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RECENT DEVELOPMENT IN THE EUROPEAN UNION REGARDING INVESTMENT DISPUTE SETTLEMENT MECHANISM —AN ANALYSIS OF THE COMPREHENSIVE ECONOMIC AND TRADE AGREEMENT: CETA—

Kiyotaka Morita*

Introduction

Fair and equitable settlement of investment disputes is the last resort to ensure the effectiveness of investment treaties (including Bilateral Investment Treaties and the investment chapter of the Economic Partnership Agreement). In this regard, investor-state dispute settlement, ISDS, which enables investors to bring the hosting country directly to arbitration, plays a major role. The number of cases registered annually to the International Centre for Settlement of Investment Disputes, ICSID, alone has increased by more than 5 times over the past 20 years, from 10 cases in 1997 to 56 cases in 2018. It is notable that approximately 64% of ICSID cases (cumulative total from 1966 to 2019) are registered under investment treaties. In fact, the ISDS clause is included in the TPP 11 and other major investment-related agreements that Japan has concluded.

The European Union has introduced the Investment Court System, ICS, as an alternative to ISDS in its recently concluded Economic Partnership Agreement with Canada, Mexico, Vietnam, and Singapore. ICS is characterized by a two-tiered mechanism introducing an Appellate Tribunal in addition to the Investment Tribunal, and the Arbitrators which are previously appointed by the Committee. This article gives an overview of the ICS under the EU-Canada Economic Partnership Agreement (Comprehensive Economic and Trade Agreement: CETA) and discusses its challenges, referring to the Opinion of the European Court of Justice (ECJ) on the consistency of the CETA with the EU laws.

In addition, the CETA gives a relatively narrow definition of the fair and equitable treatment (FET) clause compared to international arrangements such as the Energy Charter Treaty (ECT). Furthermore, the CETA emphasizes the hosting states’ “right to regulate”. This article also examines how these issues could affect investor protection.

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* Senior Manager, Keidanren (Japan Business Federation), Visiting Professor, Hitotsubashi University School of International and Public Policy, LLB (1995), LLM (1997), Hitotsubashi University Faculty of Law.

2 Ibid., p.10
3 EU-Canada CET Agreement, Opinion 1/17 of the Court, 30 April 2019
I. Investment Court System (ICS)

The Investment Court System (ICS) is a two-tiered mechanism comprised of the Investment Tribunal and the Appellate Tribunal.

1. Investment Tribunal

The framework of the Investment Tribunal under the CETA is as follows.

(1) If a dispute has not been resolved through consultations, a claim may be submitted under the ICSID Convention and Rules of Procedure for Arbitration Proceedings (or the ICSID Additional Facility Rules), the UNCITRAL Arbitration Rules, or any other rules on agreement of the disputing parties.\(^4\)

(2) The CETA Joint Committee appoints fifteen Members of the Tribunal; five nationals from the EU Member States, five nationals from Canada, and five nationals from third countries.\(^5\)

(3) The Members of the Tribunal shall possess the qualifications required in their respective countries for appointment to judicial office, or be jurists of recognised competence.\(^6\)

(4) Within 90 days of the submission of a claim, the President of the Tribunal appoints the Members of the Tribunal ensuring that the composition of the divisions is random and unpredictable, while giving equal opportunity to all Members of the Tribunal to serve.\(^7\)

(5) The President and Vice-President of the Tribunal are responsible for organisational issues and appointed for a two-year term drawn by lot from among the Members of the Tribunal who are nationals of third countries.\(^8\)

(6) The Members of the Tribunal are paid a monthly retainer fee in order to ensure their availability.\(^9\)

2. Appellate Tribunal

The framework of the Appellate Tribunal under the CETA is as follows.

