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The EU succeeds in establishing a permanent investment court in its trade treaties with Canada and Vietnam

A Legal Update from Dechert's International Arbitration Group

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The European Commission has recently successfully negotiated a new trade pact with Canada (referred to as the Comprehensive Economic and Trade Agreement or '***CETA***') and one with Vietnam (the '***EU-Vietnam FTA***') which incorporate, among other things, a new method for the resolution of disputes between foreign investors and the states which host their investments.

In this client briefing, we explain how:

(a) the EU-Vietnam FTA and CETA provide a number of important substantive protections for qualifying investors;

(b) qualifying investors can enforce these protections through a direct claim against the state hosting its investment;

(c) such a claim will be heard by a new court and appellate body (rather than through international arbitration in the traditional sense of that term);

(d) decisions rendered under the treaties will be recognizable and enforceable within the jurisdictions of the contracting states (i.e., the member states of the EU, Vietnam and Canada), but may run into difficulties elsewhere; and

(e) any foreign investors which are concerned by the new dispute resolution regime or want broader substantive protection than that which is on offer under the EU-Vietnam FTA or CETA can structure or restructure an investment so that it passes through a non-EU jurisdiction which has a bilateral or multilateral investment treaty with the country hosting the investment.

Substantive and procedural rights

The EU-Vietnam FTA and CETA incorporate investment chapters which provide a range of protections for qualifying foreign investors and their investments. These protections include the protections usually found in bilateral and multilateral investment treaties, including an obligation to provide 'fair and equitable treatment', which is expressly and arguably narrowly defined, as well as so-called 'full protection and security', 'national treatment' and 'most favoured nation treatment' (with the latter two in the case of the EU-Vietnam FTA subject to important exceptions for certain industries including communication services, cultural services, fishery, forestry, mining and oil and gas). The treaties also guarantee that any expropriation of a qualifying investment will be accompanied by 'prompt, adequate and effective' compensation.

Consistent with most bilateral and multilateral investment treaties, the EU-Vietnam FTA and CETA provide a means by which an investor of one contracting state can seek to enforce the aforementioned substantive protections through a claim directly against the other contracting state which hosts an investment. The key difference, however, is that rather than allowing an investor to pursue a claim against a state through international arbitration before ICSID or an ad hoc arbitral tribunal, as is currently allowed under most investment treaties, investment disputes arising under the EU-Vietnam FTA and CETA will be decided in the first instance by a permanent court, referred to in the treaties as the 'Tribunal'.

Permanent investment courts

Both treaties establish separate investment courts to resolve investor-state disputes. Under the terms of the EU-Vietnam FTA, the Tribunal will comprise nine members, with three nationals appointed from each of the EU and Vietnam alongside three nationals appointed from third countries. The CETA Tribunal will have 15 members, with Canada and the EU appointing five members each, which will be supplemented by five neutrals. Each member will be appointed by the EU and Vietnam through a 'Trade Committee' (or the 'CETA Joint Committee' for CETA), which will be established and function in accordance with the specific provisions of the particular

treaty. The Tribunal members will serve a four-year term (or five years under CETA), renewable once, and may continue thereafter to serve until an award on which he or she is working is completed. To ensure their availability at short notice, the Tribunal members will be paid a monthly retainer or a regular salary if they serve on a full-time basis. Importantly, the fees of the Tribunal members are paid by the contracting states – the potential significance of this is considered below.

The treaties impose specific ethical obligations on the Tribunal members. Their 'independence is [to be] beyond doubt'; they shall not be affiliated with any government (although, interestingly, that does not preclude a Tribunal member receiving income from a government); they shall not participate in the consideration of disputes that would create a conflict of interest; and they must 'refrain from acting as counsel or as party-appointed expert or witness in any pending or new investment protection dispute under this or any other agreement or domestic law.'

Cases will be heard by three-member divisions of the Tribunal selected by the President of the Tribunal on a rotation basis, and in a way which is intended to be random and unpredictable, with the chair of any division being a national of a country other than Vietnam, Canada or an EU Member State. Disputing parties may, however, agree that a matter should be decided by a sole Tribunal member such as 'where the claimant is a small or medium-sized enterprise or the compensation of damages claimed are relatively low.'

The appellate mechanism

The treaties provide that a decision of the Tribunal may be appealed within 90 days of its issuance to an 'Appeal Tribunal' in the case of the EU-Vietnam FTA or an 'Appellate Tribunal' under CETA. The grounds for appeal include errors of law, manifest errors of fact, and those provided for in Article 52 of the ICSID Convention (i.e., the Tribunal was not properly constituted, had exceeded its powers, or was corrupt, on the basis of serious procedural unfairness occurring during the proceedings, or a failure by the Tribunal to state reasons for its decision). The appellate body has the power to 'modify or reverse' the Tribunal's decision or remand it back to the Tribunal for further consideration.

