

## CETA's dispute settlement mechanism compatible with EU law—a closer look at the CJEU's opinion

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**Arbitration analysis: Is the Court of Justice Opinion 1/17, in response to Belgium's concerns over the compatibility of the Comprehensive Economic Trade Agreement (CETA) Tribunals and EU law, a further step towards investor-state dispute settlement (ISDS) reform? Georg Adler and Ole Jensen, both at WilmerHale, consider the opinion and assess what it means for investment treaty arbitration practitioners.**

### Original news

CETA investor–state dispute resolution mechanism deemed compatible with EU law, [LNB News 01/05/2019 6](#)

*The Court of Justice handed down Opinion 1/17 on the compatibility with EU law of the mechanism for the resolution of disputes between investors and states provided for in CETA. Chapter 8 of CETA provides, among other matters, for disputes to be referred to arbitration, subject to review by an appellate tribunal, and, in the longer term, by determination, instead, by a multilateral investment tribunal—ie, an 'Investment Court System' (ICS). On 7 September 2018, Belgium requested the court's opinion on CETA's dispute resolution mechanism, specifically regarding its impact on the autonomy of EU legal order, compatibility with the general principle of equal treatment and the EU law effectiveness, and its compliance with the right of access to an independent and impartial tribunal.*

### What is the background to this development

On 30 October 2016, Canada, the EU and its Member States signed [CETA](#). CETA is a so-called '[new generation](#)' free trade agreement, which means that, in addition to the classical provisions on the reduction of customs duties and of non-tariff barriers to trade in goods and services, it contains rules relating to investment, public procurement, competition, intellectual property rights and sustainable development.

In addition to the breadth of economic activity addressed under this agreement, CETA introduces a new mechanism for the settlement of disputes between investors and states. In contrast to the arbitration model of dispute resolution traditionally seen in international investment law, Chapter 8, Section F of CETA establishes a two-tiered dispute settlement mechanism. This mechanism contemplates that investor-state disputes will be heard by a first instance tribunal, whose decisions can be appealed to a second instance, appellate tribunal (together the CETA Tribunals). Tribunal members hearing these disputes will be appointed from a standing roster of panellists. The EU and Canada see this ICS as a first step towards the establishment of [a permanent multilateral investment court](#), which the European Commission (the Commission) considers the only way to address public concerns about the current type of ISDS based on dispute resolution by arbitral tribunals.

Opponents of CETA state that it [privileges foreign investors](#). It would [deter governments](#) from legislating in the public interest for fear of penalty by the CETA Tribunals. Those in favour of CETA argue that it will boost trade between the EU and Canada—the Commission described CETA as '[a milestone in European trade policy](#)' and '[the most comprehensive trade agreement the EU has ever concluded](#)'. According to the Commission's view, the proposed ICS is a fairer and more [transparent replacement](#) for the widely criticised ISDS provided for in bilateral investment treaties (BITs).

The Commission has decided to propose CETA as a '[mixed](#)' agreement, meaning that it must be ratified by each EU Member State in addition to the European Parliament. Despite this classification CETA is, to a great extent, already in force as between the parties on a provisional basis. The Commission has conceded that CETA provisions on the controversial ICS will not apply, until the parliaments in each EU Member State have ratified the agreement.

The present case concerns a request for an opinion the Kingdom of Belgium submitted to the Court of Justice on 7 September 2017, pursuant to [Article 218\(11\)](#) of the Treaty on the Functioning of the European Union (TFEU), which stipulates that a Member State 'may obtain the opinion of the Court of Justice as to whether an agreement envisaged

is compatible with the Treaties.’ In its request, Belgium expressed its doubts to the court as to whether the ICS is compatible with the EU Treaties. Under [TFEU, art 218\(11\)](#), where the opinion of the court is adverse, the agreement envisaged may not enter into force unless it is amended, or the Treaties are revised.

