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Giovanna Adinolfi · Freya Baetens
José Caiado · Angela Lupone
Anna G. Micara *Editors*

International Economic Law

Contemporary Issues

Springer

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Editors

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Foreword

'The greatest thing about big ideas is being able to share them'. The Society of International Economic Law (SIEL) believes in fostering and sharing ideas among scholars and academically minded professionals belonging to different generations and countries, representing various disciplines within the sphere of international economic law (IEL). This is why the Postgraduate and Early Professionals/Academics Network of SIEL (PEPA/SIEL) is such an important and successful project for us and for many young scholars around the world.

PEPA/SIEL offers young academics and professionals a collaborative platform where they can find ideas to grow with and ideas that they can grow further. Among its other activities, PEPA/SIEL organizes conferences at which emerging IEL academics and professionals present and discuss their work in a welcoming and, at the same time, intellectually challenging environment. I have had the chance to witness PEPA/SIEL conference through the years, and many participants address an audience for the first time. This participation can be a defining and decisive moment for many young scholars. The supportive and welcoming environment of the PEPA/SIEL conferences encourages this younger generation of academics and professionals to share and develop further their views. For the early postgraduate participants, PEPA/SIEL conferences give them a chance to refine an idea that can take the form of a paper or a project for postgraduate studies. For other participants, in more advanced stages of research or the early stages of their profession, the discussions at PEPA/SIEL conferences provide sound reasons to revisit their findings and to 'polish' their works before submitting them for publication.

In April 2015, the 4th PEPA/SIEL conference was organized in collaboration with the Department of International, Legal, Historical and Political Studies of the University of Milan. I would like to thank José Caiado and Freya Baetens from SIEL and Giovanna Adinolfi, Anna G. Micara and Angela Lupone from Milan University for their impressive dedication in organizing the conference. I would also extend my gratitude to senior colleagues who reviewed proposals or acted as discussants and without whom the conference would not be a reality. The unique mix of young scholars and experienced IEL experts has been the hallmark of PEPA/SIEL

conferences, and we would want to continue benefiting from the enthusiasm of young participants and the wisdom of senior colleagues in the next editions of this event. SIEL is proud of the mentoring opportunities that it offers to emerging academics and professionals and of successfully kindling their intellect through mediums such as PEPA/SIEL conferences. I am very proud, as the president of SIEL, to interact with these young academics and professionals who are continuously increasing the vibrancy of the field through their nuanced ideas.

The presenters of the conference deserve a special acknowledgement. As a reviewer of proposals for the conference, I know that a remarkably high number of proposals made the selection process extremely challenging. The 4th PEPA/SIEL conference witnessed presentations from the authors of exceptional proposals, and this volume contains papers based on some of those proposals. The papers in these conference proceedings comprise only a small subset of the ideas that were expressed and discussed during the conference. This volume contains 15 papers; young academics and professionals who are studying or working in the field of IEL across four different continents have authored them. Thus, these conference proceedings also represent the globally diverse opinions that exist on the subject. As the title of the conference suggests, the papers in this volume introduce the reader to some of the most challenging IEL topics, including in the areas of trade, investment, finance and monetary law.

In the area of WTO law, the young contributors have added a new dimension to thought-provoking issues such as private standards, implementation of mutually agreed solutions in WTO disputes, energy regulations and WTO subsidy rules. There is also innovative work in the area of international investment law. Other contributions relate to interesting topics that include investor-state dispute settlement system, sovereign wealth funds and mega-regional trade and investment agreements like the Trans-Pacific Partnership Agreement, EU-Canada Comprehensive Economic and Trade Agreement and MERCOSUR.

The 4th PEPA/SIEL conference was a success, and I am sure this volume will inspire stimulating conversations among young scholars, students and practitioners. I hope that the reader will find this volume an excellent starting point for considering new problems and challenges in IEL. I am confident that SIEL will continue to fulfil its objectives of '[b]uilding links and networks between and among international economic law academics and academically-minded practitioners and officials' and '[e]ncouraging research, practice, service and teaching in the field of International Economic Law', by collaborating with various academic institutions and organizations, with a particular focus on young scholars and those from the developing countries.

