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Mapping the Evolution of Legitimacy: Arbitration Clauses in Investment Chapters of American International Free Trade Agreements

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MAPPING THE EVOLUTION OF LEGITIMACY: ARBITRATION CLAUSES IN INVESTMENT CHAPTERS OF AMERICAN INTERNATIONAL FREE TRADE AGREEMENTS

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I. INTRODUCTION

A transatlantic fault line is emerging in the evolution of international trade agreements as leading countries pursue diverging strategies concerning the protection of foreign investors. Investor-state dispute settlement ("ISDS") is a key component for increasing foreign investments across the globe by providing a neutral settlement system for resolving disputes between non-state investors and states.[1] ISDS exists to provide a neutral dispute resolution venue, de-politicizing investor-state disputes. The lack of global consensus on the inclusion and structure of ISDS in international trade agreements is creating a fault line. Already, the fault line has halted international negotiations, hindering global trade.

The fault lines of development are highlighted in the United States-Mexico-Canada Agreement ("USMCA"), the Comprehensive Economic and Trade Agreement ("CETA"), and the Transatlantic Trade and Investment Partnership ("TTIP").[2] In the game of

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[1] Foreign investment protection became critical post-World War II and the last twenty years have been a "virtual explosion of investment arbitration." All the stakeholders tactically agreed that successful international investment relationships should foster a win-win environment, but whether shifting approaches perpetuate a mutually beneficial environment is uncertain. KAJ HOBÉR & JOEL DAHLQUIST CULLBORG, INVESTMENT TREATY ARBITRATION: PROBLEMS AND EXERCISES 9 (2018); *see also* Ylli Dautaj*, Between Backlash and the Re-Emerging "Calvo Doctrine": Investor State Dispute Settlement in an Era of Socialism, Protectionism, and Nationalism*, 41 NW. J. L. INT'L BUS. 3, 273, 285 (2021); Deborah Hensler & Damira Khatam, *Re-Inventing Arbitration: How Expanding the Scope of Arbitration is Re-Shaping its Form and Blurring the Line Between Private and Public Adjudication*, 18 NEV. L. J. 381, 403 (2018).

[2] The USMCA is the newest rendition of the North American Free Trade Agreement ("NAFTA"). Negotiations for USMCA occurred between 2017 and 2019. Negotiations for CETA occurred between 2009 and 2014. Negotiations for TTIP occurred between 2013 and 2016. *See* United States-Mexico-Canada Agreement Chap. 14, Nov. 30, 2018 [hereinafter USMCA]; EU-Canada Comprehensive Economic and Trade Agreement, Chap. 8, Oct. 30, 2016 [hereinafter CETA]; Transatlantic Trade and Investment Partnership Chap. 2 [hereinafter TTIP].

investment arbitration, three economic players—the United States ("U.S."), European Union ("E.U."), and Canada—are playing with very different rules in three distinct trade agreements: USMCA, CETA, and TTIP. Between these three agreements, CETA is the only agreement with full support from the signatories—support generated by the common goal of replacing ISDS with a Multilateral Investment Court ("MIC"). This displacement of ISDS may kickstart the "next generation" of investment arbitration.[3] CETA could create a new game of dispute resolution, one in which the roles of players are redefined, and the rules are uncertain. But the winners of the game are clearly the E.U. and Canada, not the investors. Producing a legitimate arbitration mechanism for investors is likely to positively influence foreign investment growth while an illegitimate system may cause retraction in foreign investments. Investors may seek engagement in countries with bilateral investment treaties ("BITs") or construct ISDS clauses within investor-state contracts when treaty protection proves inadequate.

ISDS clauses are found in international investment agreements ("IIAs") that define investor protection and dispute resolution mechanisms within BITs and multilateral investment treaties ("MITs"). Moreover, ISDS clauses are prevalent within investment chapters of free trade agreements ("FTAs") such as NAFTA. To this day, foreign direct investment ("FDI") is deeply embedded within the fabric of FTAs. FDI is a driving force in "global value chains," but the investment relationship is heavily dependent on ISDS.[4]

The evolution of ISDS within FTAs is producing a transatlantic fault line with the U.S. at the center of diverging ISDS preferences. The role and standing of international investment law found in IIAs are at a crossroad as leading international FTAs take drastically different steps in ISDS. Notwithstanding these differences, external stakeholders and underdeveloped states are questioning the

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[3] Teni Akeju et. al., *Investor-State Arbitration and the 'Next Generation' of Investment Treaties, in* INV. TREATY ARB. REV. 507-519 (Barton Legum ed., 6th ed. 2021).

[4] *Foreign Direct Investment Statistics: Data, Analysis and Forecasts*, ORG. ECON. COOP. DEV. https://www.oecd.org/investment/statistics.htm (last visited Nov. 14, 2022) [hereinafter OECD].

legitimacy of ISDS. A backlash movement has ensued. Criticism of ISDS hits at the core of the system, manifesting a so-called "legitimacy crisis."[5] This comment tells the Western story of ISDS in FTA investment chapters—illustrating the shifting landscape of arbitration.[6]

State actors are promoting conflicting priorities in arbitration reform, threatening the future legitimacy of the investor-state arbitration regime. The USMCA ISDS negotiations between the U.S., Mexico, and Canada were unsuccessful—a critical example of a state rejecting arbitration legitimacy.[7] Canada removed itself from the ISDS component of the USMCA, leaving Canadian foreign investments with limited access to treaty-based investment protection or access to ISDS.[8] Meanwhile, Canada and the E.U. agreed to break the mold of arbitration by launching a MIC through CETA.[9] Moreover, Canada's striking rejection of the USMCA ISDS agreement in favor of a MIC is antithetical to the U.S.'s rejection of the TTIP MIC for the preservation of ISDS.[10]

TTIP was planned to be the biggest trade agreement ever negotiated—an agreement between the world's two largest economies

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[5] Dautaj, *supra* note 1, at 300.

[6] Consequently, analysis is focused on the ISDS within FTAs of Western economic leaders.

[7] Brooks E. Allen et al., *The USMCA: Six Months On*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Apr. 20, 2021) https://www.skadden.com/insights/publications/2021/04/takeaways-the-usmca-six-months-on.

[8] Investment protection relates to issues of substantive law while investor access to ISDS is a procedural right. Hence, Canada's decision hinders substantive and procedural rights of investors. Yet, some believe "scrapping part of NAFTA's [Chapter Eleven] is Canada's biggest [USMCA] win." Jessica Vomiero, *Why Some Experts Say Scrapping Part of NAFTA's Ch. 11 Is Canada's Biggest Win with USMCA*, GLOB. NEWS (Oct. 5, 2015) https://globalnews.ca/news/4519161/usmca-chapter-11-investor-state-dispute-settlement/.

[9] Eur. Comm'n Press Release, *CETA: EU and Canada Agree on New Approach on Investment in Trade Agreement*, EUR. COMM'N (Feb. 29, 2016) https://ec.europa.eu/commission/presscorner/detail/en/IP_16_399.

[10] Catherine Amirfar et al., *From NAFTA to USMCA: Main Changes to the Investor-State Dispute Settlement System*, DEBEVOISE & PLIMPTON (May 7, 2020) https://www.debevoise.com/insights/publications/2020/05/from-nafta-to-usmca-main-changes-to-the-investor.

expected to grow the existing U.S.-E.U. investment market valued at nearly $4 trillion.[11] Negotiations for these trade agreements were controlled and finalized by the related state actors, with practically no input from the investors that were immediately impacted by the resulting ISDS clauses.[12] ISDS clauses and investment protection seek to redress any possible grievances arising due to the actions of a state. International investment law within IIAs and FTA investment chapters protects against indirect expropriation and provides fair and equal treatment. Secondly, the law offers investor-state arbitration for any potential investment interference.

The evolution of the dispute resolution clause within trade agreements is underpinned by a desire to increase systemic legitimacy by tackling existing criticisms. Whether the agreements have increased legitimacy is unknown. Within this comment, references to trade agreements entered by a North American country (i.e., Canada, Mexico, or the U.S.), are directed to the investment chapter and more specifically, to the dispute resolution clause. This comment seeks to address how these treaties impact investor views on the legitimacy of the new dispute settlement systems. This comment specifically analyzes the proposed reforms of ISDS clauses—clauses extending a unilateral offer to settle investment dispute through investor-state arbitration.

This comment seeks to answer whether the new investor-state dispute resolutions in the USMCA and CETA agreements increased the legitimacy of arbitration.[13] First, this comment delves into the history of investment treaty arbitration in international agreements with an introduction to NAFTA, USMCA, CETA, and TTIP. Second,

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[11] Before negotiations, the U.S.-E.U. goods and services trade accounted for "nearly half of global economic output." *Final Report: High Level Working Group on Jobs and Growth*, OFF. U.S. TRADE REP. (Feb. 11, 2013) https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2013/final-report-us-eu-hlwg.

[12] *See Negotiating EU Trade Agreements*, EUR. COMM'N, https://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149616.pdf (last visited Nov. 14, 2022); CONG. RSCH. SERV., U.S. TRADE POLICY FUNCTIONS: WHO DOES WHAT? (Jan. 14, 2022), https://sgp.fas.org/crs/misc/IF11016.pdf.

[13] In the analysis, TTIP is a secondary consideration since the agreement, presenting the same MIC proposal as CETA, was unsuccessful. The U.S. rejected the TTIP MIC system.

this comment deconstructs the dispute resolution clauses of each agreement to outline the new dispute structures. Finally, this comment considers the impact of the new structures on legitimacy from the perspective of foreign investors. Legitimacy is measured in three areas: (1) access to a neutral and effective dispute resolution forum, (2) tribunal composition, and (3) award finality. A critical question in this analysis is whether reform of the dispute resolution regime in investment chapters can be successful when "undercutting" foundational elements of international arbitration.[14] Such reforms shift the dispute landscape "farther from its equilibrium state" until only a "shell" of the arbitration regime remains.[15]

Access to a neutral and effective dispute resolution forum addresses the ability of investors to resolve the matter under a system free from state bias or influence. Tribunal composition looks at the potential impact of the selection of arbitrators on neutrality, independence, and impartiality. Award finality involves the enforceability of an award. An award is final when it can be directly enforced. Opportunities to appeal, review, or annul an award decrease finality. The actual enforcement of an award is subject to the New York Convention Article V.[16] Under ICSID, an award is to be enforced as a national judgment immediately, but the hurdle of execution remains.

An analysis of these three factors, derived from the core virtues of traditional arbitration, explains whether USMCA and CETA have increased ISDS legitimacy from the perspective of investors. The USMCA maintains the legitimacy status quo of existing arbitration mechanisms. However, decreased legitimacy exists in the accessibility to arbitration in two areas: Canadian investment protection and investments in the noncovered class. Comparatively, CETA faces tremendous legitimacy concerns by diminishing party autonomy in Member selection, diluting the independence, impartiality, and

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[14] *See* Stephan W. Schill, *Reforming Investor-State Dispute Settlement (ISDS): Conceptual Framework and Options for the Way Forward*, E15 INITIATIVE, ICTSD & WORLD ECON. F. 1 (2015).

[15] Dautaj, *supra* note 1, at 318.

[16] *See* Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. V (1959) [hereinafter New York Convention].

neutrality of Members, and decreasing the finality of tribunal awards. These agreements depict the ability of states to undercut the legitimacy of investor-state arbitration by establishing gatekeeping mechanisms through state-designed treaty clauses. Analyzing three of the largest economic players in the world, it appears arbitration and ISDS are shifting towards the preferences of states and away from the protection traditionally sought by foreign investors. Eroding the protection of investors can cripple future transborder investments and damage ISDS legitimacy.