The EU-Vietnam FTA provides that the Appeal Tribunal will comprise six members, with two appointed from each of the EU and Vietnam, supplemented by two nationals appointed from third countries. Appeal Tribunal members are expected to 'have demonstrated expertise in public international law, and possess the qualifications required in their respective countries for appointment to the highest judicial offices or be jurists of recognised competence.' (Procedural matters such as these remain to be determined by Canada and the EU through the CETA Joint Committee.)

Other procedural features

The following dispute resolution procedures agreed by the EU, Canada and Vietnam are also worthy of note.

- Consultations and mediation: if a dispute cannot be resolved amicably through negotiations or mediation, a claimant must submit a formal request for consultations.
- Cooling off period: an investor must wait 180 days after submitting a request for consultations before referring a dispute to the Tribunal.
- Procedural rules: the claimant can choose to have the dispute resolved under the rules of ICSID or UNCITRAL or any other arbitration rules agreed by the disputing parties.
- Parallel claims: a claimant cannot submit a claim to the Tribunal which is pending before a domestic or international forum. It must choose one or the other.

- Third party funding: the existence of any third party funding must be disclosed to the Tribunal and the other disputing party, which, under the terms of the EU-Vietnam FTA, may be taken into account by the Tribunal when it determines any application for security for costs.

- Frivolous claims: the Tribunal may dismiss a claim at an early stage on the grounds that it is manifestly without legal merit and/or the facts even if true would not support a case as a matter of law.

- Transparency: the UNCITRAL Rules on Transparency in treaty-based Investor-State Arbitration shall apply.

- Interim relief: the Tribunal can grant interim relief, but it cannot order a state to refrain from conduct that is alleged to constitute a breach of the treaty.

- Finality: decisions of the Tribunal are provisional and only final if not appealed within 90 days.

Enforceability of decisions rendered under the EU-Vietnam FTA and CETA

While decisions rendered under CETA and the EU-Vietnam FTA will be recognizable and enforceable within the jurisdictions of the contracting states to those treaties, it remains to be seen whether courts in other jurisdictions will take the same approach. Specifically, foreign courts may not accept that the contracting states to the treaties have the ability to deem, as they purport to do, that a decision rendered by the Tribunal or the appellate body is to be treated as a final award enforceable under the terms of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards in circumstances where only one side of the investor-state dispute - the state - has influenced the determination of the procedures, the appointment of the decision makers, and the payment of their retainers.

Characteristics similar to these have led to successful challenges to the attempted enforcement of awards in the realm of international sports disputes. For instance, the Swiss Federal Tribunal ruled in the case of *Elmar Gundel v Federation Equestrian International* that the Court of Arbitration for Sport (***CAS***) could not be considered to be an impartial arbitral institution capable of rendering enforceable awards for disputes in which the International Olympic Committee (***IOC***) was a party given the IOC's role in the financing and operation of CAS.[1] This 1993 decision led to significant reforms to the structure, funding and organization of CAS.

While those reforms were subsequently held by courts in Switzerland (being the legal seat for CAS arbitrations) and elsewhere to be sufficient for the purposes of ensuring the integrity and credibility of CAS decisions, some judges (ironically, within the EU itself) and party representatives remain unsatisfied. Earlier this year a court in Munich, the Oberlandesgericht, ruled that the CAS system remains procedurally unfair for the athletes that appear before CAS to challenge decisions of international sports federations (*Pechstein v International Skating Union*). The German court was particularly troubled by there being a closed list of CAS arbitrators, which it found comprised members which were chosen mostly by sports federations rather than the athletes.

The dispute resolution procedures established by the EU-Vietnam FTA and CETA share some of the hallmarks of the CAS system which raised eyebrows in the German court in *Pechstein*, namely the way in which the members of the Tribunals and appellate body are appointed and paid by the states, and the fact that only the states influence the rules of procedure. Thus, there is a risk that investors may seek to avoid the system or, if they do participate, challenge an unfavourable decision, resist enforcement of an adverse decision on costs or of counterclaims successfully raised by a state-respondent, or claim that a Tribunal decision does not give rise to a *res judicata* on the basis that the process is arguably weighted in favour of the states. This could include an argument that a decision rendered by the Tribunal or appellate body is not a true arbitration award capable of

[1] *Elmar Gundel v Federation Equestrian International*, CAS 92/63.

recognition or enforcement under the New York Convention or the Washington Convention on the Settlement of Investment Disputes between States and Nationals of other States. (This is unlikely to be a problem for investors wishing to enforce a favourable award, however, as the respondent state is unlikely to argue that the system the states devised is biased against them.)

With that said, a key difference between professional athletes and investors is that athletes usually have no choice other than CAS for the resolution of sports disputes arising out of an event in which they have participated, whereas an investor benefitting from the protections afforded by the EU-Vietnam FTA or CETA will be able to choose between whether to refer a claim to the courts of the state hosting an investment (which admittedly is often not an attractive option) or to the Tribunal.