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Preface

This volume consists of a selection of the papers presented at the 4th Conference of the Postgraduate and Early Professionals and Academics (PEPA) network of the Society of International Economic Law (SIEL). After the publication of the call for papers in September 2014, the Conference Committee received more than one hundred abstracts. Through a double-blind review process, more than forty emerging scholars were offered the chance to present their papers at the Conference, held on 16 and 17 April 2015 at the University of Milan. Senior economic lawyers from the academic world, the business sector and intergovernmental organizations commented on the paper presentations allowing for stimulating discussion during the Conference and offering authors thought-provoking input on their work. A further assessment of the proposals, based on the feedback of the discussants, led to the final selection of papers published in this book. The contributors are junior practitioners and academics, in line with the spirit of the PEPA network to foster 'collaboration and mentoring opportunities for emerging academics and professionals in international economic law'.

The purpose of this volume is to scrutinize the main challenges faced by states in their current international economic relations, from an interdisciplinary perspective, combining legal research with political and economic analysis. The book offers readers a series of in-depth studies on a rich variety of topics, allowing for dialogue among scientific disciplines. Its readership is aimed to encompass both academics and practitioners, those that are junior as well as those more experienced. Our hope is that all readers will find in its chapters fresh insights into international economic law issues.

The volume is divided into four parts. Part I focuses on a hotly debated topic in scientific and political circles: how to reconcile states' interest to benefit from economic liberalization with their need to pursue social goals (such as the protection of human rights or the environment) by means of measures which may be viewed as contrary to their obligations under international economic treaties. International trade law issues are specifically covered in the contributions included in Part II, where the authors analyse some of the more recent developments under WTO law and regional

integration processes. International cooperation in the energy sector is dealt with in Part III, from the perspective of bilateral (EU-Russia) relations, the Energy Charter Treaty and WTO law. Finally, Part IV is devoted to investment and finance topics, zooming in on national regulatory developments in the banking sector, sovereign wealth funds and investor-state arbitration.

The editors would like to express their gratitude to all senior scholars who have reviewed abstracts and/or participated as discussants at the Conference. Their comments encouraged the revision and the finalization of the contributions published in this volume. Thanks to the support of SIEL and the University of Milan, the 2015 PEPA Conference could be hosted in Italy. The Department of International, Legal, Historical and Political Studies of the University of Milan, inspired by its long-standing aim to facilitate the growth of young academics and professionals, financed the publication of this volume. Lastly, the editors would like to thank all participants for their enthusiastic attendance of the Conference and all contributors for their hard work, which culminated this book. *Ut vivat, crescat, floreat!*

Milan, Italy — Giovanna Adinolfi
Leiden, The Netherlands — Freya Baetens
Hamburg, Germany — José Caiado
Milan, Italy — Angela Lupone
Milan, Italy — Anna G. Micara
June 2016

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Abbreviations

Agric. Human Values	Agriculture and Human Values
AI	Arbitration International
AJP	Aktuelle Juristische Praxis
Am. J. Comp. L.	American Journal of Comparative Law
Am. J. Int'l L.	American Journal of International Law
Am. J.L. & Med.	American Journal of Law and Medicine
Am. U. Int'l L. Rev.	American University International Law Review
ASIL Proceedings	ASIL Proceedings
Berkeley J. Int'l L.	Berkeley Journal of International Law
Brook. J. Int'l L.	Brooklyn Journal of International Law
BYIL	British Yearbook of International Law
CMLJ	Capital Markets Law Journal
Colum. J. Transnat'l L.	Columbia Journal of Transnational Law
Colum. L. Rev.	Columbia Law Review
Cornell L. Rev.	Cornell Law Review
Dev. Policy Rev.	Development Policy Review
DUDI	Diritti umani e diritto internazionale
ECL	European Company Law
EJIL	European Journal of International Law
ESIL Reflections	ESIL Reflections
Eur. Foreign Aff. Rev.	European Foreign Affairs Review
EYIEL	European Yearbook of International Economic Law
Fed. Comm. L. J.	Federal Communications Law Journal
Fed. Reg.	Federal Register
Fordham Int'l L. J.	Fordham International Law Journal
Fordham J. Corp. & Fin.	Fordham Journal of Corporate and Financial Law
Fordham L. Rev.	Fordham Law Review
FSR	Financial Stability Review
Geo. J. Int'l L.	Georgetown Journal of International Law