(1) A disputing party may appeal an award rendered by the Tribunal to the Appellate Tribunal within 90 days after its issuance.\(^10\)

(2) A disputing party shall not seek to review, set aside, annul, revise, or initiate any other similar procedure as regards an award by the Tribunal.\(^11\)

(3) The Appellate Tribunal may uphold, modify, or reverse the Tribunal’s award based on

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\(^4\) CETA Article 8.23.1 and 8.23.2  
\(^5\) CETA Article 8.27.2  
\(^6\) CETA Article 8.27.4  
\(^7\) CETA Article 8.27.7  
\(^8\) CETA Article 8.27.8  
\(^9\) CETA Article 8.27.12  
\(^10\) CETA Article 8.28.9 (a)  
\(^11\) CETA Article 8.28.9 (b)
errors in the application or interpretation of applicable law; manifest errors in the appreciation of the facts, including the appreciation of relevant domestic law.\(^{12}\)

(4) An award rendered by the Tribunal shall not be considered final and no action for enforcement of an award may be brought unless: no appeal has been initiated; or an initiated appeal has been rejected or withdrawn; or the Appellate Tribunal has not referred the matter back to the Tribunal after rendering its Award.\(^{13}\)

(5) A final award by the Appellate Tribunal shall be considered as binding between the disputing parties.\(^{14}\)

(6) Functioning of the Appellate Tribunal such as procedures for the initiation and the conduct of appeals; remuneration of the Members of the Appellate Tribunal; the number of Members of the Appellate Tribunal are to be decided by the CETA Joint Committee.\(^{15}\)

3. Issues to be Addressed

An appeal in the ICS could prolong arbitration procedures because an award rendered by the Investment Tribunal could not be considered final and action for enforcement would not be possible until the Appellate Tribunal makes the decision. As the European Court of Justice (ECJ) points out in its Opinion regarding the compatibility of the CETA with the EU laws, in the absence of rules designed to ensure that the CETA Tribunal and Appellate Tribunal are financially accessible to natural persons and small and medium-sized enterprises, the mechanism may, in practice, be accessible only to investors who have significant financial resources available to them.\(^{16}\) Therefore, limiting an appeal to exceptional situations with a view to avoiding the lengthening of arbitration procedures and thereby preventing the possible snowballing of judicial costs is important from the viewpoint of protecting SMEs with limited financial resources. For instance, by analogizing the ICSID Arbitration Rules to ICS, an appeal could be limited to exceptional situations such as the discovery of fact which decisively affects the award, and evidence that the fact was unknown to the Tribunal and to the applicant when the award was rendered, and that the applicant’s ignorance of that fact was not due to negligence.\(^{17}\) An appeal may also be made possible in exceptional cases where the Investment Tribunal was not properly constituted or it has manifestly exceeded its powers.\(^{18}\)

Also, since judges are selected from a list prepared by the state under the ICS, judges who are not necessarily familiar with business may be appointed. It may be possible to address this issue, to a certain extent, by adding lawyers who are knowledgeable about business to the list, through consultation with the business community. However, in light of the fact that ICS is an arbitral tribunal between investors and the state, and from the viewpoints of fairness, neutrality, and impartiality, judges should be, in principle, selected by the state and investor, and the third judge should be selected by the agreement of both parties.\(^{19}\)

\(^{12}\) CETA Article 8.28.2

\(^{13}\) CETA Article 8.28.9 (c)

\(^{14}\) CETA Article 8.28.9 (d)

\(^{15}\) CETA Article 8.28.7

\(^{16}\) Supra, footnote 3 at para. 213

\(^{17}\) ICSID Arbitration Rules, Rule 50, (1) (c) (ii)

\(^{18}\) ICSID Arbitration Rules, Rule 50, (1) (c) (iii)

\(^{19}\) Keidanren (Japan Business Federation), ‘Policy Proposal on Investment Treaties’, October 15, 2019, pp.8-9
II. Fair and Equitable Treatment (FET)

There are many investment treaties, both bilateral and multilateral, which include provisions on fair and equitable treatment (FET) to protect investors from mistreatment by host countries such as the unilateral changes of domestic laws. It could be assumed, however, that the extent to which investors are protected differs depending on the wording of the FET clause. This article compares the cases under the Energy Charter Treaty and NAFTA (Currently USMCA), then considers to what extent the investors would be protected under the FET clause of CETA.