## What issues were before the court?

With its request for an opinion, Belgium raised three major concerns. It questioned the compatibility of the CETA Tribunals with:

- the autonomy of the EU legal order
- the general principle of equal treatment and the requirement of effectiveness, and
- the right of access to an independent tribunal

### Autonomy of the EU legal order

Belgium derived from the court’s [Opinions on the EU’s accession to the European Convention on Human Rights \(Opinion 2/13\)](#) and on the proposed unified patent litigation system ([Opinion 1/09](#)) that the court must have exclusive jurisdiction over the definitive interpretation of EU law. As CETA did not—in contrast to EU law ([TFEU, art 267](#))—include a provision that allowed the CETA Tribunals to refer a question on the interpretation of EU law to the court for preliminary ruling, CETA Tribunals would, in Belgium’s view, be incompatible with the autonomy of the EU legal order.

### Principle of equal treatment

Belgium considered the principle of equal treatment to be infringed because Canadian investors would be able to bring a claim against the EU, while EU investors would be precluded from doing so (Articles 20 and 21 of the Charter of Fundamental Rights of the European Union (CFR)). Belgium’s further concern was that the effectiveness of EU competition law might be implicated because, in case of fines imposed by the Commission under [TFEU, arts 101 and 102](#), the impact of the fine could be absorbed by an award by the CETA Tribunals granting the investor damages in the amount of the fine.

### Right of access to an independent tribunal

Finally, Belgium doubted that the CETA Tribunals guarantee the right of access to an independent tribunal as required by CFR, art 47. In particular, Belgium considered it difficult for natural persons and small and medium-sized enterprises (SMEs) to bring claims before the CETA Tribunals, as the costs for such proceedings would be considerable and a legal aid scheme does not exist under CETA. Belgium also considered the remuneration of tribunal members problematic—in circumvention of the separation of powers, the remuneration would be set by the CETA Joint Committee rather than by an independent body and the remuneration would not be fixed, but dependent on the number of cases they decide. This would entice tribunal members to artificially increase their caseloads by ruling in favour of investors to motivate them to bring more cases. The separation of powers would also be infringed because the decision to appoint and remove members is made by the CETA Joint Committee rather than an independent body. Neither did the International Bar Association Guidelines on Conflicts of Interest in International Arbitration (IBA Guidelines), to which CETA refers, satisfy Belgium’s understanding of appropriate ethical guidelines for the members, as these were developed for and by arbitration practitioners, not judges.

## What did the court decide?

With its [Opinion 1/17](#), the court rejected all of Belgium’s concerns and held that the CETA ICS ‘is compatible with EU primary law’.

### Autonomy of the EU legal order

The autonomy of the EU legal order remains intact because CETA Tribunals do not have jurisdiction to interpret and apply EU law and their awards are not liable to infringe upon the effective functioning of the EU institutions. The court set out by confirming ‘the principle that [it] has exclusive jurisdiction over the definitive interpretation of EU law’. To demonstrate that the CETA Tribunals comply with this principle, the court distinguished the present case from the

patent litigation system and the arbitral tribunal foreseen in the Netherlands-Slovakia BIT, which was at the heart of *Slovak Republic v Achmea*, [Case C-284/16](#). Contrary to the arbitral tribunal in *Achmea*, the CETA Tribunals are not called on to interpret an agreement between Member States, but an agreement of international law concluded between the EU and a third country. Moreover, while the Netherlands-Slovakia BIT empowered the arbitral tribunal to interpret and apply primary EU law CETA, art 8.31.2 expressly stipulates that the CETA Tribunals may only consider the parties' domestic laws 'as a matter of fact'. The court held that, because the CETA Tribunals are bound under this provision by the 'prevailing interpretation given to the domestic law by the courts or authorities of that party', the CETA Tribunals do not have jurisdiction to interpret and apply EU law. This also meant that there is no need for CETA Tribunals to be endowed with the power to refer questions of law to the court under [TFEU, art 267](#).

Moreover, the court did not see a risk that awards by CETA Tribunals might affect the operation of the EU institutions in accordance with the EU constitutional framework. It acknowledged that CETA Tribunals may—without interpreting them—at least have to weigh principles of EU law when determining whether an administrative decision by an EU institution violates CETA. If the CETA Tribunals repeatedly found that a certain public interest does not trump the freedom to conduct business, the EU institution may be deterred from protecting that public interest (regulatory chill). Yet, the court considered that CETA sufficiently protects against such regulatory chill, as CETA, art 8.9 safeguards the parties' right to regulate. In addition, CETA, art 28.3.2 prevents the CETA Tribunals from awarding damages in specific areas of public interest and the standard of 'fair and equitable treatment' is sufficiently defined. As a result, the court held that 'the parties have taken care to ensure that those tribunals have no jurisdiction to call into question the choices democratically made within a party'.