Harv. Int'l L. J.	Harvard International Law Journal
Harv. L. Rev.	Harvard Law Review
Hous. J. Int'l L.	Houston Journal of International Law
ICLQ	International & Comparative Law Quarterly
ICSID Review – FILJ	ICSID Review – Foreign Investment Law Journal
IELR	International Energy Law Review
IJIEL	Indian Journal of International Economic Law
Int'l L. Pol.	International Law and Politics
Int. Latinoam.	Integración Latinoamericana
Int'l Org.	International Organization
Int. Lawyer	The International Lawyer
IPG	Internationale Politik und Gesellschaft
It. YIL	Italian Yearbook of International Law
J. Int'l Agr. Tr. & Dev.	Journal of International Agricultural Trade and Development
J. Legal Stud.	Journal of Legal Studies
JBE	Journal of Business Ethics
JCES	Journal of Contemporary European Studies
JECLAP	Journal of European Competition Law & Practice
JERL	Journal of Energy & Natural Resources Law
JFR	Journal of Financial Regulation
JIA	Journal of International Arbitration
JIDS	Journal of International Dispute Settlement
JIEL	Journal of International Economic Law
JWELB	Journal of World Energy Law & Business
JWIT	Journal of World Investment & Trade
JWT	Journal of World Trade
Kyklos	Kyklos International Review for Social Sciences
L. & Practice Int'l Courts & Tribunals	The Law and Practice of International Courts and Tribunals
Law Contemp. Probl.	Law and Contemporary Problems
LBRA	Law and Business Review of the Americas
LIEI	Legal Issues of Economic Integration
McGill L. J.	McGill Law Journal
Mich. J. Intl' L.	Michigan Journal of International Law
Mich. St. Int'l L. Rev.	Michigan State International Law Review
N.C. L. Rev.	North Carolina Law Review
New Pol. Econ.	New Political Economy
New York Univ. J. Int'l L. & Pol.	New York University Journal of International Law and Politics
Non-State Actors and Int'l L.	Non-State Actors and International Law
N.Y.U. Envtl. L.J.	New York University Environmental Law Journal
OGEL	Oil, Gas & Energy Law Journal
Ohio St. L.J.	Ohio State Law Journal

Pol. YIL	Polish Yearbook of International Law
Renew. Sust. Energ. Rev.	Renewable and Sustainable Energy Reviews
Rev. Arb.	Revue de l'arbitrage
Rev. Bras. Pol. Int.	Revista Brasileira de Política Internacional
Rev. Gen. Dr. Int'l Public	Revue Générale de Droit International Public
RIPE	Review of International Political Economy
RIS	Review of International Studies
S. Cal. L. Rev.	Southern California Law Review
SAYIL	South African Yearbook of International Law
Seattle L. Rev.	Seattle Law Review
South Af. J. Int'l L.	South African Journal of International Law
Stan. J. Int'l L.	Stanford Journal of International Law
Stan. L. Rev.	Stanford Law Review
SZW	Schweizerischen Zeitschrift für Wirtschafts- und Finanzmarktrecht
TDM	Transnational Dispute Management
Theor. Inq. L.	Theoretical Inquiries in Law
TL & D.	Trade, Law and Development
TLCP	Transnational Law & Contemporary Problems
U. Rich. Law Rev.	University of Richmond Law Review
UCD Law Rev.	University College Dublin Law Review
VA J. Int. Law	Virginia Journal of International Law
WTR	World Trade Review
Yale J. Int. Affairs	Yale Journal of International Affairs
Yale J. Int'l L.	Yale Journal of International Law
ZBl	Schweizerisches Zentralblatt für Staats- und Verwaltungsrecht

Acronyms

AfDB	African Development Bank
ALPDP	Areas of Law Pest or Disease Prevalence
APEC	Asia-Pacific Economic Cooperation
AsDB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral investment treaty
CFR	Code of Federal Regulations
CIL	Customary international law
DSB	Dispute Settlement Body
DSS	Dispute settlement system
DSU	Dispute Settlement Understanding
CETA	Comprehensive Economic and Trade Agreement
EBRD	European Bank for Reconstruction and Development
ECHR	European Convention on Human Rights
ECJ	Court of Justice of the European Union
ECLAC	Economic Commission for Latin America and the Caribbean
ECT	Energy Charter Treaty
EU	European Union
FDI	Foreign direct investment
FET	Fair and equitable treatment
FIT	Feed-in tariff
FTAs	Free trade agreements
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GSP	General System of Preferences
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
ICSID	International Centre for Settlement of Investment Disputes
ICJ	International Court of Justice
IFIs	International financial institutions