FTAs with investment chapters that include ISDS clauses are designed to remove commercial barriers between foreign countries to foster increased economic integration.[17] Intensified integration demands a dispute resolution mechanism capable of protecting foreign investors. In this light, international arbitration emerges as "intrinsic" to the "accomodat[ion] of cross-border bargains"—a central component to facilitating investment.[18] The core values of international arbitration include: (1) party autonomy, (2) the provision of a neutral adjudicatory system free of national bias, (3) a tribunal with relevant expertise, and (4) a final and enforceable award.[19] Transatlantic fault lines in the shifting landscape of ISDS within FTAs raise questions on the legitimacy and impact of reformation. "The proof of the pudding is in the eating"—while new reforms emerge, "there is simply no better, realistic alternative" to international investment arbitration.[20]

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[17] USMCA, *supra* note 2, at Preamble:

> [R]esolving to:
> STRENGTHEN ANEW [. . .] the strong economic cooperation that has developed through trade and investment;
> FURTHER strengthen their close economic relationship;
> REPLACE [NAFTA . . . and] support mutually beneficial trade leading to freer, fairer markets, and to robust economic growth in the region . . .

[18] Dautaj, *supra* note 1, at 282; *see also* Hensler & Khatam, *supra* note 1, at 390-92.

[19] TIBOR VÁRADY ET. AL., INTERNATIONAL COMMERCIAL ARBITRATION– A TRANSNATIONAL PERSPECTIVE 9-11 (7th ed., 2018).

[20] HOBÉR & CULLBORG, *supra* note 1, at 14-15.

II. BACKGROUND

A. Alternative Dispute Mechanisms: The History of Arbitration

Arbitration is facing increasing demands for a structural metamorphosis in a shifting dispute settlement environment with expanding priorities.[21] International arbitration emerged in response to growing business-to-business trade disputes post-World War I and World War II.[22] Newly developed nations were eager for foreign investment, but vulnerable to canceled projects, failed plans, and detrimental losses.[23] Multinational corporations needed assurance that their rights would be protected from domestic instability and politicized judiciaries. A new system was needed to replace "primitive remedies such as hostage taking, ransom demands, and reprisals" through gunboat diplomacy.[24] The international arbitration system eased this uncertainty in foreign engagement by providing increased protection, integration, and stability. Further uncertainty emerged with the threat of expropriation arising from domestic regulations infringing on foreign investment rights.[25] Investors needed a legitimate and enforceable dispute mechanism for bringing claims against national governments implementing investment regulations in violation of foreign investor rights.

The traditional arbitration mechanisms were formulated around corporate transactions arising between non-state actors. Foreign investment disputes raise claims against state governments. Moreover, investors could not—and still cannot—feasibly raise claims in domestic investment courts due to state immunity rights and

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[21] Systemic pressures are consistent across domestic arbitration jurisprudence, international commercial arbitration, and investor-state arbitration due to growing emphasis on liberal values including environmental and human rights. Hensler & Khatam, *supra* note 1, at 381.

[22] *See* discussion, *supra* Part I.

[23] Hensler & Khatam, *supra* note 1, at 409.

[24] FRANCES DELACEY, *Enforcing Contracts in Developing Countries, in* EUROPEAN BANK OF RECONSTRUCTION AND DEVELOPMENT, LAW IN TRANSITION: CONTRACT ENFORCEMENT 16 (2001).

[25] Schill, *supra* note 14, at 1.

concerns of domestic bias.[26] Large foreign investors contracted directly with states; however, smaller investors were unable to achieve the same level of contractual protection due to weakened negotiation leverage.[27] In time, governments began structuring broad protection mechanisms for foreign investors via negotiated BITs and MITs.[28]

Transnational trade agreements seek to increase the flow of FDI between contracting states by establishing standing trade and investment protection standards for a broad class of investments.[29] Protection from expropriation—the "most severe form of governance interference"—is "the heart and soul" of investment treaty protection.[30] ISDS institutions, investor-state contracts, and state drafted treaties simultaneously address investment arbitration concerns. The World Bank founded the International Centre for the Settlement of Investment Disputes ("ICSID"), the premier international investment dispute settlement institution, which is available for disputes arising under FTAs.[31] ICSID has 164 member

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[26] Vera Korzun, *The Right to Regulate in Investor-State Arbitration: Slicing and Dicing Regulatory Carve-Outs*, 50 VAND. J. TRANSNAT'L L. 355, 405 (2017).

[27] Isabella Bellera Landa, *State Parties in Contract-Based Arbitration: A Report from the 16th Annual ITA-ASIL Conference*, KLUWER ARB. BLOG (June 17, 2019) http://arbitrationblog.kluwerarbitration.com/2019/06/17/state-parties-in-contract-based-arbitration-a-report-from-the-16th-annual-ita-asil-conference/.

[28] BITs first gained popularity in the 1980s. In 2015, there were approximately 180 countries involved in around 3,000 BITs. Hensler & Khatam, *supra* note 1, at 409-10. NAFTA is considered "[o]ne of the earlier exemplars" of a BIT. Frederick M. Abbott, *Introductory Remarks*, 108 AM. SOC'Y INT'L L. PROC. 311 (2014).

[29] FDI is defined as "a category of cross-border investment made by a resident in one economy (the direct investor or parent) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise or affiliate) that is resident in an economy other than that of the direct investor." Int'l Trade Admin., *FDI from Small Businesses: Understanding the Behavior and Impact of Foreign-Owned SMEs in the U.S. Economy,* U.S. DEP'T COM. 1, 2 (2020), https://www.trade.gov/sites/default/files/2022-08/SelectUSAFDISmallBusiness Report.pdf.

[30] HOBÉR & CULLBORG, *supra* note 1, at 10.

[31] Founded in 1966, ICSID [hereinafter ICSID] administers the majority of ISDS cases in an "independent, depoliticized and effective dispute-settlement institution." *About ICSID*, INT'L CTR. SETTLEMENT INV. DISPS., https://icsid.worldbank.org/about (last visited Nov. 14, 2022).

state signatories and contracting states.[32] The ICSID system has administered over 700 cases with fifty-eight cases registered during the 2020 calendar year.[33] In conjunction with robust arbitration institutions, the Vienna Convention on the Law of Treaties serves as the guide for interpreting ISDS treaty clauses.[34] Increased institutionalization and regulation of treaties and arbitration has exponentially strengthened the legitimacy of investment arbitration. In 2014, investment arbitrators rendered the highest ever dispute award of over $50 billion in favor of shareholders—twenty times larger than any other arbitration award.[35] The massive award amount highlights the tremendous scope and growing importance of investment arbitration.[36] Put simply, there has been a "virtual explosion of investment treaty arbitration."[37]

Traditional investor-state arbitration awards are final and enforceable through the New York Convention, institutional rules, and

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[32] *Database of ICSID Member States*, ICSID, https://icsid.worldbank.org/about/member-states/database-of-member-states (last visited Nov. 14, 2022).

[33] *See The ICSID Caseload – Statistics*, ICSID (July 28, 2021), https://icsid.worldbank.org/resources/publications/icsid-caseload-statistics.

[34] Vienna Convention on the Law of Treaties, art. 31(1) (1969), 1155 U.N.T.S. 331 [hereinafter VCLT]. ("1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.").

[35] The tribunal ordered Russia to pay shareholders of Yukos, a defunct oil company. The dispute "generated 6,500 pages of court filings, 11,000 exhibits, 3,300 pages of hearing transcripts and 37 days of hearings." The case shows the "extraordinary tenacity of the people involved in shaping international law." Jennifer Morrison Erison, *Investor State Dispute Settlement and the $50 Billion Case*, JONES, SWANSON, HUDDELL & DASCHBACH LLC, (March 24, 2016) https://jonesswanson.com/news/investor-state-dispute-settlement-and-the-50-billion-case/; *see also* Yukos Universal Ltd. (Isle of Man) v. Russ. Fed'n, Case No. 2005-04/AA27, (Perm. Ct. Arb., 2005); Sergio Puig & Anton Strezhnev, *The David Effect and ISDS*, 28 EUR. J. INT'L L. 731, 732 (2018). The award has since been annulled by The Hauge Court of Appeal. *Court Actions at a Glance*, YUKOS CASE INT'L CTR. LEGAL PROT., https://www.yukoscase.com/court-actions/at-a-glance/ (last visited Nov. 14, 2022).

[36] Erison, *supra* note 35.

[37] In 2015, there were between 500-600 decided and pending arbitration cases. Kaj Hobér, *Investment Treaty Arbitration and Its Future - If Any*, 7 Y.B. ON ARB. MEDIATION 58 (2015).

domestic arbitration acts.[38] In investor-state arbitration, awards are taken from the tribunal seat to the home state court of the losing party for domestic review and enforcement. National domestic courts may review the enforceability of an award, but a high standard of deference is applied with narrow opportunities for award annulment.[39] Institutional rules on the power of review granted to domestic courts vary. The Model Law restricts national interventionism by limiting domestic courts to the "censor[ship of] egregious conduct and errors."[40] The ICSID allows for annulment of an award when: (1) the arbitrators are unable to exercise independent judgment, (2) the tribunal clearly exceeds its powers, or (3) there is corruption by a member of the Tribunal.[41] Comparatively, the United Nations Commission on International Trade Law ("UNCITRAL") Rules leave domestic courts to decide their capacity to annul awards.[42] The New York Convention supports "nearly universal . . . enforcement of . . . awards."[43] Under Article V, an award may be refused recognition when it is contrary to domestic public policy or in violation of domestic law.[44] Most national reviews involve "low-intensity challenges" restricted to the "basic requirements of due process, procedural fairness, and deference toward public policy" rather than substantive findings.[45] Similarly, most domestic arbitration acts provide for narrow review. For example, the United States Federal Arbitration Act ("FAA") allows four limited grounds for vacating an arbitration award.[46]

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38 New York Convention, *supra* note 16, at art. V.

39 The level and type of deference granted by a court to the tribunal award fluctuates across jurisdictions. Antonia Eliason, *Evident Partiality and the Judicial Review of Investor-State Dispute Settlement Awards: An Argument for ISDS Reform*, 50 GEO. J. INT'L L. 1, 7 (2018).

40 Filippo Fontanelli et. al., *Lights and Shadow of the WTO-Inspired International Court System of Investor-State Dispute Settlement*, 1 EILA REV. 191, 231 (2006).

41 Eliason, *supra* note 39, at 17; *see also* Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) art. 52, 53 (1965).

42 Eliason, *supra* note 39 at 18; *see also* United Nations Commission on International Trade Law, *UNCITRAL Model Law on International Commercial Arbitration 1985: with Amendments as Adopted in 2006* art. 6 (Vienna: UN, 2008).

43 Eliason, *supra* note 39, at 18; *see also* New York Convention, *supra* note 16, at art. 1.

44 *See* New York Convention, *supra* note 16, at art. V(2)(b) and (1)(a).

45 Fontanelli et al., *supra* note 40, at 233; *see also* Eliason, *supra* note 39, at 19.

46 *See* Federal Arbitration Act, 9 U.S.C.S. §10(a) (Lexis) [hereinafter FAA].

Overall, public policy claims attempting to set aside tribunal awards have been unsuccessful.[47] Most successful claims derive from tribunals acting beyond their power.[48] Generally, national courts have "not indulged in trespassing upon the merits of the dispute" and international arbitration awards remain final and enforceable.[49]

Within FDI, small and medium enterprises ("SMEs") face increased obstacles and vulnerability in comparison to large corporations.[50] The main barriers for SMEs include "unfair competition, complex regulatory environments, challenging approval processes, corruption, and lack of financing."[51] Despite these barriers, SMEs generate significant local impact by providing more jobs, greater

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> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
> (1) where the award was procured by corruption, fraud, or undue means;
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

47 Fontanelli et al., *supra* note 40, at 232.

48 *Id.*

49 *Id.* at 233.

50 SMEs are defined as "independent firms which employ fewer than a given number of employees. The U.S. considers SMEs to include firms with fewer than 500 employees." Int'l Trade Admin., *supra* note 29, at 2. The E.U. defines an SME as having between ten and 250 employees or an operating revenue between €2 and 50 million or total assets between €2 and 43 million. Eva Rytter Sunesen et al., *The World in Europe, global FDI flows towards Europe: FDI by European SMEs,* EPSON EUR. GRP'G TERR. COOP. (2018), https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/1/441/1525771561/espon-fdi-11-main-report-fdi-by-european-smes_0.pdf.