1. The Energy Charter Treaty (ECT)

ECT Article 10 (1) stipulates as follows: Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable, and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment, or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

In the *Masdar Solar & Wind v. Spain*20, whether specific commitments under Spanish domestic legislation (RD661/2007 and other texts) offering incentives to renewable energy plants gave rise to legitimate expectations of the Claimant; and whether the domestic legislation was modified in a manner incompatible with the fair and equitable treatment (FET) standard of the ECT were issues. The Award is summarized as follows:

(1) The FET constitutes a standard to ensure that an investor may be confident that the legal framework in which the investment has been made will not be subject to unreasonable or unjustified modification; and the legal framework will not be subject to modification in a manner contrary to specific commitments made to the investor21.

(2) The RD661/2007 regime held out the prospect that provided an installation complied with certain registration requirements and within the prescribed time limits, it would acquire the right to receive the regulated tariff or premium22. In the interim, the Claimant, on the basis of due diligence exercised, believed that it had a legitimate expectation that the laws would not be modified, as they included stabilization clauses23.

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20 *Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain*, Case No. ARB/14/1, Award of 16 May, 2018,
21 *Ibid.*, para. 484
22 *Ibid.*, para. 496
23 *Ibid.*, para. 499
(3) The fact that RD661/2007 and other texts include a stabilization clause is sufficient to exclude any modification of the law, as far as investors that had made investments in reliance upon its terms were concerned.

(4) There is a school of thought that considers that a specific commitment giving rise to legitimate expectations cannot result from general provisions and that something more is needed. However, in this case, Spain has issued a Resolution addressed to each Operating Company confirming that the Plants are qualified under the RD661/2007 regime for their operational lifetime. Because of the Resolution, the Claimant had legitimate expectations that the benefits granted by RD661/2007 would remain unaltered irrespective of whether general provisions would be sufficient.

(5) By reason of the loss of the RD661/2007 regime and the rights accrued by the Claimant, the respondent is in breach of the FET obligations pursuant to Article 10 (1) of the ECT.

Here, the Tribunal regards the FET clause of the ECT as a standard to ensure that the legal framework will not be modified in a manner contrary to specific commitments made to the investor. Therefore, the investor’s legitimate expectation that the laws would not be modified falls under the scope of protection offered by the clause. In other words, infringement of the investor’s legitimate expectation constitutes a stand-alone element of the FET standard under the ECT.

In the Sol Es Badajoz v. Spain, a similar case regarding provision and subsequent reduction of feed in tariff, the Tribunal concluded that the disputed measures were disproportionate because they suddenly and unexpectedly removed the essential features of the regime in place when Claimant invested, and did not meet Claimant’s legitimate expectations, resulting in the breach of Article 10 (1) of the ECT. Here again, the Tribunal regards legitimate expectation as a stand-alone element.

2. NAFTA

NAFTA Article 1105 (1) provides “each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security”. On 31 July 2001, the NAFTA Free Trade Commission adopted the Note of Interpretation regarding this Article 1105(1). According to the Note,

(1) Article 1105 (1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

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24 Ibid., para. 503
25 Ibid., para. 504
26 Ibid., para. 520
27 Ibid., para. 521
28 Ibid., para. 522
29 Sol Es Badajoz GmbH v. Kingdom of Spain, ICSID Case No. ARB/15/38, Award of 31 July, 2019, paras. 462-463
(2) The concepts of ‘fair and equitable treatment’ and ‘full protection and security’ do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

Following this interpretation, in the Waste Management v. Mexico, the Tribunal made the following decision.

(1) The minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust, or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.31

(2) In applying this standard, it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.32

Firstly, the Waste Management Tribunal is of the view that the existence of State acts or omissions that fall under the list of categories such as arbitrary, grossly unfair, unjust etc. is the precondition for the breach of Article 1105. Those acts or omissions are presumed to be of a serious nature. For example, in the Clayton v. Canada, the Tribunal, referring to the Waste Management, points out that intensifying adjectives such as “grossly” unfair, “manifest” failure of natural justice, and “complete” lack of transparency implies that there is a high threshold for the conduct of a host state to rise to the level of a NAFTA Article 1105 breach.33

Secondly, unlike the Masdar Solar & Wind v. Spain, “Representations made by the host State which were reasonably relied on by the claimant”, in other words, legitimate expectations, are only “relevant” in applying the FET standard and not regarded as a stand-alone element.

In the Mobil Investments & Murphy Oil v. Canada, the Tribunal’s position was similar to that of the Waste Management v. Mexico. Interpretation by the Tribunal of the FET clause is as follows.