IIA	International investment agreement
IMF	International Monetary Fund
IMS	International minimum standard
ISSBs	International standard-setting bodies
LAIA	Latin American Integration Association
LDCs	Least Developed Countries
MAS	Mutually agreed solution
MDGs	Millennium Development Goals
MFN	Most-favoured nation
MoU	Memorandum of understanding
NAFTA	North American Free Trade Agreement
NGOs	Non-governmental organizations
NGPF-G	Norwegian Government Pension Fund Global
NRAs	National Regulatory Authorities
NT	National treatment
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PA	Partnership agreement
PCA	Partnership and cooperation agreement
PDFA	Pest- or disease-free areas
PEEREA	Protocol on Energy Efficiency and Related Environmental Aspects
PTAs	Preferential trade agreements
RDBs	Regional development banks
RCEP	Regional Comprehensive Economic Partnership
SACU	Southern African Customs Union
SCC	Stockholm Chamber of Commerce
SCM	Subsidies and Countervailing Measures
SDGs	Sustainable development goals
SFOE	Swiss Federal Office of Energy
SPS	Sanitary and phytosanitary measures
SRI	Socially responsible investments
SWFs	Sovereign wealth funds
TBT	Technical barriers to trade
TEP	Third Energy Package
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TiSA	Trade in Services Agreement
TP	Transit Protocol
TPP	Trans-Pacific Partnership
TRIMs	Trade-Related Investment Measures
TRIPs	Trade-Related Aspects of Intellectual Property Rights
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union
TSO	Transmission system operator

TTIP	Transatlantic Trade and Investment Partnership
UDHR	Universal Declaration of Human Rights
UN-PRI	United Nations Principles for Responsible Investment
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
VCLT	Vienna Convention on the Law of Treaties
WBG	World Bank Group
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Part I
International Economic Law and Other Concerns

The First Twenty Cases Under GATT Article XX: Tuna or Shrimp Dear?

Niall Moran

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Abstract When the general exceptions to the GATT have been invoked before the Appellate Body, they have only been deemed a legitimate defence in two cases since the inception of the WTO and its Dispute Settlement Body in 1995. This article analyses why so many defences taken under the general exceptions to the GATT have failed and whether this low success rate is indicative of a priority being given to market access over public policy objectives at the WTO. In August 2014, the Appellate Body issued its twentieth report in a case appealed under the general exceptions. These first twenty reports are analysed to see which stage of the two-tier test measures have failed and why they have failed.

To better understand Article XX's context, this article first examines its historical evolution and recent interpretations of its two-tier test. It then turns to application of the two-tier test and why measures have failed the necessity test or failed to comply with Article XX's chapeau (the two elements of Article XX's two-tier test).

Finally, in light of Article XX's case law and how the two-tier test has been interpreted, it considers whether the Appellate Body is striking the right balance

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between Members' substantive rights and Members' rights to pursue public policy objectives under the general exceptions.

1 Introduction

Twenty years have seen twenty cases appealed under the general exceptions to GATT Article XX at the WTO. In August 2014, the Appellate Body issued its twentieth such report in the *China – Rare Earths* case.[1] When the general exceptions have been invoked under Article XX of the GATT,[2] it has only been deemed a legitimate defence in two cases since the inception of the WTO and its Dispute Settlement Body (DSB) in 1995. The general exceptions address the conflict between trade and other legitimate policy objectives of Members. There are ten such objectives including public morality, the protection of life and the conservation of exhaustible natural resources.

The aim of this paper is to analyse recent cases involving Article XX defences and whether a new interpretation of Article XX is needed in light of this low success rate of Article XX defences.[3] Is this low success rate attributable to systemic reasons at the DSB or is it indicative of a priority being given to market access over public policy objectives? This paper considers this question and whether the Appellate Body is striking the right balance between Members' rights to market access and Members' rights to pursue public policy objectives under the general exceptions.

Article XX allows the DSB to strike a balance between free trade and other public policy goals. The *US – Tuna I* and *US – Shrimp II* cases are famous in the WTO lexicon and have become symbolic of the larger trade and the environment debate. In the former, it was felt that the panel report shifted the balance in the trade and environment debate in favour of free trade. This balance was seemingly restored in the *US – Shrimp II* case in 2001 where a US measure protecting sea turtles was deemed compliant with the WTO agreements. However, since 2001, no measure defended under Article XX has been deemed compliant with the WTO Agreements. In assessing whether a revised way of interpreting Article XX is needed, this paper considers how well the Appellate Body is striking this balance.