### **Principle of equal treatment**

The court further held that the CETA ICS complies with the principle of equal treatment. While [TFEU, art 18](#) and CFR, art 21(2)—the core provisions on equal treatment—only apply in an intra-EU context, the court did consider the broader CFR, art 20 to apply (everyone is equal before the law). The court rejected the idea that there was inequality between Canadian investors and EU investors investing in the EU, as EU investors were not foreign investors and therefore not comparable to Canadian investors.

### **Principle of effectiveness of EU competition law**

The court also struggled to see a danger to the principle of effectiveness of EU competition law. An award of damages for a fine imposed by the Commission under [TFEU, art 101](#) or art 102 is only imaginable if the fine does not comply with EU competition rules. Otherwise, the court held that CETA, art 17.2 makes it 'unimaginable' that the CETA Tribunals could order damages for a fine by the Commission. Where the Commission has failed to observe the rules, the effectiveness is not endangered as EU investors would also have recourse against the fine.

### **Right of access to an independent tribunal**

The CETA ICS also guarantees the right of access to an independent tribunal, as required by CFR, art 47. As the court's biggest criticism to the CETA ICS, the court agreed with Belgium insofar as it acknowledged that the considerable costs involved in bringing a claim before the CETA Tribunals may deter natural persons and SMEs from doing so. While there was no legally binding commitment by the parties to remedy this situation, the court noted that the CETA Joint Committee was tasked with creating 'better and easier access to this new court for the most vulnerable users' and that the Commission 'will propose appropriate measures of co-financing of actions of [SMEs] before that court'. For the purpose of its analysis under [TFEU, art 218\(11\)](#), the court was satisfied with these informal commitments.

The court also confirmed the independence of the CETA Tribunals. According to the court, a judicial body is independent if it is free of external influence and maintains internal impartiality. The CETA Joint Committee does not exert improper external influence by appointing and removing tribunal members, determining the amount of their monthly retainer fee and issuing binding interpretations of the CETA text. There is no rule prohibiting parties from setting up a body in charge of these tasks and binding interpretations by a Joint Committee are neither alien to international law (Article 31(3) of the Vienna Convention on the Law of Treaties) nor to EU law ([TFEU, art 218\(9\)](#)).

Finally, the CETA ICS also ensures the internal impartiality of tribunal members. The absence of any personal interest of the members on the outcome of the proceedings is safeguarded by the random appointment of members to particular tribunals and by CETA's reference to the IBA Guidelines. If a member was to decide in favour of investors to increase his or her personal fees, that Member States would be liable to be removed from the tribunal under the IBA Guidelines. The court also noted that the lack of affiliation with a government, which CETA, art 8.30.1 requires, does not apply to law professors (who are regularly paid by governments). This is an important clarification to ensure a wider pool of potential CETA Tribunal members.

### **How, if at all, did the court differ from the Advocate General (AG) opinion in this case?**

Contrary to the *Achmea* decision—where the court substantially disagreed with [AG Wathelet's Opinion](#)—the court in CETA agreed with [AG Bot's analysis](#) and expressly referred to his conclusions in a number of instances.

The AG opinion is a more thorough examination of the issues before the court and therefore goes beyond the court's reasoning in some respects. For instance, AG Bot addressed an argument often raised against ISDS generally, namely the alleged lack of a need to protect foreign investors in sophisticated legal systems. AG Bot agreed that Canada's 'judicial system is presumed to offer sufficient guarantees'. Yet, he did not consider this to be a decisive factor against the CETA Tribunals, as they serve as a blueprint for other ICSs to be included in future agreements with third states that have less guarantees in place. But even in the case of CETA, AG Bot considered it prudent to provide for an ICS because the substantive rights afforded to investors differ between Canadian domestic and EU law.

### **What does this mean for the EU's push for a multilateral investment court as part of ISDS reform? What are the implications for investment treaty arbitration practitioners?**

It is essential to first recall the scope of the court's opinion. The opinion pertains to ICS which the EU plans to include in future free trade agreements with third countries and which is meant as the 'first stage' of a possible multilateral investment court. Contrary to the *Achmea* decision, the opinion does not deal with the 'old' type of ISDS, which relies on dispute settlement by arbitral tribunals and which is provided for in many intra-EU BITs and the Energy Charter Treaty (ECT). Thus, the opinion should not be understood as '*Achmea 2.0*'.