(1) The fair and equitable treatment standard in customary international law will be infringed by conduct attributable to a NAFTA Party and harmful to a claimant that is arbitrary, grossly unfair, unjust, or idiosyncratic, or is discriminatory and exposes a claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety.35

(2) In determining whether that standard has been violated it will be a relevant factor if the treatment is made against the background of: (i) clear and explicit representations

31 Waste Management, Inc. v. Mexico (No.2), ICSID No. ARB(AF)/00/3 Award of 30 Apr. 2004, para.98
32 Ibid.
34 Mobil Investments Canada Inc. & Murphy Oil Corp. v. Canada, ICSID No. ARB(AF)/07/4, Decision on Liability and on Principles of Quantum, 22 May 2012
35 Ibid., para. 152
made by or attributable to the NAFTA host State in order to induce the investment, and (ii) were, by reference to an objective standard, reasonably relied on by the investor, and (iii) were subsequently repudiated by the NAFTA host State\(^{36}\).

Thus, for the Mobil Tribunal, *legitimate expectation* is not a stand-alone element that constitutes a breach of the FET standard. It is a *relevant factor* which may be taken into account when assessing whether or not other elements of the FET standard have been breached (i.e., whether state conduct was arbitrary, grossly unfair, involved a lack of due process, etc.).

In the *Glamis Gold v. USA*\(^{37}\), the Tribunal, in line with the above NAFTA cases, held that a violation of the customary international law minimum standard of treatment, as codified in Article 1105 of the NAFTA, requires an act that is sufficiently egregious and shocking—a *gross* denial of justice, *manifest* arbitrariness, *blatant* unfairness, a *complete* lack of due process, *evident* discrimination, or a *manifest* lack of reasons\(^{38}\).

On the other hand, the Tribunal mentions that such a breach may be exhibited by a gross denial of justice or manifest arbitrariness falling below acceptable international standards; “*or*” the creation by the State of objective expectations in order to induce investment and the subsequent repudiation of those expectations\(^{39}\). From the wording “*or*”, it might be possible to interpret that the *Glamis Gold* Tribunal regards *legitimate expectation* a stand-alone element that constitutes a violation of the FET clause, in parallel with the gross denial of justice, manifest arbitrariness etc.\(^{40}\) Even if that is the case, there is a high threshold in order for the repudiation of *legitimate expectation* to constitute a breach of the FET clause. According to the *Glamis Gold* Tribunal, at least a quasi-contractual relationship between the State and the investor, whereby the State has purposely and specifically induced the investment is required\(^{41}\).

The *Cargill v Mexico* casts a similar view regarding this point. In this case, the Claimant asserted that NAFTA State Parties are bound to provide a stable and predictable environment in which reasonable expectations are upheld\(^{42}\). The Tribunal held that there is no such requirement in the NAFTA or in customary international law, at least where such expectations do not arise from a contract or quasi-contractual basis\(^{43}\).

### 3. CETA

As seen above, under the ECT, the FET clause is regarded as a standard to ensure that the legal framework will not be modified in a manner contrary to specific commitments made to the investor, while the FET clause is interpreted as the customary international law minimum standard of the treatment of aliens under the NAFTA.

Article 8.10.2 of the CETA stipulates the following: a Party breaches the obligation of fair

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\(^{36}\) Ibid.,

\(^{37}\) *Glamis Gold, Ltd. V. United States*, UNCITRAL, Award of 8 Jun. 2009

\(^{38}\) Ibid., para. 627.

\(^{39}\) Ibid.


\(^{41}\) *Glamis Gold*, supra footnote 37 at para. 766

\(^{42}\) *Cargill, Inc. v. Mexico*, ICSID No. ARB(AF)/05/02, Award of 18 Sep. 2009, para. 289

\(^{43}\) Ibid., para. 290
and equitable treatment if a measure or series of measures constitutes: (a) denial of justice in criminal, civil, or administrative proceedings; (b) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings; (c) manifest arbitrariness; (d) targeted discrimination on manifestly wrongful grounds, such as gender, race, or religious belief; (e) abusive treatment of investors, such as coercion, duress, and harassment; or (f) a breach of any further elements of the fair and equitable treatment obligation adopted by the Parties.