[1] WTO doc. WT/DS431/AB/R, Appellate Body Report, *China – Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, 7 August 2014.

[2] The general exception clause is also found under Article XIV of GATS, which has an identical wording to the GATT in the parts considered here. As the vast majority of cases in this area have been taken under the GATT, for the sake of simplicity the general exceptions clauses are referred to as being under GATT Article XX throughout this paper.

[3] See Appendix 1 for a table showing the case-by-case success rate of Article XX defences.

The 2014 *EC – Seals*[4] case illustrates recent developments under Article XX. The interpretative evolution of Article XX is considered in light of this case in Sect. 3. In particular, the nature of Article XX's two-tier test, the "rational connection" test and the distinction between a measure and its application are considered.

The rest of the paper is structured as follows. Section 2 introduces Article XX and its two-tiered test for qualifying as a general exception. Section 3 looks at some of the issues raised under Article XX in the aftermath of *EC – Seals*. Section 4 examines why measures defended under the general exceptions have infringed Article XX. Section 5 considers whether or not a revised interpretation of Article XX is needed given the low success rate for defences. Finally, Sect. 6 concludes.

2 Introducing the General Exceptions

When a government measure is found to restrict trade, Article XX may be invoked as a defence. A measure is analysed in two stages under Article XX in assessing whether it qualifies for protection. Firstly, it must be capable of being provisionally justified under one of the ten policy objectives contained in subparagraphs (a)–(j) of Article XX. Secondly, a measure must comply with Article XX's chapeau, or introductory clauses. The chapeau's primary purpose is prevention of abuse of the exceptions listed in the subparagraphs.[5]

It has been the traditional view at the DSB, that before turning to the chapeau, the panel or Appellate Body must consider whether a measure is: necessary to protect public morals (let a), necessary to protect human, animal or plant life or health (let b), necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement (let d), or relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption (let g).

Article XX(a), (b), (d) and (g) are the only subparagraphs that have formed the basis of cases that have come before the Appellate Body. Article XX(a), (b) and (g) concern moral and environmental issues, which is where the focus of this paper lies. Article XX(d) is thematically different, dealing with measures necessary for compliance with laws in areas such as customs enforcement. For this reason, the content of these cases is not analysed in this paper.

[4]WTO doc. WT/DS401/AB/R, Appellate Body Report, *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products*, 22 May 2014.

[5]Ibid., para 5.327.

In determining whether a measure is "necessary" under Article XX(a) and (b), the Appellate Body balances factors including the contribution of a policy to its objective, the importance of the objective and its impact on international trade.[6] If confirmed as necessary preliminarily, the measure is then compared to less restrictive alternative measures. On whether a measure is "relating to the conservation of exhaustible natural resources" under Article XX(g), a "substantial relationship" must exist between the measure and the conservation effort.

To comply with the chapeau, *inter alia,* a measure must not be applied in a manner that constitutes "arbitrary or unjustifiable discrimination" or "a disguised restriction on international trade". It is a flexible tool provided by the agreements that gives the Appellate Body a degree of freedom in attributing weight to the various concerns of the parties. Factors considered by the Appellate Body in its assessment have included a measure's design, flexibility, rationale and whether it has been exercised in good faith.

Article XX functions as a two-tier test, a sequence that has been deemed by the Appellate Body to be logical and fundamental to the Article.[7] Interpreting the chapeau without this sequence of investigation has been deemed by the Appellate Body to be difficult "if . . . possible at all".[8] The idea is that the specific exception should be examined first to set the context before turning to the application of a measure under the chapeau. This logic of interpreting the provisions before the chapeau has been disputed and labelled as "arbitrary" by Bartels (2014) though he cedes that a two-tier test is appropriate on the grounds of judicial economy.[9]

Whether an examination of the application of a measure under the chapeau is needed at all has been questioned. Davies believes that "the nexus requirements in the heads of provisional justification provide ample protection" against the abuse of Article XX.[10] Along this line of thinking, if something is "necessary" to protect life or "related to" the conservation of exhaustible natural resources it should automatically qualify for an Article XX exemption. The impact of removing the chapeau from Article XX's two-tier structure would be to restrict the DSB to solely looking at the nature of a measure without regard to discriminatory treatment in place resulting from the measure. The contribution of the two-tier test and interpreting the chapeau to the low success rate of Article XX defences is considered in the next sections.