51 Int'l Trade Admin., *supra* note 29, at 4.

output, and higher employee compensation in the U.S.[52] Similarly, SMEs accounted for thirty percent of FDI projects by E.U. investors with increasing investments from 2003 to 2015.[53] North America receives the largest amount of E.U.-based SME foreign investment.[54] Thus, trade agreements between the U.S., Canada, and the E.U. are particularly important for SMEs to improve standardization and remove existing barriers.

Despite the growing importance of ISDS, international tribunals are continually "defend[ing] themselves . . . against attacks on their legitimacy as mechanisms for resolving disputes [that directly impact] the scope and limits of state sovereignty."[55] Yet, continual increases in transborder investment have contributed to international investment arbitration becoming one of the fastest growing areas of international law.[56] This comment defines "legitimacy" as the "acceptance of 'a rule or rule-making institution which itself exerts a pull toward compliance on those addressed normatively because those addressed believe that the rule or institution has come into being and operates in accordance with generally accepted principles of [the] right process.'"[57] Within investment arbitration, "those addressed" by the institution are investors and states party to the dispute. Generally, states and investors have deemed investor-state arbitration and international treaties protecting investments as legitimate.[58] However, USMCA, CETA, and TTIP present a fault line in the acceptance of the traditional trajectory of investment arbitration. Treaty shifts do not instantly indicate legitimacy doubts of the "entire [arbitration] system,"

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52 SME FDI generated "over five million jobs, over $1 trillion in output, and $350 billion in employee compensation in 2016" and "nearly 7.4 million U.S. jobs, $62.6 billion in research and development funding, and $382.7 billion in contributions to U.S. goods exports" in 2017. *Id.* at 2.

53 The increasing FDI statistics exclude 2008 to 2009. Sunesen et al., *supra* note 50, at V, VI.

54 *Id.* at V.

55 Charles N. Brower & Stephan W. Schill, *Is Arbitration a Threat or Boon to the Legitimacy of International Investment Law?*, 9 CHI. J. INT'L L. 471 (2009).

56 *Id.*

57 *Id.* at n1.

58 *Id.* at 495.

but changing the rules of dispute settlement may fragment existing legitimacy.[59]

The increased legitimacy and popularity of investment arbitration have come with evolving trends and criticisms. Two prominent trends in arbitration are the substantive expansion of claims and the increased judicialization of arbitral proceedings. These developments have altered the nature of investor-state arbitration and amplified criticisms across a broad spectrum of commentators. That spectrum includes foreign investors, state governments, domestic legislatures, and members of the broader public—each category raising distinct criticisms that damage the perceived legitimacy of arbitration.

The first trend is the "expansion in substantive scope" that has allowed the disputes to transition from simple and low-stakes issues to complex matters with "significant public policy implications."[60] The prominence of investment arbitration comes with ripple effects felt in the domestic legal regimes where the arbitration award is enforced. One domestic ripple is seen in the impact of arbitral decisions on the domestic rule of law, prompting public policy concerns. First, arbitration requires automatic and "open access" to state governments against whom a claim is filed.[61] Next, certain sectors of investment are intertwined with natural resources, public utilities, and national economic issues that generate increased public interest. Further, tribunals have the power to order the government to pay massive rewards to corporations—rewards funded by taxpayer money.[62] Payment with taxpayer money raises public policy concerns about the accuracy, legitimacy, and power of arbitral tribunals acting beyond state control.[63]

Another public policy concern exists where legislative regulation is rewritten by a corporation's unilateral decision to

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59 *Id.*

60 Hensler & Khatam, *supra* note 1, at 420; *see* discussion *supra* Part II.A.

61 Hensler & Khatam, *supra* note 1, at 414.

62 *Id.* at 413.

63 *Id.*

arbitrate, igniting debates over democratic deficits.[64] Tribunals act beyond state control and outside of the national public policy environment, operating in an international legal investment vacuum when deciding investor-state disputes. The tribunal analyzes an investment dispute through a narrow economic lens without consideration of broader societal implications of the resulting arbitration award.[65] In contrast, state legislatures and judicial systems deliver regulations and legal decisions rooted in democratic dialogue, integrating public opinion and domestic concerns into the decisionmaking. This dialogue is a key feature of the democratic process. International tribunals lack democratic dialogue with state legislators. Instead, they are siloed in an international investment regime. The resulting arbitral award is delivered to states, enforced, and integrated into the domestic legal system with limited review and repeal opportunities.[66] The impact of the siloed arbitration process—a stain on state sovereignty—raises legitimacy problems from disgruntled states and their concerned citizens. Treaty negotiations allow states to directly alter the domestic ripple arising from arbitration awards.[67]

The second trend in investment arbitration is the adoption of arbitral procedures that "resembl[e] a public adjudicative forum" with formal rules, due process protections, and, at times, public access.[68] However, increased formality reduces the flexibility, speed, and cost traditionally seen as a benefit of arbitration by claimants.[69] Despite the

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64 Christian Calliess & Miriam Dross, *Regulatory Cooperation in the Transatlantic Trade and Investment Partnership TTIP – Thrill or Threat for the Environment*, 13 J. EUR. ENV'T PLAN. L. 350, 372-73 (2016); *see also* Thea M. Lee, *TTIP Must Protect Jobs, Workers and Public Services*, 50 INTERECONOMICS 317 (2015).

65 *Id.*

66 Eliason, *supra* note 39, at 5-6.

67 Australia chose to exclude investor-state arbitration clauses in future BITs as corporations can undermine domestic rule of law as seen in Phillip Morris Asia Ltd v. Commw. Austl. which arose under the Australia-Hong Kong BIT. The corporation (Phillips Morris) initiated a dispute in international arbitration despite Australia's highest court rendering a decision against the corporation due to public policy concerns. *Phillip Morris Asia Ltd v. Commw. Austl.*, Case No. 2012-12, (Perm. Ct. Arb. 2012).

68 Hensler & Khatam, *supra* note 1, at 420, 411.

69 Dautaj, *supra* note 1, at 313.

increasing judicialization of arbitration, many critics demand further regulations of arbitration.[70]

Procedural criticism focuses on the selection and payment of arbitrators. Traditionally, disputing parties select their arbitrators within the International Bar Association ("IBA") Guidelines on Conflicts of Interest which prioritize independence, impartiality, and neutrality through disclosure.[71] This selection process promotes party autonomy which upholds several key virtues of arbitration: fairness and the freedom to contract. The arbitral tribunal is formed when each party appoints an arbitrator. Those two arbitrators then select a third arbitrator that typically serves as the tribunal chair.[72] These three arbitrators deliberate in private after a hearing and subsequently release the tribunal award.[73] Arbitrators are paid by the appointing party.[74] The ad hoc nature of tribunal composition prompts criticism on the authority of parties to select their arbitrators, accountability of arbitrators, and consistency of awards. These critiques highlight the lack of "corrective mechanisms" for "erroneous judgments" arising out of arbitration.[75] These concerns relate to the siloed nature of

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[70] From the state perspective, arbitration limits the state's authority to regulate the financial marketplace. *See* Calliess, *supra* note 64, at 371; *see also* Puig, *supra* note 35, at 733.

[71] The IBA Guidelines are the default arbitration mechanism for arbitrator appointment. The Guidelines include waivable dynamics fostered on disclosure. Neutrality means the arbitrator lacks family and business connections with the arbitrating parties. Independence is the objective test assessing whether the arbitrator is free of influence from the parties. Impartiality is a subjective assessing whether actual or apparent bias exists relating to the party or the dispute outcome. International Bar Association Guidelines on Conflicts of Interest in International Arbitration (2014).

[72] *Number of Arbitrators and Method of Their Appointment – Additional Facility Arbitration*, ICSID https://icsid.worldbank.org/services/arbitration/additional-facility/process/number-of-arbitrators-and-method-of-their-appointment (last visited Nov. 14, 2022).

[73] *Award - Additional Facility Arbitration*, ICSID https://icsid.worldbank.org/services/arbitration/additional-facility/process/award (last visited Nov. 14, 2022).

[74] Institutional arbitration provides administration of arbitration costs including the arbitrator fee. *Costs and Payments*, INT'L CHAMBER OF COM., https://iccwbo.org/dispute-resolution-services/arbitration/costs-and-payments/ (last visited Nov. 14, 2022).

[75] Lee, *supra* note 64, at 319.

arbitration and limited review mechanisms, prompting demands for increased arbitration transparency.[76]

As for the payment of arbitrators, some commentators decry the financial benefits realized by repeat arbitrators. There are minimal restrictions on the rotation of arbitrators across cases and little documented information on arbitrator compensation.[77] Low estimates indicate arbitrators are compensated $1.28 million per dispute—accounting for approximately sixteen percent of arbitration costs.[78] On a three-person tribunal, this averages to $427,000 per arbitrator with further opportunities for increased earnings.[79] Whether arbitration creates "economic incentives" for arbitrators is nuanced.[80] When comparing arbitrator compensation to partners at corporate law firms, clearly arbitrators are earning far lower wages.[81] Yet, judicial salaries are lower than that of arbitrators who serve in a similar position to judges.[82] Despite the minimal information on arbitrator compensation, critics still complain of arbitration fueling "economic incentives" for arbitrators.[83]

The legitimacy of arbitration hangs on a careful balance of foreign investor protection, domestic rule of law, and public policy concerns. Traditional tenants of legitimacy are interwoven in an investor's ability to access arbitration, the tribunal's composition, and the award's finality. Evolving trends and criticisms of investment arbitration are shifting the arbitration environment. The virtues of arbitration will be analyzed in the shifting mechanisms provided to foreign investors under USMCA and CETA.

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[76] *See* discussion *supra* Part II.A.

[77] David Gaukrodger, *Adjudicator Compensation Systems and Investor-State Dispute Settlement* 34 (May 2017) (OECD WORKING PAPERS INT'L INV.), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/adjudicator_compensation_systems.pdf.

[78] *Id.* at 34-35.

[79] *Id.*

[80] *Id.*

[81] *Id.*

[82] *Id.*

[83] *Id.* at 5.

B. A Snapshot into NAFTA, USMCA, CETA, and TTIP

Investment treaty arbitration ("ITA") arises when an investor is granted rights under an investment treaty to initiate arbitration.[84] According to the United Nations Conference on Trade and Development ("UNCTAD") approximately $15.6 trillion of international investments are protected by an investment treaty.[85] Treaties define an investor's rights, the ability to arbitrate, and the scope of an arbitration tribunal's jurisdiction. Treaties create "promises to protect [foreign] investments" with signatory states consenting to arbitration.[86] ITA was designed to create a "more balanced playing field" for foreign investors.[87] Under ITA, unilateral consent allows investors to initiate arbitration without requiring individualized consent but is limited by the treaty. Removing ITA for a MIC raises questions as to the legitimacy and success of transitioning to the new state-controlled mechanism. This comment specifically investigates treaty-based dispute resolution as granted by USMCA and CETA with references to the failed TTIP provisions.

1. American Trade Agreements: NAFTA & USMCA

The USMCA emerged from the renegotiation and modernization of NAFTA, an agreement that operated for over twenty-five years.[88] Through NAFTA, foreign investments between Canada, Mexico, and the U.S. were granted treaty violation remedies via a three-person independent arbitration tribunal that possessed the

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84 SUSAN D. FRANCK, ARBITRATION COSTS: MYTHS AND REALITIES IN INVESTMENT TREATY ARBITRATION 1-2 (2019).

85 Approximately 68% of foreign investment are covered under treaties. *Id.* at 2, 6 ("R[eplace] the 1994 North American Free Trade Agreement with a 21st Century, high standard new agreement to support mutually beneficial trade leading to freer, fairer markets, and to robust economic growth in the region. . . ."); *see also* USMCA, *supra* note 2, at Preamble.