There is also an important precedent for what the EU, Canada and Vietnam are seeking to achieve. Iran and the United States established the rules of procedure for the Iran-US Claims Tribunal in 1981, appointed six of the nine judges (with the remaining three judges chosen by the first six judges from neutral countries), and pay the judges' fees. Iran-US Claims Tribunal decisions have been recognized and enforced in the United States and in other countries. Importantly, however, the English High Court in *Dallal v Bank Mellat* did so out of respect for international comity rather than through the application of the New York Convention. In that case, the English High Court refused to apply the New York Convention as it found that there was not a valid arbitration agreement under Dutch law, being the law of the seat of the Iran-US Claims Tribunal.[2] (Nonetheless, as mentioned above, the English High Court still gave effect to the decision.)

Further, unlike a claimant investor in proceedings under the EU-Vietnam FTA and CETA, a claimant in proceedings before the Iran-US Claims Tribunal has some influence over the constitution of the decision-making body through its choice of a judge to hear a particular case from one of the nine sitting judges appointed by the states.

In short, the effect of decisions rendered under the EU-Vietnam FTA and CETA outside the jurisdictions of the contracting states may be open to question. If so, the answer will depend upon the specific laws of the country in which enforcement is sought, a decision is challenged, or an assertion of *res judicata* is contested.

Potential benefits of the new system of dispute resolution

While some commentators have suggested that the new court and appellate mechanism may simply lead to increased delays and costs before an aggrieved investor secures a suitable remedy for a breach of a treaty, in reality it could do the opposite.

The new procedures could save time and cost. CETA provides that the Tribunal shall render a final award within 24 months of a claim being submitted, which is comparable to current practice under investment treaties. Reasons must be given by the Tribunal to the disputing parties for any extensions of time beyond the two years. The EU-Vietnam FTA provides that any appeal should not exceed six months, and in no case can it exceed nine months, with the result that the entire process should be completed within three years.

The new system could also facilitate enforcement of a favourable decision. The EU-Vietnam FTA requires the appellant to lodge security for the costs of the appeal and a 'reasonable amount' to cover the substance of the dispute. Therefore, should an appeal fail, the amount deposited could be used to satisfy the award partially or in full, thereby alleviating the need for enforcement action.

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2 *Dallal v Bank Mellat* [1986] 1 QB 441. See also *The Nature of the Iran-United States Claims Tribunal and the Evolving Structure of International Dispute Resolution*, D. Caron, The American Journal of International Law, Vol 84, p 104 at p 107: 'One Dutch commentator has concluded that its [ie the Iran-US Claims Tribunal] proceedings are not "arbitration" as understood under Dutch law'.

The establishment of an appellate body could also improve the quality and consistency of challenges to an award as compared to the current situation. The right of appeal, at least under the terms of the EU-Vietnam FTA, appears intended to replace challenges to an award that might otherwise have been available before national courts within the EU or Vietnam. Subject to a five-year transitional period for Vietnam, a final award rendered under the EU-Vietnam FTA is not subject to any challenge in Vietnam or the EU and is directly enforceable within those countries as though it were a decision of a court in the relevant contracting state where enforcement is sought. This has the attraction of a single body of experienced lawyers considering the validity and enforceability, at least in those countries, of a first instance decision. In contrast, decisions rendered by arbitral tribunals today (other than those operating under the auspices of ICSID) are being scrutinized by municipal judges of varying abilities, who are subject to disparate national procedures and precedents, and who are required to interpret and apply amorphous and uncertain concepts like 'public policy' when applying the New York Convention to an award which a party seeks to have enforced. From that perspective, the appellate mechanism could achieve the benefits of 'predictability' and 'consistency' sought by the European Union when advocating for the establishment of an investor-state court and appeal body.[3]

Conclusion

The EU-Vietnam FTA will supersede the bilateral investment treaties concluded between 21 EU member states and Vietnam when the FTA comes into force; CETA will replace seven bilateral investment treaties between Canada and EU member states. This marks a significant change in the level of substantive protection afforded to investors operating between these countries and the manner in which investor-state disputes are resolved.

Those investors which wish to benefit from a similar level of substantive and procedural protection currently afforded to investors under the existing BITs between the EU and Vietnam or Canada after the new treaties come into force can continue do so through the structuring (or restructuring) of an investment through a non-EU state. For instance, investments by a European investor in Vietnam which are channeled through Singapore will be protected by the Singapore-Vietnam Bilateral Investment Treaty and the ASEAN Comprehensive Investment Agreement (among other ASEAN agreements), which provide a full range of substantive protections for the investment, and which, importantly, are backed up by a right of the investor to refer disputes to international arbitration. The structuring or restructuring of an investment in this way would, among other things, allow an investor to choose one of the three arbitrators appointed to determine the claim, which, as explained above, is not the case with the Tribunals being established under the terms of the EU-Vietnam FTA and CETA.

3 For further reading on the potential benefits of the creation of a regional or global court for determining challenges to an award and applications for enforcement, see M. Mangan, *With the Globalisation of Arbitral Disputes, is it Time for a New Convention?* [2008] Int. A.L.R. 133.

This briefing has been written by **Mark Mangan**.

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