Kluwer Arbitration Blog

Mexico and EU propose a Permanent Arbitration Court and an Appellate Mechanism: Modernization or Destruction of ISDS?

Daniel Avila II, Nicolas Borda (Reed Smith) · Thursday, August 20th, 2020

Mexico and the EU recently released a draft text of the upcoming EU-Mexico Free Trade Agreement (the "**Agreement in Principle**"), including its proposed investor-State dispute chapter. As explained in the draft agreement, "*The texts are published for information purposes only and may undergo further modifications including as a result of the process of legal revision. The texts are still under negotiations and not finalized.*"

The Agreement in Principle continues a trend of the EU and some States modifying (and in some cases removing) protections that were traditionally afforded to foreign investors under international investment agreements. For example, the United States Mexico Canada Agreement (the "**USMCA**"), which replaced the North American Free Trade Agreement ("**NAFTA**") on July 1, 2020, removed investor-State arbitration for Canadian investors and against the Canadian State, and limited other aspects of protection that NAFTA once provided.

Among the many innovations reflected in the Agreement in Principle, this article focuses on two: (1) the elimination of party-appointed arbitrators in favor of a pre-selected pool of arbitrators, appointed by States; and (2) the inclusion of a permanent appellate arbitration court also appointed by the States. These changes are consistent with the EU's announced approach to ISDS in 2018.

Appointment of Arbitrators

> *"The Members of the Tribunal System will be appointed in advance by the EU and by Mexico and will be subject to strict requirements of independence and integrity."*

The EU-Mexico Agreement in Principle proposes a **pre-selected** arbitrator pool. The following describes the manner in which the pre-selected arbitrator pool is organized:

- The "Joint Council shall, upon the entry into force of [the] Agreement, appoint nine Members to the Tribunal [Board]. Three of the Members shall be nationals of a Member State of the European Union, three shall be nationals of Mexico and three shall be nationals of third countries." Art. 11(2).
- The Members of the Tribunal Board are appointed for five-year terms. Art. 11(5).

- Each tribunal for each individual case will consist of three Members, of whom one shall be a national of a Member State of the European Union, one a national of Mexico, and one a national of a third country. Art. 11(6).
- The individual tribunals will be chaired by the Member who is a national of a third country. Art. 11(6). The Parties may also agree that a case be heard by "a sole Member who is a national of a third country…" Art. 11(7).
- "Within 90 days of the submission of a claim pursuant to Article 7 (Submission of a Claim to the Tribunal), **the President of the Tribunal**…shall appoint the Members or Member composing the division of the Tribunal hearing the case on a rotation basis, ensuring the composition of the divisions is random and unpredictable, while giving equal opportunity to all Members to be selected." Art. 11(8) (emphasis added).

This is a **stark** change from typical investor-State dispute resolution clauses, which allow for the claimant and respondent to appoint their own arbitrator. It would thus test the debate between those in favor of maintaining the practice of party-appointed arbitrators and those proposing a centralized appointment mechanism.

Several debates have transpired recently regarding party-appointed arbitrators. Commentators in favor of the traditional method of constituting a tribunal have opined that selecting an arbitrator is a "basic and important" right of parties in international arbitration. Investor-State disputes may arise in several different sectors and industries of an economy. The ability to "vet" an arbitrator for the relevant experience in a given industry is thus highly valued by parties and counsel alike. Moreover, commentators also argue that parties generally sign arbitration agreements to submit intricate and complex business disputes to the hands of experts of such industries. Consequently, it may be argued that electing the pool of arbitrators beforehand could compromise this valued aspect of investor-State arbitration.

Commentators in favor of the Agreement in Principle's method of freely choosing an arbitrator have criticized party appointed arbitrators in international arbitration as having an unconscious bias towards the party who selected them. The same have pointed to the fact that dissenting arbitrators are nearly always those who have been appointed by the party aggrieved by the majority decision and that parties are motivated by winning the case rather than issues of experience.

The drafters of the EU-Mexico treaty have attempted to address these concerns by requiring that the arbitrators "have [a] demonstrated expertise in public international law and possess the qualifications required for appointment as a judge to the International Court of Justice…" Art. 11(4). Further, the proposed text attempts to address consistency in interpretation by subjecting arbitrators to 5-7 year terms. Art. 11(5). Whether these proposals will be effective is remained to be seen.

Appellate Arbitration

> *"Decisions of the Tribunal of First Instance can be appealed to a permanent Appeal Tribunal which will ensure legal correctness and certainty about the interpretation of the agreement."*

According to the Agreement in Principle, the "EU-Mexico agreement fully implements the new EU approach to investment protection and investment dispute resolution by fundamentally reforming the old-style ISDS system. It establishes a standing international investment court system composed of a Tribunal of First Instance and on an Appeal Tribunal."

The proposal of an appellate mechanism is not novel. The UNCITRAL Working Group III was established in the fall of 2017 to "provide a useful model for possible reforms in the field of investor-State arbitration, in conjunction with interested organizations." In its Thirty-eighth session, the UNCITRAL Working Group IIII provided a possible reform adding appellate and multilateral court mechanisms.

Commentators analyzing the strengths and weaknesses of the proposed appeal reform by UNCITRAL in international arbitration have argued that an appellate mechanism replaces "crucial parts of the system such as annulment mechanisms, enforcement and finality of awards." On the other hand, commentators note, "Consistency in the application of substantive norms in BITs would contribute to the confidence in ISDS" and will serve as a check against legal error. Further, commentators have raised concerns of costs and time increasing by allowing appeals to go forward in international arbitration.

The EU-Mexico Agreement in Principle attempts to address efficiency concerns by (i) providing a fork-in-the-road clause, waiving an investor's opportunity to litigate the same dispute in domestic courts; (ii) allowing for an expedited review on appeal where it is clear that an appeal is "manifestly unfounded"; (iii) requiring appeals to be decided within 180 days (with exceptions) but in no case no more than 270 days; as well as (iv) allowing for requests for the corresponding party to post a security bond pending the appeal.

Finally, the proposal of an appellate mechanism also raises practical questions. For instance, ICSID, a proposed institutional option in the EU-Mexico Agreement in Principle, provides for an annulment mechanism in Article 52 of the Convention and states in Article 53 that the award "shall not be subject to any appeal or to any other remedy except those provided for in this Convention" (which only includes annulment). Similarly, the New York Convention only provides limited grounds for the annulment of an arbitral award—none of which includes an error in the law which is a ground for an appeal under the EU-Mexico Agreement in Principle.

It thus remains to be seen how the proposed appellate mechanism would be compatible with ICSID Convention arbitration and the New York Convention.

Conclusion

The EU-Mexico FTA Agreement in Principle continues a trend of recent EU treaties modifying the mechanisms for protecting foreign investment. Disputes arising out of the new EU treaties, including with Mexico—EU's number one trade partner in Latin America—will likely serve as a testing ground for these new dispute resolution procedures on selecting arbitrators. The attractiveness of future foreign investment covered under these new treaties will likely depend on whether an appeal mechanism and pre-selected arbitrators is truly feasible in investment arbitration or whether it is a destruction of the basic principles of neutrality, finality, and the freedom to select one's arbitrator.

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

This entry was posted on Thursday, August 20th, 2020 at 8:00 am and is filed under EU-Mexico, International arbitration, Pre-Selected Tribunal Pool, Transnational Investment Law
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.