86 *Id.*

87 FRANCK, *supra* note 84, at 14.

88 *United States-Mexico-Canada Trade Fact Sheet Modernizing NAFTA into a 21st Century Trade Agreement*, OFF. OF THE U.S. TRADE REP., https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/fact-sheets/modernizing (last visited Nov. 14, 2022).

power to award compensation.[89] However, under NAFTA several significant dispute arbitrations led to "damages awards that were legally significant for investment law."[90] Tribunal decisions began to mold the domestic investment law for the signatories. This ripple effect created "unease" for the three NAFTA governments.[91] There existed a "widespread appetite" to limit the NAFTA protections—such as a right to fair and equal treatment, full physical protection and security, and most favorable nation treatment.[92] The USMCA addressed the unease and worked to satiate the desire for limiting the protections offered to foreign investors by decreasing these three components of NAFTA, shifting the scope of arbitration, and increasing the role of domestic litigation in the ISDS clause.[93]

The USMCA investor-state arbitration mechanism involves only the U.S. and Mexico-related investments. Canadian investors are left to rely on local or state-to-state mechanisms.[94] The investors that remain covered by the USMCA are granted fewer protections compared to that of NAFTA. The fair and equal treatment and full physical protection and security protection are reduced to international minimum standards which prevent "only shocking or outrageous government misconduct."[95] Further, the ISDS clause limits direct access to arbitration to a specific group of covered investors. Noncovered investors lose direct access to arbitration and are forced to pursue domestic litigation.[96] NAFTA did not compel investors to seek local judicial remedies before filing an arbitration claim. Forcing a dispute to local remedies is seen in "[v]ery few BITs and treaties."[97]

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89 Allen et al., *supra* note 7.

90 *Id.*

91 *Id.*

92 *Id.*; Most successful ITA claims arise under fair and equal treatment. HOBÉR & CULLBORG, *supra* note 1, at 10.

93 Allen et al., *supra* note 7.

94 *Id.*

95 *Id.*

96 *Id.*

97 Daniel Garcia-Barragan et al., *The New NAFTA: Scaled Back Arbitration in USMCA*, 6 J. L. INT. ARB., 739, 741 (2019). Some of the treaties requiring "exhaustion of local remedies" include the 1976 Germany-Israel BIT, the 1981 Romania-Sri Lanka BIT and the 2007 Albania-Lithuania BIT. Martin Dietrich

The USMCA illustrates the power of negotiating states to redefine who has access to ITA and how a foreign investor can access arbitration. Governments respond to public criticism and governmental concerns, which often depict international arbitration as eroding state sovereignty and infringing on democracy for the benefit of foreign investors, by restructuring the regulations, rights, and obligations for investors. Foreign investors are left to suffer from the unease governments feel when state-granted treaty rights are enforced by international arbitration.

2. European Trade Agreements: CETA & TTIP

CETA and TTIP arise under the E.U. governance umbrella, a system with a deep history of economic integration and cohesion. The E.U. is a "separate legal personality" existing beyond the political and legal systems of national Member States.[98] The Lisbon Treaty directly confers exclusive competence for the protection of investments to the E.U.[99] Further, the E.U. Convention of Human Rights establishes a "general economic interest" to "promote the social and territorial cohesion of the Union."[100] The negotiation of trade agreements in the E.U. is a joint process involving the E.U. Commission, Council of the E.U., and E.U. Parliament.[101] The Commission is responsible for

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Brauch, *Exhaustion of Local Remedies in International Investment Law*, INT'L INST. SUSTAINABLE DEV. BEST PRAC. SERIES 7 (Jan. 2017), www.iisd.org/sites/default/files/publications/best-practices-exhaustion-local-remedies-law-investment-en.pdf.

98 Anna M. Lopez-Rodriguez, *It Takes Two to Tango: Regional Investment Treaties and Investor Protection on Both Sides of the Atlantic*, 2 EILA REV. 412, 419 (2017).

99 The E.U. is granted exclusive FDI competence which includes the ability to create international investment agreements. *See* Stephen Woolcock, *The EU Approach to International Investment Policy After the Lisbon Treaty*, THINK TANK EUR. PARL. (Oct. 21, 2010) https://www.europarl.europa.eu/thinktank/en/document/EXPO-INTA_ET(2010)433854. The exclusive competence of the E.U. includes the ability to "establish[] competition rules," regulate the customs union, and "conclude[] international agreements." An "exclusive competence" means only the E.U. can act on the matter. Treaty on the Function of the European Union art. 3 (2012) [hereinafter TFEU]; *see also FAQ EU Competences and Commission Powers*, EUR. CITIZENS' INITIATIVE, https://europa.eu/citizens-initiative/faq-eu-competences-and-commission-powers_en (last visited Nov. 14, 2022).

100 European Union Convention on Human Rights art. 36 (1950).

101 *Negotiating EU Trade Agreements*, *supra* note 12, at 2.

preparing and negotiating the trade agreement, then the Council and Parliament jointly decide on approving the agreement.[102] CETA and TTIP are "mixed agreements" requiring ratification by all Member States, meaning until the agreement is ratified by all twenty-seven Member States, it is "provisionally" applied.[103] The agreement is not fully enforceable until all Member States ratify the agreement, the partner country signs the agreement, the Council adopts the decision, and depositories are notified of the agreement's ratification.[104] Relevant to the enforcement of E.U. law is the E.U. Court of Justice ("EUCJ") which exists to "ensur[e] E.U. law is interpreted and applied the same in every E.U. country."[105] The E.U.'s commitment to economic cohesion and consistent application of E.U. law, which encompasses foreign investment, propels the push towards increased E.U. influence on arbitration via the investment court system.

a. The E.U.-Canada Comprehensive Economic & Trade Agreement

The E.U. and Canada are venturing to establish a new structure for alternative dispute settlement, abandoning the existing international arbitration tribunals for the Investment Court System ("ICS").[106] The process, approval, and legitimization of this dispute mechanism is ongoing, awaiting ratification by the E.U. Member States. Currently, sixteen Member States have ratified the agreement.[107]

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[102] *Id.*

[103] The ratification by Member States requires a vote dispensed according to national procedures, which usually requires national parliamentary approval and may require regional approval. *Id.* at 6-7.

[104] *Id.* at 7.

[105] *Types of Institutions and Bodies*, EUR. COMM'N, https://european-union.europa.eu/institutions-law-budget/institutions-and-bodies/institutions-and-bodies-profiles/court-justice-european-union-cjeu_en (last visited Nov. 14, 2022).

[106] The court is modeled after the World Trade Organization ("WTO") Settlement System. *See Dispute Settlement,* WORLD TRADE ORG., https://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm (last visited Nov. 14, 2022).

[107] Major E.U. players including France and Germany have yet to ratify the agreement. Ratification is needed from Belgium, Bulgaria, Ireland, Greece, Italy, Cyprus, Hungary, Netherlands, Poland, and Slovenia. *Comprehensive Economic and Trade Agreement (CETA) Between Canada, of the on part, and the European Union and its Member States, of the Other Part*, EUR. COUNCIL https://www.consilium.europa.eu/en/documents-publications/treaties-agreements/agreement/?id=2016017 (last visited Nov. 14, 2022). Notably, after years of political "deadlock" in the Irish Oireachtas

The proposed ICS includes a two-tier structure consisting of a Tribunal of First Instance and an Appellate Tribunal with plans for a semi-permanent body of arbitrators.[108] The inaugural ICS tribunal size is to be comprised of fifteen members with six serving at the appellate level.[109] To survive legitimacy concerns, the system must adequately address the ICS accessibility, selection and payment of arbitrators, and the decreased finality of awards arising with appellate rights.[110] The ICS proposal steps away from many of the traditional components of arbitration—components contributing to the legitimacy of investor-state dispute resolution.

The E.U. has negotiated similar court structures under the FTA agreements with Vietnam, Singapore, and Mexico.[111] The campaign for ICS faces opposition as indicated by the refusal of the U.S. and Japan to accept the ICS mechanism.[112] Japan questioned the fairness of ICS and the system's ability to "obtain legitimacy and confidence."[113] Japan recognizes a need to increase the legitimacy of arbitration, but "recognition of a disease [in arbitration] does not lead to the conclusion that the investment court approach is the right medicine."[114]

Committee over the ratification of CETA, the Supreme Court of Ireland held CETA violates the Irish Constitution and cannot be ratified in its current form. Harry McGee, *Deadlock at Committee Examining Controversial CETA Trade Deal*, IRISH TIMES (Sep. 15, 2021) https://www.irishtimes.com/news/politics/deadlock-at-committee-examining-controversial-ceta-trade-deal-1.4674820; Costello v. Att'y Gen. [2022] IESC 44 (Ir.).

108 Nikos Lavranos, *The Impact of EU Law on ISDS*, in INVESTOR-STATE ARBITRATION: A PRACTICAL CROSS-BORDER INSIGHT INTO INVESTOR-STATE ARBITRATION LAW 6 (Glob. Legal Grp., Dominic Roughton & Kenneth Beale eds., 3d ed. 2021); Hensler & Khatam, *supra* note 1, at 419.

109 Lavranos, supra note 108, at 6.

110 *See* Steffen Hindelang & Teoman M. Hagemeyer, *In Pursuit of an International Investment Court: Recently Negotiated Investment Chapters in EU Comprehensive FTA in Comparative Perspective*, THINK TANK EUR. PARL. (June 4, 2017) https://www.europarl.europa.eu/thinktank/en/document/EXPO_STU(2017)603844.

111 Lavranos, *supra* note 108, at 6.

112 Gaukrodger, *supra* note 77, at 32.

113 *Id.*

114 Lopez-Rodriguez, *supra* note 98, at 412.

b. The Transatlantic Trade Investment Partnership

The initial positive momentum of TTIP was quickly confronted by opposition in the E.U. and U.S. due to fears of job loss, weakened public interest protections, lack of transparency, and the influence of corporate lobbying.[115] More concerning to the E.U. was the positioning of investor-state tribunals as an authority "entirely outside of the institutional and judicial framework" of the Union.[116] The European Commission proposed the new ICS during the TTIP negotiations as a political tool aimed at garnering increased support across E.U. institutions.[117] ICS was presented as a replacement for ISDS mechanisms in "all ongoing and future EU investment negotiations."[118] The proposal drew broad input through public consultation involving the European Parliament, E.U. Member States, national parliaments and stakeholders, yet representatives entrenched in the field of arbitration raised concerns over the dearth of input from arbitration stakeholders.[119] This breadth of input was orchestrated to ensure "full trust" in the system.[120] To proactively increase the legitimacy of the ICS, the E.U. attempted to address arbitration criticisms from state and E.U. actors in the innovative TTIP proposal.

The European Parliament and Council's approval of TTIP is necessary to implement the ICS.[121] The consent of national parliaments is critical for maintaining supranational cohesion founded on the ongoing political dialogue between European institutions and nationally elected representatives. Elected representatives cannot directly influence treaty negotiations.[122] The multi-level structure of the

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115 *Id.* at 441-42.

116 *Id.* at 424, 441.

117 Monique Goyens & Léa Auffret, *TTIP: What Is in It for Consumers?*, 50 INTERECONOMICS 333, 337 (2015).

118 *Commission Proposes New Investment Court System for TTIP and Other EU Trade and Investment Negotiations*, EUR. COMM'N (Sep. 16, 2015) https://ec.europa.eu/commission/presscorner/detail/en/IP_15_5651 [hereinafter New Investment Court]; *see also* Charles H. Brower, *Politics, Reason, and the Trajectory of Investor-State Dispute Settlement*, 49 LOY. U. CHI. L. J. 271, 295 (2017).

119 New Investment Court, *supra* note 118.

120 *Id.*

121 *See* discussion *supra* Part II.B.2.

122 *Id.*; *see also* Lopez-Rodriguez, *supra* note 98, at 443.

E.U. creates a difficult road for negotiators struggling to earn a "green light" for broad trade agreements.[123] Unlike the E.U. treaty-approvement process, the U.S. must gain Congress's approval before the agreement can be enacted.[124]

During the TTIP negotiations, over 1,500 groups and 200 professors and economists wrote to Congress protesting the treaty so long as the ICS mechanism remained.[125] After fifteen rounds of negotiations, two Republican Chairmen expressed concern regarding "the EU's apparent unwillingness to include an adequate mechanism in the agreement for the effective resolution of investment disputes."[126] The U.S. negotiators faced strong resistance. The TTIP negotiations came tumbling down. Many blame the failure on fierce stalemates involving one topic: the ISDS clause being replaced with a MIC.[127] The transatlantic fault line in ISDS preferences was conclusively divisive.