It seems quite apparent that the wording of CETA Article 8.10.2 is a codification of the above NAFTA cases, therefore, it is rational to assume that this Article would be interpreted by analogy of those NAFTA cases.

It is presumed, by analogy of the Glamis Gold and the Clayton Tribunal, thresholds for the conduct of a CETA Party to rise to the level of a breach of Article 8.10.2 would be high because intensifying adjectives such as fundamental breach, manifest arbitrariness, targeted discrimination, and manifestly wrongful are added. If this Article is interpreted by analogy of the Waste Management and the Mobil, acts or omissions by the host State must fall under the categories (a) to (f) in order to constitute a breach, and legitimate expectations of the investor would not be a stand-alone element. Actually the ECJ is of the view that the jurisdiction of the CETA Tribunal to find infringements of the FET obligation is specifically circumscribed, since Article 8.10.2 lists exhaustively the situations in which such a finding can be made.

Moreover, Article 8.9.2 of the CETA stipulates: the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor’s expectations, including its expectations of profits, does not amount to a breach of an obligation under this Section. Therefore, even if legitimate expectation is interpreted as a stand-alone element, the threshold is presumed to be high. By analogy of the Glamis Gold, at least a quasi-contractual relationship between the State and the investor, whereby the State has purposely and specifically induced the investment could be required.

III. Right to Regulate

Article 8.9.1 of the CETA stipulates that the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection, or the promotion and protection of cultural diversity. As Article 8.31.1 stipulates, the function of the CETA Tribunal is to apply the Agreement as interpreted in accordance with the Vienna Convention on the Law of Treaties, and other rules and principles of international law applicable between the Parties. That is to say the Tribunal, as stipulated in Article 8.31.2, has no jurisdiction to determine the legality of a measure under the domestic law of a Party. In other words, as the ECJ points out, the CETA Tribunal has no jurisdiction to declare incompatible with the Agreement the level of protection of a public interest established by the EU measures.

It should be noted, however, this does not necessarily mean that the CETA Tribunal has

44 Supra, footnote 3 at para. 158
45 Supra, footnote 3 at para. 153
no jurisdiction regarding disputes related to legitimate policy objectives such as those exemplified in Article 8.9.1. International investment tribunals, in general, are intended to resolve individual disputes and do not require a respondent country to change its public policy, nor does it interpret the domestic laws of a Party as such. In the Masdar Solar for instance, the ICSID Tribunal did not interpret RD661/2007 and other texts as such. It regarded the domestic legislation as evidence that gave rise to the Claimant’s legitimate expectations. Having found that modification of the domestic legislation in this case infringed on the Claimant’s legitimate expectations, the Tribunal concluded that the Respondent was not in conformity with the FET standard of the ECT. In the same manner, the CETA Tribunal would not determine the legitimacy of a public policy as such. Rather, according to Article 8.31.2, it considers as appropriate, the domestic law as a matter of fact with a view to determining the consistency of the public policy with the provisions of the CETA. Even if the public policy was found inconsistent with the CETA, the respondent Party would not be required to change the policy. The dispute would be solved through compensation for damage. Therefore, the case should not be excluded from the jurisdiction of the CETA Tribunal simply because it relates to public policy.

IV. Conclusion

The Japan-EU Economic Partnership Agreement (EPA) has been in force since February 2019. However, the chapter on investment protection including dispute settlement mechanism is yet to be concluded and subject to extended negotiations. With a view to achieving enhanced investor protection compared to the CETA, it is desirable that the future investment protection chapter of the Japan-EU EPA:

1. Adopts, with a view to ensuring fairness, neutrality and impartiality, an investor-state arbitration mechanism in which the arbitrators are appointed by the State and investor, and the third arbitrator is selected by the agreement of both parties.
2. Promotes rapid arbitration procedures by limiting revision, annulment of an award and appeal (should it be incorporated) to exceptional situations such as the discovery of fact which decisively affects the award etc.
3. Adopts a FET clause in which infringement of the investor’s legitimate expectation constitutes a stand-alone element.
4. Does not exclude a case from jurisdiction of the tribunal simply because it relates to the public policy of the defendant state.

46 Supra, footnotes 22 and 23
47 Supra, footnote 28