[6]See https://www.wto.org/english/tratop_e/envir_e/envt_rules_exceptions_e.htm (accessed 30th January 2016).

[7]WTO doc. WT/DS58/AB/R, Appellate Body Report, US – Import Prohibition of Certain Shrimp and Shrimp Products, 12 October 1998, para 119.

[8]Ibid., para 120.

[9]Bartels (2014), p. 7.

[10]Davies (2009), p. 32.

3 The Objective of a Measure and the Two-Tier Test

One ongoing question concerning Article XX and its interpretation is whether the reasons for preliminary justification need to be the same as those provided for satisfying the chapeau. This question as to whether the reason for discriminating has to be the same as the reason for restricting trade was addressed in *EC – Seal*s.

In *Brazil – Retreaded Tyres*, the Appellate Body found that it would be difficult to find any discrimination compliant with the chapeau where it "does not relate to the pursuit of or would go against the objective that was provisionally found to justify a measure under a paragraph of Article XX".[11] The same paragraph tells us that it is an abuse of the exceptions where there is "no rational connection" between the objective pursued under the first part of the two-tier test and the discrimination seeking to be justified under the chapeau.

The WTO website endorses the idea of there being a "rational connection test" for a trade restrictive measure to be justifiable under the chapeau: "WTO jurisprudence has highlighted some of the circumstances which may help to demonstrate that the measure is applied in accordance with the chapeau. These include ... an analysis of the rationale put forward to explain the existence of a discrimination (the rationale for the discrimination needs to have some connection to the stated objective of the measure at issue)".[12] Other circumstances listed include a measure's design, flexibility and coordination and cooperation activities undertaken by the defendant.

Bartels suggests that the rational connection test should be viewed as an error[13] and that it was overturned in *EC – Seals*. The Appellate Body found in *EC – Seals* that the "relationship of the discrimination to the objective" is one of the most important factors but not the sole test for compliance with the chapeau. The Appellate Body's finding in *EC – Seals* that the objective for discrimination is not the sole test but that there are additional factors that may be relevant does not necessarily run contrary to *Brazil – Retreaded Tyres* which itself acknowledges one such factor in assessing compliance with the chapeau. The additional factor considered was whether the discrimination was being applied in a manner that would "go against that objective" cited under Article XX's subparagraph. When considering the test laid down in *Brazil – Retreaded Tyres*, this second element of the analysis must be borne in mind. These two elements are; (1) that a measure may not discriminate where it is not rationally connected to the objective pursued under the subparagraph; (2) where not rationally connected, the discrimination must not run contrary to the initial objective. In Bartels's example of the medical use of narcotics, it is not necessarily an affront to public morality to allow the use of a narcotic

[11]WTO doc. WT/DS332/AB/R, Appellate Body Report, Brazil—Measures Affecting Imports of Retreaded Tyres, 3 December 2007, para 227.

[12]https://www.wto.org/english/tratop_e/envir_e/envt_rules_exceptions_e.htm (accessed 30 January 2016).

[13]Bartels (2014), p. 15.

for public health reasons. If the two elements of the test are considered, it is difficult to find that the *Brazil – Retreaded Tyres* dictum has been overturned in *EC – Seals*.

This exception to the EU Seal Regime is for seal products derived from hunts by Inuit or indigenous communities. The assessment of whether the Inuit exception supported Inuit communities (IC) is seen by Bartels as evidence that *Brazil – Retreaded Tyres* has been overturned. Bartels deems that such an analysis would be "impossible" under it as there is no rational connection between supporting Inuit communities and the public morals objectives of the EU seal regime.[14]

Protecting traditional methods is however part of a broader public morality of upholding ethical standards even if this is not the same specific moral concern that is expressed when banning the importation of seal products. The EU submitted that IC hunts were distinguishable from commercial hunts as they contributed to the subsistence and identity of Inuit. IC hunts were of significance for Inuit "culture and tradition as well as for their livelihood".[15]

The EU contested the panel's finding that there was no rational connection between the public morals objective and the exception to it for Inuit communities.[16] The EU submitted on appeal that an integral part of legislating based on a moral standard was to have a "balancing of interests" as reflected in the IC exception, which was the outcome of "the application of that moral doctrine to the specific circumstances of seal hunting".[17]

Whether or not the rational connection test is desirable in the context of the general exceptions is another question. Considering the case in which it was laid down, if a retreaded tyre ban's objective is to protect the environment, is it unreasonable to say that the reason for discrimination should be connected to this objective or at least not run contrary to it?