The legitimacy of investor-state arbitration and conceptualization of legitimacy deficits in investor-state arbitration are vastly different based on the party's position. Treaties grant states the omnipotent power to reconstruct an ISDS clause to the benefit of states and the potential detriment of investors, yet the fundamental purpose of trade agreements is to strengthen foreign economic

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123 Goyens, *supra* note 117, at 337.

124 Lopez-Rodriguez, *supra* note 98, at 442.

125 The voices of dissent raised concerns in the name of "human rights and democracy." Within Congress, the criticism comes primarily from the Democrats with thirty-one Democratic Congressional members demanding the exclusion of an ISDS mechanism *Id.* at 425, 440; *see also Negotiating EU Trade Agreements, supra* note 12.

126 The word "effective" should be understood as being rooted in the tested and successful core tenants of arbitration. Aaron Forbes & Julia Lawless, *Hatch, Brady Send Letter to USTR as TTIP Negotiations with EU Resume*, U.S. S. COMM. FIN. (Oct. 3, 2016), https://www.finance.senate.gov/chairmans-news/hatch-brady-send-letter-to-ustr-as-ttip-negotiations-with-eu-resume.

127 The ISDS clause was used as a "straw man" against which individuals would "vigorously" fight. The Germans adamantly fought against the ISDS mechanisms—ironically, the Germans were the original creators of the ISDS mechanisms. Jacques Pelkmans, *TTIP: Definition, Rationale and Significance*, 50 INTERECONOMICS 312, 314, 315 (2015). Relying on ISDS mechanisms as a scapegoat in trade negotiations potentially diminishes a complex and vast agreement to the "narrow lens of investors rights." Lee, *supra* note 64, at 318.

relationships.[128] Legitimacy demands approval by all parties; thus, states must remain attentive to investor concerns when reforming arbitration. To perpetuate positive foreign economic relationships, states should consider the core virtues of arbitration that have been critical to decades of success. Particular attention should be granted to investor-friendly virtues such as accessibility, party autonomy, tribunal independence, impartiality, neutrality, and award finality—these tenants establish a legitimate investor-state system for the vulnerable foreign investors.

III. TREATY ANALYSIS

Treaties strive to increase FDI by fostering trust through ISDS clauses designed to protect international investors from treaty violations. However, international investor-state arbitration faces ongoing questions of legitimacy.[129] International investment arbitration has swiftly evolved through the years via revisions of institutional rules, multi-national trade agreements, and the ability of parties to construct working procedures.[130] The "flexibility" of international arbitration is a "main attraction" as parties can create "tailor-made" processes fitting the needs of the particular dispute.[131] FTAs incorporating traditional ISDS clauses articulate trust in the ability of an arbitral tribunal to produce legitimate resolutions to investment disputes. The fault lines in treaty dispute mechanisms heighten legitimacy concerns for vulnerable investors—investors who are bound by the treaty protection. Investor-state arbitration legitimacy

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128 Franck, *supra* note 84, at 6.

129 *See supra* Part II.A.

130 Arbitration parties are permitted to draft procedural orders defining the "when" and "how" of the dispute proceedings based on past experiences. This practice allows for a slow evolution of the procedural process based on party amendments and joint consent to the adapted procedural orders. Thus, those directly involved in arbitration can monitor and fine-tune the arbitration system one dispute at a time. *See International Arbitration Practice Guideline: Managing Arbitrations and Procedural Orders Preamble*, art.1, CHARTERED INST. ARB. https://www.ciarb.org/media/4198/guideline-6-managing-arbitrations-and-procedural-orders-2015.pdf (last visited Nov. 14, 2022) [hereinafter *Managing Arbitration*]; *see also* UNCITRAL Rules for Transparency art. 2 (Jan. 2014) https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/rules-on-transparency-e.pdf.

131 *Managing Arbitration*, *supra* note 130, at Preamble.

questions arise from a range of parties including: (1) the legal community, (2) the investment community, (3) state political communities, and (4) the public. This section focuses on systemic legitimacy from the foreign investor's perspective, grading USMCA and CETA ISDS clauses according to the core virtues of arbitration. Without credible investment protection, foreign investors face risks that could dampen investor appetites for future transnational investment.

Legitimacy from an investor's perspective is tied closely to the fundamental principles underpinning international arbitration with an emphasis on neutrality, independence, and impartiality orchestrated to free the dispute resolution from state control.[132] Here, legitimacy is analyzed by the following: (1) the ability of an investor to access a neutral and effective dispute resolution forum, (2) the level of party autonomy in selecting arbitrators, (3) the independence, neutrality, and impartiality of the tribunal, and (4) the finality of the arbitration award. In the treaty environment, investor preferences conflict with the state's arbitration preferences and ability to define the scope of ITA.

Dispute settlement legitimacy from the state's perspective is found in a system that respects the domestic rule of law, considers national public policy, and permits a level of sovereign control over investment regulations. Understanding the tension between the systemic desires of investors and states is critical for evaluating the consequences arising from the USCMA and CETA. Treaties define an investor's access to international investment arbitration—outlining the protection afforded an investor when a state violates the related trade treaty. Investments falling under BITs and MITs, such as USMCA and CETA, are fully controlled by the negotiating treaty parties. The states define the remedies available to foreign investors and mold the emerging investor-state dispute structures to address the criticisms states deem most vital.

The USMCA, CETA, and TTIP exemplify the modern evolution of ITA, wherein states recreate the rules of ISDS. The USMCA follows the traditional ISDS model while CETA and TTIP

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132 *See supra* at Part II.

venture towards a "revolutionary" two-tiered ICS.[133] The USMCA decreases access to arbitration, but maintains party autonomy, tribunal independence, and award finality. However, the clause lengthens the dispute process and expands state influence through forced litigation. Overall, the USMCA ISDS structure remains closely aligned with the dominant international investment arbitration model. Meanwhile, CETA and the failed TTIP agreement present a radically new method of dispute resolution through permanent, multistate court systems that judicialize arbitration. CETA provides an accessible dispute settlement system, but diminishes party autonomy, tribunal independence, and award finality. The system aligns more closely with the WTO Settlement of Dispute mechanism than traditional international investment arbitration. Concerns revolve around the fiscal impact of an ICS on SMEs and the overall weakened legitimacy of facilitating an entirely new ISDS mechanism. USMCA and CETA clearly incorporated treaty adjustments relating to legitimacy questions surrounding the traditional system, but legitimacy is not one size fits all.

The following sections deconstruct the dispute resolution clauses of each agreement to identify how the new mechanisms impact the legitimacy of the relief available to foreign investors. Legitimacy is measured in three areas: (1) access to a neutral and effective dispute resolution forum, (2) tribunal composition, and (3) award finality. The FTA clauses will be interpreted in "good faith in accordance with the ordinary meaning" applied to terms in the "context and light of its object and purpose."[134] The analysis of these three factors, founded in the core tenants of traditional arbitration, clarifies how the legitimacy of FTA investor protection has evolved from the perspective of investors.

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133 Ian Laird & David Wingfield, *CETA:A Revolutionary Change in Investor-State Dispute Resolution*, GLOB. LEGAL GRP. (Apr. 29, 2016) https://iclg.com/cdr/arbitration-and-adr/6351-ceta-a-revolutionary-change-in-investor-state-dispute-resolution.

134 VCLT, *supra* note 34, at 31(1).

A. Access to Neutral and Effective Dispute Settlement

The first legitimacy factor is access to neutral and effective dispute settlement. In FTAs, the negotiating governments are gatekeepers of foreign investor accessibility to arbitration. The states define the scope of protection granted to foreign investors by their investment type. The USMCA decreases accessibility to arbitration, while CETA and TTIP have a mixed impact on access to a neutral and effective dispute settlement venue based on the financial resources of the investor. USMCA is the substitute to the pre-existing NAFTA, thus, investments made under NAFTA face shifting and, for many investors, diminished access to arbitration compared to the original NAFTA investment conditions. Comparatively, CETA establishes new standards and expectations for investment protection that drastically change investor expectations. The dispute settlement access of each treaty is analyzed below, beginning with USMCA, then moving to CETA with selected insights from TTIP.

The U.S. and Mexico have established an accessible arbitration mechanism for some foreign investors; however, the agreement imposes two significant restrictions. Accessibility is a fundamental first step for providing relief when a state violates the treaty-based rights of a foreign investor. Removing access to a neutral arbitration mechanism can extinguish enthusiasm for foreign investment.

First, Canada opted out of the ISDS section of the agreement—refusing to ratify the amended approach to ITA. This cataclysmic fault line shatters trade agreement integration as it eliminates investment protection in two directions. ITA protection is eliminated for Canadians investing into the U.S. and Mexico. Similarly, Mexican and American investments into Canada are unprotected. While the U.S. and Mexico ratified the ISDS clause with traditional arbitration mechanisms, remedies arising from Canadian investments in either direction remain woefully undefined.

Second, USMCA restricts which investors can access arbitration and through what procedures. Investors are divided into "covered" and "noncovered" classes of investment contracts. The covered contracts are those between a national authority and a covered

investment sector or an investor of another party.[135] The covered sectors are oil and gas, electric power generation, telecommunications, transportation, and ownership and management of certain infrastructure projects (such as roads, railways, bridges, and canals).[136] All other investments are in the noncovered class.[137]

The treaty allows for the direct submission of a dispute to arbitration when filing for a "Mexico-United States Investment Dispute" or a "Mexico-United States Investment Disputes to Covered Government Contracts."[138] This grants access to arbitration to entities participating in government contracts and when Mexico or the U.S. serve as the "annex parties."[139] Consequently, to immediately access arbitration, the investment must involve Mexico or the U.S. as a party to the investment contract. Once a party initiates arbitration, the mechanisms continue to reflect the traditional ISDS structure wherein party autonomy is retained.[140] The scope of covered investments diminishes the ease of arbitration accessibility for investors outside of government associated investments.

The extent of arbitration limits concerning the noncovered investors will not be felt immediately. The USMCA provides a three-year transition period under the NAFTA legacy clause wherein Canadian investments and USMCA noncovered investments can continue to seek relief.[141] Once the NAFTA legacy clause expires, the noncovered investors can only initiate arbitration after commencing litigation in the relevant domestic court.[142] This allows the U.S. and Mexico to retain significant control over the investor-state disputes by requiring domestic litigation to even access arbitration. An investor can seek arbitration only after "obtain[ing] a final decision from a court of last resort of the respondent or [thirty] months have elapsed from the

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135 USMCA, *supra* note 2, at art. 14.1.

136 *Id.* at art. 14.1, 14.2(1),(4), Annex 14-C, 14-D, 14-E(6)(a-b).

137 Allen, *supra* note 7.

138 USMCA, *supra* note 2, at art. 14.2(4), Appendix 3, 14.D.3, 14.E.2, 14.E.4.

139 *Id.* at art. 14.D.3(a), 14.E.6(a-b).

140 *Id.* at art. 14.D.3.

141 The USMCA entered into force on July 1, 2020. The Legacy Clause expires in 2023. *Id.* at Annex 14.C.1, 14.C.3, 14.C.6(a).

142 *Id.* at 14.D.5(1).

date the proceeding . . . was initiated."[143] A noncovered investor cannot file for arbitration against the state without first participating in thirty months of court proceedings. Yet, after forty-eight months, an investor's right to bring a claim to an arbitral tribunal expires.[144] This creates an eighteen-month window for the investor to pursue arbitration after initiating litigation, thus extending the dispute settlement process, and increasing related costs.

The USMCA ISDS coverage is severely limited compared to the protection of NAFTA. Consequently, there is decreased legitimacy fostered by the narrow, covered sector of investments able to bring investor-state arbitration under the treaty. Further, the litigation requirement increases the time and cost of filing an arbitration claim, hindering and discouraging the pursuit of ITA by SMEs. Lastly, the forced domestic litigation clause amplifies state control over the dispute in direct contrast to the neutrality of arbitration that is highly valued by foreign investors. Domestic litigation enhances opportunities for state immunity, internal bias, and unsatisfactory results. Comparatively, CETA and TTIP eliminate the pre-arbitration litigation costs and increase accessibility, but potentially create increased arbitration costs due to the two-tiered structure.

