in ensuring the obedience of the losing party, whether it is a government or a private-sector entity. By doing so, the FTA dispute settlement procedure will provide enhanced avenues of appeal and more opportunities to create better understanding of RoOs between interested parties regarding the specific agreement in dispute.

Unifying and simplifying the RoO may be a dream of both companies and governments. To prevent countries from using RoO as protectionist trade policy instruments, and to bridge the differences in the interpretation of the RoO that often escalate into dispute, expedite and efficient dispute settlement procedures should be established within the FTA. Given that improved dispute settlement procedure for the preferential RoO may guarantee the enforcement and application of the FTA preferential treatment and foster genuine free trades, more in-depth studies must be conducted on this topic.

References

Avraham Azrieli. (1993). Improving Arbitration Under the U.S.-Israel Free Trade Agreement: A Framework for a Middle-East Free Trade Zone. *St.John's Law Review,* 67(2).187-263.

Bhagwati, J. (1995). U.S. trade policy: The infatuation with FTAs. In C. Barfield (Ed.), *The Dangerous Obsession with Free Trade Areas* (pp. 1-20). New York: AEI.

Brenton, P. and Imagawa, H. (2005).Rules of origin, trade, and customs. In L. D. Wulf and J. B. Sokol (Eds.), *Customs Modernization Handbook* (pp. 183-214). Washington, D.C.: The World Bank.

Cadot, O., Carrère, C., Melo, J., and Tumurchudur, B. (2006). Product-specific rules of origin in EU and US preferential trading arrangements: an assessment. *World Trade Review, 5*(02), 199-224.

Cantin, F. P. and Lowenfeld, A. F. (1993).Rules of origin, the Canada-US FTA, and the Honda case.*The American Journal of International Law,* 87(3), 375-390.

Choi, Seung-Whan.(2014). Korea-China FTA and the Implementation of Dispute Settlement Clause. *National Assembly Library Periodical,* 15(9), 22-27.

Choi, Song-Za.(2013). A Comparison of Korea and China's FTA Dispute Settlement Agreement with ASEAN. *Journal of Arbitration Studies,* 23(1), 25-53.

Commission of the European Communities.(2003). *Green Paper on the Future of Rules of Origin in Preferential Trade Arrangements*. Brussels: European Commission.

Do, Hyun-Soo. (2008). A study on the legal analysis of FTA dispute settlement system – focused on NAFTA (master's thesis). Hannam University, Daejon, Korea.

Estevadeordal, A., Harris, J., and Suominen, K. (2007).*Multilateralizing preferential rules of origin around the world.* Paper presented at the WTO/HEI/NCCR Trade/CEPR Conference, Geneva, Switzerland.

European Court of Justice (1997), Judgement of 17.07.1997, C-97/95 Pascoal & Filhos Ld. v. Fazenda Pública, ECR I-4209,para. 32.

Harris, J., & Staples, B. R. (2009). Origin and Beyond: Trade Facilitation Disaster or Trade Facility Opportunity? *ADBI Working Paper Series* (pp. 1-12): Asian Development Bank Institute.

Izam, M. (2003).*Rules of Origin and Trade Facilitation in Preferential Trade Agreements in Latin America*. Santiago, Chile: United Nations, Economic Commission for Latin America and the Caribbean,.

Ju, J. and Krishna, K. (1998).Firm Behavior and Market Access in a Free Trade Area with Rules of Origin.*NBER Working Paper No. 6857*.

Kim, Sang-Ho. (2007). Settlement of Private Commercial Dispute under the FTA. *Journal of Arbitration Studies,* 17(1), 3-32.

Krishna, K. and Krueger, A. O. (1995). Implementing free trade areas: Rules of origin and hidden protection: National Bureau of Economic Research.

Krueger, A. O. (1993). Free trade agreements as protectionist devices: Rules of origin (pp. 1-27). Washington DC: National Bureau of Economic Research.

Manchin, M. and Pelkmans-Balaoing, A. (2007).Rules of origin and the web of East Asian free trade agreements *World Bank Policy Research Working Paper* (pp. 1-29). Washington DC: World Bank.

Park, Deo-Young and Lee, Joo-yun (2012).A comparative analysis of the dispute settlement procedures under the major FTAs, *Issue Studies 2012-09.* Seoul: Korea Legislation Research Institute.

Schrombges, U. and Wenzlaff, W. (2011) Doubts regarding the origin of the goods based on OLAF mission reports vs protection of confidence The World Customs Journal, 5(1), 89-94

The U.S. District Court for the Western District (2007),Judgment of 17.12.2007, United States v. Ford Motor Company, Case No. 06-cv-00013-DB (WDTX)

WTO. (2016). "Regional trade agreements and preferential trade arrangements ". WTO Portal: https://www.wto.org/english/tratop_e/region_e/rta_pta_e.htm/Search result as of June 30 2016

Yi, Jisoo (2015) A study on the influence of post verification of origin on the utilization of FTA, The Journal of Korea Research Society for Customs, 16(4), 93-115.

Yi, Jisoo (2016) A study on simplification of preferential RoO. The Journal of Korea Research Society for Customs, 17(2), 71-91.

Yin, R. K. (2013).Case study research: Design and methods: Sage publications.