In terms of the EU's push for a multilateral investment court, the [Commission has welcomed](#) the court's opinion as confirmation of its efforts to modernise ISDS. An adverse opinion would have had serious political consequences and not only required the amendment of CETA (pursuant to [TFEU, art 218\(11\)](#)) but also, on a broader level, would have affected the entry into force and conclusion of the free trade agreements with Singapore, Vietnam and Mexico. Ultimately, an adverse opinion would have endangered the entire ISDS reform process and the EU's investment policy generally. AG Bot's and the court's opinion reflect their respective awareness of these implications.

Overall, Opinion 1/17 clarified that the ICS is compatible with the EU legal order, underscoring the importance and pragmatism that the court placed on the EU being able to act globally and to work with other states in the development of a multilateral investment court. The court provided specific guidance to the EU and its Member States on the elements required of any dispute resolution system, including a multilateral investment court, within a treaty to ensure its compatibility with EU law. In particular, the court emphasised that the CETA Tribunals have no jurisdiction to rule on a great number of public policy issues, including:

- the level of protection of public order or public safety
- the protection of health
- the preservation of food safety
- protection of plants and the environment
- product safety
- consumer protection, and equally
- fundamental rights

The court therefore found that the drafters of CETA have taken care to ensure that the CETA Tribunals do not have jurisdiction to call into question choices that have been 'democratically made' within the EU or Canada, relating to the protection of such public interests.

Arguably, the court's opinion could be also seen as being motivated by the overall goal to affirm the compliance of the ICS with EU law, at the cost of providing reasoning that is not always in tune with the realities of actual cases. For example, while the court acknowledges that CETA Tribunals may need to weigh the freedom to conduct business against public interests as set out in EU primary law, its assurance that the CETA Tribunals nevertheless lack 'the discretionary power...to call into question the level of protection of public interest determined by the EU following a democratic process' raises more questions than it answers. Is the reference to 'public interest' a trump card that always cancels out legitimate interests by the investor? How specifically should a CETA Tribunal proceed when weighing competing interests without exercising discretion? Does the weighing of interests not necessarily entail some degree of discretion? As one arbitration practitioner pointed out, '[t]his may lead to serious legal issues once the CETA enters into force'.

As the court's opinion concerns the long-term structural reform of ISDS towards a multilateral investment court, the opinion also has implications for today's investment treaty arbitration practitioners. By recognising the compatibility of the ISDS mechanism in CETA with EU law, practitioners can trust in the continued existence of some form of ISDS in future disputes involving the EU and third countries. As the CETA Tribunals will incorporate not only elements drawn from international arbitration, but also features of judicial proceedings—in the court's words a 'hybrid' dispute resolution method—arbitration practitioners will likely develop new skills tailored to this new type of proceeding. For instance, arbitration practitioners working on either side of disputes will have to become acquainted with the new appeals process under CETA and will need to think creatively about issues such as the standard of review. But also, in terms of substantive standards, arbitration practitioners have a slate of newly constructed treaty obligations which the CETA Tribunals will further develop with their interpretation (for example, the standard of 'fair and equitable treatment').

Before any ICS under CETA enters into force or begins to operate, CETA needs ratification by all EU Member States. It remains to be seen whether Belgium and other EU Member States will now [complete their domestic ratification procedures](#)—at the date of the opinion, only ten of 28 Member States had provided notification to the EU that they had done so. As one commentator noted, it remains to be seen how many states are keen to follow what the Commission considers to be the [new gold standard of international investment dispute settlement](#). There is still Italy's threat not to ratify CETA as it considers that the protection afforded by geographical indications is insufficient. Moreover, some EU Member States have indicated that they will await their domestic Supreme or Constitutional Courts' scrutiny before ratifying CETA. The German Parliament, for instance, is awaiting a judgment on the constitutionality of CETA by the German Federal Constitutional Court, to be rendered later in 2019.

It thus appears that the shift to new fora for the resolution of investor-state disputes is already in full motion. Investment treaty arbitration practitioners practicing in the EU will continue to pay close attention to these developments.

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