The TTIP and CETA proposals state a commitment that the ICS is available as a standing mechanism for investment disputes.[145] The investment court is a two-tiered system set to include a permanent Tribunal of First Instance ("Tribunal") and Appellate Tribunal.[146] The E.U. and Canada have committed themselves to creating a revolutionary ICS, but the system does not presently exist. ICS implementation will require a carefully orchestrated transition to a new,

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143 *Id.* at art. 14.D.5(1)(b), 14.D.5(1)(b)FN25.

144 *Id.* at art. 14.D.5(1)(c).

145 CETA establishes a "multilateral investment tribunal and appellate mechanism" in Article 8.29 stating: The [Treaty] Parties [Canada and the E.U.] *shall pursue* with other trading partners the establishment of a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes. Upon establishment of such a multilateral mechanism, the CETA Joint Committee shall adopt a decision providing that investment disputes under this Section will be decided pursuant to the multilateral mechanism and make appropriate transitional arrangements. CETA, *supra* note 2, at art. 8.29 (emphasis added).

146 CETA, *supra* note 2, art. 8.27, 8.29.

untested dispute settlement method. The E.U. and Canada have looked to the WTO dispute mechanisms for guidance in forming their own ICS.[147] The extent to which the E.U. and Canada mirror existing WTO structures may influence the speed of the court's establishment. However, the decision to replicate the WTO system raises questions as to how the existing WTO dispute resolution systemic problems will be redressed.[148] One major flaw is seen in the WTO Appellate Body being defunct and inactive since 2019.[149] Warnings label the new WTO-inspired system as a decision influenced by the "extremes of the political spectrum."[150]

CETA entered into "provisional application" in 2017, but no definite timeline for establishing the court or transitioning to the new system has been prepared.[151] In January 2021, the CETA Joint Committee released four decisions regarding the implementation of ICS which concerned appeals, interpretation, code of conduct, and mediation options.[152] The ICS system in Chapter Eight is unenforceable until every E.U. Member State ratifies the agreement.[153] The first step in access to dispute resolution is the creation of the

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147 *See Dispute Settlement, supra* note 106.

148 Fontanelli, *supra* note 40, at 253-60.

149 Yuka Hayashi, *Countries Seek New Fix for Dormant International Trade Court*, WALL ST. J. (Feb. 24, 2021) https://www.wsj.com/articles/countries-seek-new-fix-for-dormant-international-trade-court-11614189115.

150 Gary B. Born, *Court-Packing and Proposals for An EU Multilateral Investment Court*, KLUWER ARB. BLOG (Oct. 25, 2021), http://arbitrationblog.kluwerarbitration.com/2021/10/25/court-packing-and-proposals-for-an-eu-multilateral-investment-court/.

151 *See supra* Part II.B.2.

152 CETA Joint Committee Decision No. 2/2021, 2021, O.J. (L 59/45), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22021D0265&rid=1.

153 Ratification is halted as the Irish Supreme Court found the enforcement of awards via CETA would be "plainly incompatible with judicial sovereignty" and offend the "key constitutional objective of democratic legitimacy" in violation of the Irish Constitution. Costello v. Att'y Gen. [2022] IESC 44, Opinion of Hogan J., 91-94, ¶¶ 219, 225, 229 (Ir.); *see also CETA Investment Court System Advances Toward Implementation While Irish Activists Launch Campaign Opposing Ratification*, INV. TREATY NEWS (March 23, 2021) https://www.iisd.org/itn/en/2021/03/23/ceta-investment-court-system-advances-toward-implementation-while-irish-activists-launch-campaign-opposing-ratification/.

dispute system. An ICS can potentially increase accessibility simply by designing a standing dispute mechanism in place of the existing ad hoc international investment system.

The second step in accessing a neutral and effective dispute settlement forum is investor-specific coverage as dictated by the scope granted under the treaty. The ICS agreement proposes ICS access to investors with "non-frivolous" treaty-violation claims—granting protection to more investors than USMCA.[154] Covered CETA investments are those: (1) within the related territory, (2) in "accordance with the applicable law at the time" of investment, (3) "directly or indirectly owned or controlled by an investor of the other Party," and (4) existing at the time CETA enters into force, or thereafter.[155] The treaty language indicates any investment made prior to CETA and after the establishment of CETA can access the ICS. Beyond this, there are no further restrictions for a covered investment to be in a specific sector. Allowing broad access to the dispute mechanism encourages a system of fairness by removing limitations on who can challenge government regulations. CETA increases ISDS legitimacy by enhancing the protection offered to investors based on the permanency of the court and the broad scope of covered investments.

B. Tribunal Composition

Tribunal composition is the second legitimacy factor in this analysis, which encompasses the selection, payment, and retention of the arbitrators empowered to resolve investor-state disputes. Independence, impartiality, and neutrality in arbitrator selection are common areas of criticism; wherein the investor or state's ability to

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[154] ITA protection under USMCA is limited to specific types of investment contracts and sectors, while CETA's scope would include investors classified as noncovered under the USMCA. CETA, *supra* note 2, at art. 8.23; TTIP, *supra* note 2, at sub-sec 1 art. 1(1). *But see,* CETA, *supra* note 2, at Annex 8-C.

[155] "Covered investment means, with respect to a Party, an investment:
(a) in its territory;
(b) made in accordance with the applicable law at the time the investment is made;
(c) directly or indirectly owned or controlled by an investor of the other Party; and
(d) existing on the date of entry into force of this Agreement, or made or acquired thereafter. . . ." CETA, *supra* note 2, at art. 8.1.

control an arbitrator can extinguish all sense of legitimacy. Dispute resolution free from state bias has been a critical hallmark strengthening the legitimacy and success of international arbitration.[156]

1. Arbitrator & Member Selection

Arbitration tribunals are traditionally built through party autonomy. The disputing parties appoint an arbitrator based on a candidate's subject matter expertise, arbitration experience, neutrality, independence, and impartiality. Each arbitrator completes an ethics and conflicts of interest disclosure process wherein the opposing party can object to an arbitrator's appointment. After an appointment, the selecting party is responsible for compensating their appointee. Parties are free to find their own arbitrator.[157] They are not restricted to a set list or lottery selection process when creating an investment arbitration tribunal. This is a core feature of party autonomy carefully preserved in most arbitration systems. Party autonomy is rooted in the contracting nature of the initial relationship between the disputing parties. Parties are free to contract away their right to litigation in exchange for arbitration. This contracting power translates to the ability to initiate an arbitration proceeding and form the arbitration tribunal that resolves the dispute. This section observes whether party autonomy is retained in tribunal composition under USMCA and CETA.

The USMCA maintains the status quo within the field of arbitration by upholding party autonomy through arbitrator selection.[158] Parties may allow the Secretary-General to appoint the entire tribunal; however, this is not mandated.[159] In maintaining the status quo, existing legitimacy problems remain, but no further concerns arise. Currently, investment arbitration rules allow parties to

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156 *See supra* Part I, II.

157 Parties pay close attention to experience and expertise when selecting an arbitrator, doing a "prudent job in selecting their arbitrator." Ylli Dautaj, *Dissenting Opinions in Investment Treaty Arbitration: The Investment Court System*, 17 U.C. DUBLIN L. REV. 37, 53 (2017).

158 USMCA, *supra* note 2, at art. 14.D.3, 14.D.6.

159 *Id.* at art. 14.D.6(3).

object to an arbitrator upon the finding of a conflict of interest.[160] Overall, the USMCA ISDS clause operates within the rules of traditional arbitration provisions.

Comparatively, party autonomy to compose the tribunal is eradicated by the ICS proposed by CETA and TTIP. The permanent structure requires the hiring of semi-permanent members or judges.[161] In CETA, the E.U. and Canada control the hiring process of tribunal members, placement of members on a specific case, and the length of service on the tribunal.[162] CETA outlines a Tribunal of First Instance consisting of fifteen Members.[163] There are to be five Members that are nationals of an E.U. Member State, five Canadian nationals, and five Members from any third-party country.[164] Footnote nine of the composition clause allows either treaty party to appoint "up to five Members of the Tribunal of any nationality" instead of appointing individuals from its own country.[165] An arbitral tribunal proceeding will consist of a national from Canada, a national from the E.U., and a third-country national.[166] Members will be selected to a dispute through a "random and unpredictable" rotation to provide an "equal

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160 *Id.* at art. 14.D.6(4), (6).

161 The USMCA arbitration mechanism dictates appointment of an arbitrator to the tribunal. CETA calls the semi-permanent arbitrators "Members of the Tribunal." TTIP labels semi-permanent arbitrators as "Judges."

162 USMCA, *supra* note 2, at art. 8.27, 8.28.

163 *Id.* at art. 8.27(2).

164 "Any third-party country" means five Members are to be non-European and non-Canadian. These five can come from any country. All Members must meet the CETA standards for appointment.

The CETA Joint Committee shall, upon the entry into force of this Agreement, appoint fifteen Members of the Tribunal. Five of the Members of the Tribunal shall be nationals of a Member State of the European Union, five shall be nationals of Canada and five shall be nationals of third countries. *Id.* at art. 8.27(2). The TTIP mirrors this language by outlining the appointment of fifteen Judges with an even number of E.U., U.S., and third-country appointments. *See* TTIP, *supra* note 2, at art. 9(2).

165 For example, Canada could elect to appoint three Canadian Members, a French Member, and an American Member instead of five Canadian Members. After selecting these five Canadian Members, there would remain five positions for third-party appointments. CETA, *supra* note 2, at art. 8.27(2) fn9.

166 CETA, *supra* note 2, at art. 8.27(6).

opportunity" of selection for each Member.[167] The language of the CETA appointment process clause highlights "equal opportunity" and "random and unpredictable" as verbiage designed to increase appearances of procedural impartiality, independence, and neutrality.

Members of the Tribunal are appointed for a "five-year term, renewable once."[168] Seven of the fifteen original appointees will be selected to serve six years through a lottery process.[169] This allows an eleven-year term for most of the original appointees. Any other Member can serve a maximum of ten years.[170] The TTIP proposal mirrors the selection language of CETA, however, the TTIP appoints Judges for six-year terms, renewable once, and allows seven of the original appointees to serve a nine-year term.[171] The increased TTIP term length is a strong indicator that the E.U. prefers longer terms for Members than those outlined by CETA.[172] A five-year term—let alone an eleven-year term—for arbitrators in an ISDS structure is a significant departure from the current ad hoc system of investment arbitration.

The CETA ICS system faces critical legitimacy questions concerning the selection of Members by the treaty signatures, the assignment of Members to disputes, the retention, and the opportunity for Members to run for a second term. The system erases party autonomy, placing state control at the forefront of tribunal composition.

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167 *Id.* at art. 8.27(7). The appointment of Members to an Appellate Tribunal will be random, with further specification on the Appellate Tribunal to be addressed by the CETA Joint Committee. *See id.* at art. 8.28(5), (7). The TTIP Appellate Tribunal Judges shall be selected by the Committee. *See* TTIP, *supra* note 2, at art.9(7), 10(3), (9).

168 CETA, *supra* note 2, at art. 8.27(5).

169 *Id.*

170 *Id.*

171 TTIP, *supra* note 2, at art. 9(5).

172 TTIP is an E.U. dominated proposal lacking U.S. engagement. Comparatively, CETA involved rounds of negotiation between the E.U. and Canada resulting in the selected term-limit.

2. Arbitrator Compensation

The next component of tribunal composition legitimacy is the arbitrator payment structure—a strongly criticized aspect of arbitration.[173] Arbitrators are usually compensated via institutional fees, personal fees, and expense charges funded by the arbitrating parties. The particulars of arbitrator compensation are managed by the selected institution and applicable arbitration guidelines.[174] In fact, investment treaties rarely addressed the matter—until the introduction of ICS founded in FTAs.[175] Who pays an arbitrator shapes perspectives on the legitimacy of the appointment and potential arbitrator bias. One view is that arbitrators serve as contractors providing a service to the parties. This view promotes party autonomy based on a conception of the freedom to contract. A competing view describes arbitrators as actors within a broader international regime rather than players within a single dispute tribunal. This second view promotes an increased role in institution-based payment. Most arbitrators continue to be paid by the party that contracted them to provide dispute settlement services. A conservative 2017 estimate calculated arbitrators earn $427,000 per case.[176] As previously mentioned, the USMCA allows for ad hoc arbitrators to be paid by the hiring party within the institutional rules adopted by the U.S. and Mexico. However, ICS demands the creation of a salary or retainer structure for the semi-permanent Members of the Tribunal.

CETA articulates a monthly retainer payment structure, with an option to shift to a salary system if necessary. Members of the Tribunal are slated to receive a "monthly retainer fee to be determined by the CETA Joint Committee" created to ensure availability to hold dispute hearings.[177] The ICSID Administrative and Financial Regulations are to be used in determining the amount of fees and

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173 *See supra* Part II.A.

174 Gaukrodger, *supra* note 77, at 3.

175 *Id.*

176 *See supra* Part II.A.

177 CETA, *supra* note 2, at art. 8.27(12). The TTIP also suggested potential monthly retainer fees and fees for each day of work. *See* TTIP, *supra* note 2, at art. 10(12).

expenses allocated to the Tribunal.[178] Notably, the CETA Committee has retained the power to shift the monthly retainer fee system to a "regular salary."[179] If the salary system is implemented, compensation will be tiered based on the position of each Member within the ICS.[180] Currently, CETA equally divides costs of administrative, remuneration, travel, lodging, and general expenses of the arbitrators between the disputing parties.[181] All other expenses are funded by the FTA signatories.

This comment will diverge to discuss the TTIP proposal to highlight a difference in the TTIP arbitrator payment structure compared to CETA. The TTIP salary payment clause specifically refers to the fee system used for the WTO Dispute Settlement Body ("DSB").[182] The E.U. suggests the TTIP salary structure directly correspond with the WTO payment system. Further, Judges on the Appellate Tribunal would receive a higher salary than Tribunal of First Instance Judges.[183] The tiered payment structure mirrors the WTO structure wherein members of the Appellate Body receive higher pay, despite the decreased likelihood of a dispute ever reaching this panel.[184]

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178 The CETA Joint Committee may adopt an alternative position. CETA, *supra* note 2, at art. 8.27(14).

179 *Id.* at art. 8.27(15).

180 "The CETA Joint Committee shall promptly adopt a decision" on matters including "remuneration for Members of the Appellate Tribunal." *Id.* at 8.28(7)(d).

181 *Id.* at Annex 29-A.

182 The E.U. suggests that Members of the Tribunal of First Instance have a retainer fee that is "around [one third] of the retainer fee for the WTO Appellate Body members (i.e., around €2,000 per month)." The Appellate Tribunal would receive "the same as for WTO Appellate Body members (i.e., a retainer fee of around €7,000 per month)." TTIP, *supra* note 2, at art. 9(12), 10(12).

183 The Judges on the Appellate Tribunal would make €5,000 more per month—on par with the payment of WTO Appellate Body members. *Id.*

184 The WTO DSB research indicates four categories of cases: (1) those settled before arbitration begins, (2) those settled during arbitration, (3) those that accept the initial arbitration award, and (4) those that file for an appeal on the initial award. The DSB panel (equal to a first instance tribunal) participates in more disputes than the Appellate Body since categories one through three will never reach the Appellate Body. In the WTO, nearly 66 percent of cases receiving a DSB panel report file for an appeal. *WTO Dispute Settlement Process – Dispute Settlement Activity*, WORLD

The WTO DSB appears to have heavily influenced the E.U.'s approach to constructing an ICS. Yet, CETA never articulates this preference—a potential signal of Canada's influence on the ICS negotiations.

The ICS salary approach presented in CETA removes party autonomy in composing the tribunal, replacing it instead with an institution established and managed by the treaty signatories. This institution is directly under the control of the E.U. and Canada—eliminating any imagination of institutional independence. The system orchestrates tribunals built on "random and unpredictable" appointees to create "equal opportunities." However pleasant these words sound, they cannot replace the core values of arbitration, which prioritize independence, impartiality, and neutrality. The ICS fails to alleviate criticisms surrounding the beneficiary nature of arbitrator compensation. The creation of a permanent court with Members of Tribunal receiving retainer and daily fees perpetuates the criticism as it fosters state influence and bias.

The drastically different approaches to hiring, paying, retaining, and appointing of arbitrators, as seen in the USMCA, CETA, and TTIP, emphasize differences in the interpretation and prioritization of legitimacy problems in the existing ISDS structure. USMCA entrusts party autonomy and a traditional understanding of party-approved neutrality, impartiality, and independence by allowing party selection of arbitrators. Meanwhile, CETA and TTIP revoke party autonomy for the consistency and availability of a permanent pool of Members selected, retained, and paid by the MIT signatories.

C. Award Finality

The last legitimacy factor is the finality of tribunal awards. Finality is vital for retaining expedient, cost-effective dispute settlement options. Additionally, finality ensures that tribunal awards are given sufficient legitimacy through immediate enforceability in the relevant national court. Stripping tribunal awards of finality and enforceability reduces them to useless pieces of paper. The New York

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TRADE ORG., https://www.wto.org/english/tratop_e/dispu_e/dispustats_e.htm (last visited Nov. 14, 2022).

Convention strives to maintain finality through enforcement, however domestic courts retain the ultimate power to vacate an award. The USMCA follows traditional review standards as dictated by the New York Convention and FAA. CETA clearly strays from the existing arbitral processes by systemically providing an avenue for appealing a tribunal's award.

The USCMA proposal does not include any appellate or review mechanism beyond those provided by the ICSID Convention.[185] However, it does allow parties an opportunity to submit written comments on the tribunal's proposed decision. The treaty states that disputing parties can request the tribunal transmit the proposed decision or award to the parties prior to the issuing of the final award. Then the parties "may submit written comments to the tribunal concerning any aspect of its proposed decision or award."[186] Following the submission, the tribunal "shall consider" the comments before issuing the award.[187] There is no mechanism compelling the tribunal to fully evaluate or implement party comments. However, the opportunity for parties to comment provides increased dialogue between the disputing parties and the tribunal not provided under NAFTA. This dialogue may increase the investor's perspective of legitimacy by providing for a more engaged tribunal atmosphere and more informed tribunal decisions.

CETA specifically integrates an appellate mechanism into the dispute resolution process by establishing the Appellate Tribunal. CETA and TTIP state the same grounds for appeal, yet the selection

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185 *See* USMCA, *supra* note 2, at art. 14.D.14(9).

186 *Id.* at art. 14.D.7(12) (emphasis added).

> [A]t the request of a disputing party, a tribunal shall, before issuing a decision or award on liability, transmit its proposed decision or award to the disputing parties. Within 60 days after the tribunal transmits its proposed decision or award, the disputing parties *may submit written comments* to the tribunal concerning any aspect of its proposed decision or award. The tribunal *shall* consider any comments and issue its decision or award no later than 45 days after the expiration of the 60 day comment period.

187 *Id.*

method for Members of the Appellate Tribunals differs.[188] The legal ground for appeal extends beyond the traditional review opportunities provided by the New York Convention.[189] CETA permits the Appellate Tribunal to "uphold, modify, or reverse a Tribunal's award" on three grounds.[190] Appellate action may be based on: (1) "errors in the application or interpretation of applicable law," (2) "manifest errors in the appreciation of facts, including the appreciation of relevant domestic law," or (3) on the grounds outlined by the ICSID Convention.[191] This broadens the prospect for tribunal awards to be revoked, removing the high standard of deference traditionally granted to tribunal awards. The potential for an appeal on a tribunal award increases the length, costs, and uncertainty for the arbitrating parties, with the burden of this uncertainty being felt more acutely by investors than states. Further, the appeal rights under CETA extend beyond those granted by WTO DSB which is "limited to issues of law covered in the panel report and legal interpretations developed by the panel."[192] CETA's decision to grant review of "errors in the appreciation of facts" increases the adjudicatory nature of the dispute settlement process and reduces the finality of the First Instance Award.

The CETA Joint Committee recognizes that an appellate mechanism increases the financial burden of disputing parties with particular concern for SMEs. The Committee "shall consider supplemental rules aimed at reducing the financial burden on claimants who are natural persons or [SMEs]."[193] This provision should specifically consider the financial resources of the claimant and the amount sought.[194] SMEs and individual investors face financial difficulties unfelt by large entities and most states.[195] Lengthening the dispute settlement process amplifies the financial burden experienced

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188 *See CETA, supra* note 2, at art. 8.27(7); *see also TTIP*, *supra* note 167.

189 *See supra* Part II.A.

190 CETA, *supra* note 2, at art. 8.28(2).

191 *Id.*; *see also* ICSID Convention, *supra* note 41, at art. 52(1)(a-e).

192 Understanding on Rules and Procedures Governing the Settlement of Disputes, art. 1, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, art. 17.6, 1869 U.N.T.S. 401.

193 CETA, *supra* note 2, at art. 8.39(6).

194 *Id.*

195 *See supra* Part II.A.

by investors with limited resources. This may foster trepidation for a potential party to even file a claim should the ICS mechanism be deemed too costly. Costs can sever a segment of investors from their legal right to arbitration under CETA.

The construction of an E.U.-Canada ICS raises many red flags. In one view, the decision to create a permanent tribunal court, designated for MIT claims is "revolutionary."[196] Yet, others articulate a fear of increased national control, eroded neutrality, and entrenched politicization. A radical shift in dispute mechanisms displaces the known for the unknown in search of systemic legitimacy that may displace investors' trust in the regime.[197] Meanwhile, USMCA remains comfortably lodged in the existing review structures—structures with high rates of enforcement and clear award finality.

D. The New Rules of ITA: Are they legitimate?

If investors were to give the ISDS clauses of USMCA and CETA a "legitimacy grade," how would the systems fair? The three factors of legitimacy used in this analysis are: (1) access to a neutral and effective dispute resolution forum, (2) tribunal composition, and (3) award finality. USMCA would receive a higher legitimacy score than CETA—mostly due to USMCA's reliance on traditional arbitration mechanisms that promote party autonomy and award finality. CETA appears to prioritize state and political objectives over the promotion of party autonomy and award finality. While the USMCA maintains the status quo, CETA prompts uncertainty and diminished legitimacy by forcing arbitration through a non-neutral ICS.

The first factor of legitimacy is access to a neutral and effective dispute resolution forum—a factor critical for foreign investors who face heightened vulnerability to treaty violations by a host state. This

196 *See supra* Part III.

197 The ICS structure instills institutionalization, an approach rampant within the E.U. The model replaces traditional arbitration with one built on "global governance." However, these conceptions of governance and institutionalization are geared towards the state actors and remove core tenants of investment arbitration—thus eroding elements that have long bolstered investor trust in the system. Dautaj, *supra* note 1, at 305-07.

factor is where the USMCA ISDS clause raises legitimacy concerns. There is decreased legitimacy in the access to arbitration in two areas: Canadian investment protection and investments in the noncovered class. Canada's decision to remove itself from the USMCA ISDS clause creates an area of international investment arbitration to monitor. Canadian investor and investment trends can be compared to those under USMCA and CETA. The depletion of designated protection for Canadian investments expands the legitimacy crisis felt by investors; yet it presents a "control" population of investors for future ISDS comparisons. To understand the fault lines developing in investor-state arbitration, future analysis should contrast the perceptions of systemic legitimacy developing across the Canadian, USMCA, and CETA investors.

The second problematic component of USMCA accessibility exists due to the treaty narrowing the field of covered investors and investments. This decision to sever a broad spectrum of investors from FTA protection will strain investment relations. Removing protection can signal a diminished sense of accountability to foreign investors. Placing treaty-based protection beyond the grasp of investors hinders the ability to access dispute settlement outside of domestic structures. The full backlash from this harsh approach to reducing state liability is likely to become prominent after the expiration of the NAFTA legacy clause.[198] In 2023, the U.S. could face a shift in relations with foreign investors which could increase contract-based arbitration or diminish foreign investment.

Comparatively, CETA proposes a standing dispute settlement mechanism that may promote accessibility by reducing arbitral ambiguity occurring under ad hoc arbitration. Additionally, CETA offers a broad scope of investment protection. This scope may exist to promote a larger number of claim submissions at the foundation of the ICS. The E.U. and Canada want investors to use the court. Allowing more players into the ICS dispute settlement game may foster perceptions of systemic legitimacy. The CETA Joint Committee should strive to balance the claim-load for the ICS system. Too many claims could create a backlog as seen in many domestic courts. A

198 The legacy clause expires in 2023. *See supra* at Part III.A.

backlog may instead highlight why traditional arbitration, which is prized for its flexibility and efficiency, is often preferable to a semi-permanent court system that judicializes the process. The E.U. and Canada maintain the power to redefine the scope of covered claims, but they also hold the power to restructure the ICS to fit the needs of investors.

The next factor of legitimacy is party autonomy which is maintained by USMCA and dismantled by CETA. USMCA promotes ITA under the pre-existing arbitration mechanisms. Thus, parties can appoint an arbitrator, compensate their appointed arbitrator, and object to the opposing counsel's appointee.[199] While external critics decry the system of arbitrator appointment, their viewpoints are simply "unsubstantiated."[200] By upholding the existing tribunal composition rules, the USMCA maintains the status quo without introducing new legitimacy concerns.

Yet, CETA specifically eliminates the "hallmark" attribute of party autonomy—replacing it instead with government control in the selection, appointment, and payment of tribunal members.[201] Suddenly, the party right of appointing an arbitrator—one with experience related to the dispute at hand—has been usurped by Canada and the E.U. The E.U. and Canada possess the autonomy to select Members, cherry-picking which ideologies and experiences are important for their ICS. Party autonomy provides increased assurance of arbitrator expertise, a balance in ideological viewpoints, and cross-party oversight. The E.U. and Canada can select individuals that investors view as state-biased or inexperienced with a dearth of oversight that prompts—or should prompt—intense criticism. Currently, there is no mechanism for even the E.U. or Canada to object to the other's appointment. Arbitration is founded in neutrality, the removal of state influence. Yet, the E.U. and Canada are erasing this critical feature to produce an ICS creature directly aligned with their

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[199] An arbitrating party's objection to the appointment of an arbitrator is a tool for ensuring an effective arbitral system. Parties will advocate for themselves to ensure the arbitrator does not threaten their chances of success. An objection creates grounds for a post-award appeal, balancing the broad power of arbitrators.

[200] Dautaj, *supra* note 1, at 309-12.

[201] Lavranos, *supra* note 108, at 6.

dispute settlement priorities. CETA presents a façade of neutrality by designating third-country representatives and appointing arbitrators at random. This does not negate the ability of the E.U. and Canada to cherry-pick the ideologies of the ICS Members with no guarantee of neutrality, independence, or impartiality.

Further, the ICS will manage dispute matters that could involve any of the twenty-seven E.U. Member States or Canada—raising questions of fair representation of the state governments under the CETA structure. The E.U. Member States possess vastly different views on arbitration, foreign investment, and the legitimacy of an ICS. The E.U.'s appointments will be unable to represent the breadth of arbitration ideologies, economic needs, and constitutional requirements of Member States. Most notably, the Irish Supreme Court held the current CETA arbitration structure is unconstitutional as it violates domestic sovereignty and lacks democratic oversight.[202] Democratic deficits exists as Tribunal Members "who are not appointed by or answerable to any of the institutions of [Ireland]" create binding and enforceable awards—leaving States "virtually powerless to refuse the enforcement [of the] award."[203] In contrast, the Irish Supreme Court has "no constitutional issue with regular international [] arbitration."[204] Further, the E.U. appointees will dominate the ICS system for a minimum of five years and potentially ten years. The first appointees will lay the foundation of the ICS and particular investment ideologies may become deeply rooted without the full support of individual E.U. Member States. Member States have varying ISDS preferences since they experience vastly different investment types, operate in distinct economic structures, and engage based on their national history and politics. The E.U. must promote the fair representation of Member State ideologies that supports distinct sectors of investment based on their investor demographics. Legitimacy from the perspective of Member States is critical. A state rejecting the ICS can strongly influence investor perceptions of the system. Ultimately, government appointed tribunals heighten

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202 "[R]atification by the Government of CETA would be unconstitutional [and would] violate the democracy guarantee . . . ." Costello v. Att'y Gen. [2022] IESC 44 Opinion of Hogan J., 93, ¶ 227 (Ir.).

203 *Id.* at Part XII, ¶ 225; Part XIII, ¶ 230.

204 *Id.*

legitimacy concerns by instilling politicization and Member State competition with little oversight for representation in a manner adamantly avoided by traditional arbitration.

Another issue arises with the random assignment of Members to a dispute. Random selection removes specialization, a matter particularly important to the investors who prioritize informed decision-making. Members' expertise is rendered void by the appointment process for increasing appearances of neutrality. Moreover, the quality of emerging awards diminishes when arbitrators are randomly assigned generalists rather than carefully selected experts. The ICS empowers Members to establish an arbitral system focused on consistency, but this goal should not come at the cost of the core virtues of arbitration. If the court operates with a goal of establishing precedents for increased settlement consistency, there arises a clear need for outlining the level of deference to be granted to prior decisions. Further, if investors see the Tribunal Members as illegitimate, perpetuating their decisions potentially propagates systemic illegitimacy. Express deference to prior decisions should be secondary, preceded by the ICS gaining broad legitimacy from the investor perspective.

Moreover, the salary or retainer mechanism must be carefully constructed to attract experienced arbitrators and avoid the perception that the E.U. and Canada are the financial sponsors of the ICS Members. If Members make less money as semi-permanent arbitrators, the system may fail to attract arbitrators with a high level of expertise. Since the investment court mechanism is fundamentally different from prior ISDS mechanisms, the caseload and willingness of investors to participate in the ICS is uncertain. The quality of arbitrators is important for promoting legitimate tribunals; thus, salaries must be sufficient to attract such arbitrators no matter the ICS caseload. Hence, a second problem arises—the question of impartiality. Members of the Tribunal will appear to be in the pocket of the E.U. and Canada—the entities structuring and managing their salaries. Investors will bring their claims against the state to arbitrators seemingly employed by the state. Can foreign investors trust arbitrators compensated by the opposing party? Even if parties contribute to the arbitrator's expenses, the arbitrators remain on retainer for the CETA

signatories. Arbitrators benefit from the appointment and automatic assurance of future work. Further, the prospect of reappointment may influence the decision-making of arbitrators who desire such an opportunity. The relationship and level of engagement between Members and founders of the ICS abolishes any notion of neutrality, independence, or impartiality.

To paint a picture of the ICS system proposed by CETA, imagine the following: you are an Irish investor bringing a claim against Canada. You have witnessed the Irish political debate on the ratification of CETA evolve into a Supreme Court decision rejecting the constitutionality of the CETA arbitration mechanism. You are bound to question legitimacy and legality of the system from the outset. Bound by the treaty, you proceed, filing the claim in a system created by Canada, under an ISDS clause defined by Canada, with Members selected and paid by Canada. But fear not, the arbitrators are randomly appointed, and the E.U. helped with appointments! Party autonomy, influence, and buy-in are eradicated in an environment dominated by the treaty signatories. This ISDS approach creates a system of insecurity for foreign investors by prioritizing state control over neutrality, independence, and impartiality.

The third factor of legitimacy is award finality which is partially maintained under USMCA and severally impaired under CETA. The USMCA arbitration mechanism follows traditional arbitration finality with enforcement under the New York Convention and FAA. A threat to finality under the USMCA arises due to domestic litigation requirements. Certain investors are mandated to initiate domestic judicial proceedings before filing an arbitration claim. The investor can file an arbitration claim only after a set period or at the conclusion of domestic proceedings. The first option increases the length and cost of arbitration, contrary to key arbitral features. The second option is potentially disruptive to finality. The opportunity to bring a dispute to a tribunal after obtaining a judicial decision creates a convoluted arbitration environment.[205] There is no existing legal standard for

[205] The *Phillips Morris* case highlights the clash between domestic courts and the international arbitration award. *See supra* Part II.

reviewing domestic court decisions in international arbitration. Tribunal awards deviating from a court decision may create grounds for vacating an arbitral award, thus diminishing the finality and legitimacy of the tribunal. The USMCA ISDS system enhances state sovereignty and domestic rule of law while diminishing investor rights—particularly for SMEs with limited resources for extensive litigation and arbitration.

CETA also enhances state control over award finality through the creation of the Appellate Tribunal. Currently, investment arbitration awards are enforced in the relevant Member State, placing award review opportunities beyond the control of the E.U. The E.U.'s exclusive jurisdiction to define E.U. investment law is undermined by the international investment arbitration system.[206] The Appellate Tribunal creates an opportunity to rectify this dilution of power by directly promoting reviews of tribunal awards. This allows the E.U. to regain control over the interpretation of E.U. directives as E.U.-appointed Tribunal members interpret them. Establishing a standing Appellate Tribunal runs counter to tradition. Further, there is no guarantee the process will foster increased consistency, cohesion, or accuracy in tribunal decision-making. The ICS will exist in contrast to the "globally accepted" investment arbitration system with awards that are "automatically recognized and enforced."[207] Finality is an "intrinsic" virtue of arbitration.[208] Removing finality by providing an appellate tribunal increases the cost, length, and uncertainty of arbitration. Core virtues of arbitration are eliminated while investor trepidation is heightened due to the growing financial burdens of dispute settlement.

IV. CONCLUSION

The perception of what constitutes a core tenant of legitimacy in investor-state arbitration is molded by a rich arbitral history, but broad public backlash has raised legitimacy questions and revolutionary FTA reforms. The USMCA, CETA, and TTIP have

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206 *See supra* Part II.B.

207 Fontanelli, *supra* note 40, at 240.

208 Hobér, *supra* note 1, at 64.

exposed fault lines in the arbitration landscape via their ISDS clauses, but also via heightened politicization and publicity. The irresolvable differences in how key economic players envision the future of ITA impacts perceptions of ISDS legitimacy. Most critical in "grading" the development of ITA legitimacy are the investors. Investors raising claims against a government prioritize the core arbitral virtues of easy access to a dispute resolution mechanism that is neutral, impartial, independent, and final. Practical considerations of the cost and length of new ISDS mechanisms change the way investors can participate in the game of arbitration.

The USMCA maintains the legitimacy status quo of existing arbitration. However, decreased legitimacy exists due to the overall narrowed scope of ISDS protection and Canadian investments entirely lacking protection. Comparatively, CETA's ICS is an untested approach to investor-state dispute resolution—an approach that entrenches state control, decimates venue neutrality, eradicates investor autonomy, and diminishes arbitrator expertise. Even during ratification, CETA is fighting for legitimacy—the battle to approve the ICS is far from over. ISDS is shifting towards the ideals of states and away from the protection traditionally sought by foreign investors. Eroding the protection of investors can cripple future transborder investments and damage ISDS legitimacy. The CETA, USMCA, and the Canadian investments beyond the scope of USMCA foster a dispute settlement environment ripe for comparative research evaluating the investment, contracting, and ISDS trends.

The transatlantic fault lines emerging from diverging state ISDS preferences halted global trade. Canada withdrew from the USMCA. The U.S. terminated TTIP negotiations. The Irish Supreme Court declared CETA's investor-state arbitration mechanism unconstitutional. Globally, state preferences are fracturing. The mutually beneficial environment of arbitration is eroding. Failed trade negotiations, political deadlocks, and constitutional rulings articulate distrust in arbitration developments. Without state and investor consent, the new rules of arbitration are illegitimate—threatening the future of investor-state arbitration without a *consensus ad idem*.