While this test fits the facts of *Brazil – Retreaded Tyres* well enough, its shortcomings are more apparent in a scenario more like the *US – Shrimp* cases. Conserving sea turtles may be a conservation objective under Article XX(g) but discrimination in this measure's application could be grounded in a moral concern. E.g. a WTO Member may give a waiver of a particular fishing requirement enacted for environmental reasons to a small island if this would facilitate the sustainability of a traditional way of life. The exception is not rationally connected to the objective pursued, runs contrary to it but may be a justified form of discrimination based on the balancing of interests concerned.

While there may be some instances where an exception is not rationally connected to an objective pursued and even runs contrary to it, it is questionable whether justifications under the subparagraphs and chapeau need to be delinked in a

[14]Ibid.

[15]*European Communities – Measures Prohibiting the Importation and Marketing of Seal Products*, (AB-2014-1, 2/DS400, DS401), Other Appellant Submission by the European Union, 29 January 2014, para 142.

[16]Ibid., para 16.

[17]Ibid., paras 110–11.

general manner. As per *EC – Seals*, additional factors may be considered but the relationship of the discrimination to the objective of a measure is one of the most important factors and will be in the majority of cases.

The traditional basis for the two-tier test is the distinction between a measure and its application. Bartels claims that *EC – Seals* has abolished this distinction as regard was had to the content of a measure in considering its application. The Appellate Body cited *Japan – Alcoholic Beverages,* a national treatment case, in finding that it may be "*relevant to consider* the design, architecture and revealing structure of a measure" (para 5.302).[18]

In *EC – Asbestos*, the Appellate Body reminded the panel in its report that Articles III and XX "are distinct and independent provisions".[19] The case involved considerations of the health reasons behind an Article III measure which was not deemed to deprive Article XX(b) of its *effet utile* as different inquiries were made under the different Articles. GATT Articles III and XX are separate provisions, which require separate inquiries.

The reference to *Japan – Alcoholic Beverages* does acknowledge that the chapeau does not exclusively concern the application of a measure and that the substantive content of a measure may also be an element. Such an interpretation widens the scope for interpreting the application of a measure but while the Appellate Body may consider an element used in an Article III analysis, such a consideration does not constitute a fundamental re-evaluation of the two-tier test. As such, it is pre-emptive to say that the two-tier test's fundamental distinction has been abolished. In applying the two-tier test, regard is still fundamentally split between the consideration of a measure under the subparagraphs and the application of the measure under the chapeau albeit with a widened interpretation of the term "application", which may include additional factors. The question of whether or to what extent the reference to *Japan – Alcoholic Beverages* and the design of a measure will impact upon compliance with the chapeau in future Appellate Body reports remains to be seen.

The Appellate Body found that in considering the design, architecture and structure of a measure, its "actual or expected application" is relevant in determining whether a measure infringes the chapeau.[20] This is the first time the "expected application" of a measure was referred to in an Appellate Body report (it was repeated by reference to *EC – Seals* in *China – Rare Earths*, later in 2014).[21] Given the implications of paragraph 5.302 for future interpretations of the chapeau, the implications of each word must be considered.

Traditionally, a Member does not have to show that damage has actually occurred to satisfy the chapeau and has only needed to show a measure to be

[18]WTO doc. WT/DS401/AB/R, *supra*, n. 4 (emphasis added).

[19]WTO doc. WT/DS135/AB/R, Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos – Containing Products*, 12 March 2001, para 115.

[20]Ibid.

[21]WTO doc. WT/DS431/AB/R, *supra*, n. 1, fn 625.

discriminatory. As such, the need to introduce the term "expected application" is questionable when damage does not need to be shown. Paragraph 5.302 refers to how a measure is "applied" three times before introducing this distinction between actual and expected application. It is this author's opinion that the words "actual or expected" add no value to the concept of what constitutes application under the chapeau and should be avoided in future reports.

4 Why Measures Have Failed Article XX

This section looks at the reasons why measures have failed the necessity test or failed to comply with Article XX's chapeau.[22] The success rate for all Article XX claims has been two out of twenty (10 %). However, for measures relating to public morals and the environment under Article XX(a), (b) and (g) the success rate is one in six (16.6 %).

Before the DSB, an Article XX(a) defence has failed on each of the three occasions it has been invoked. While *China – Audiovisual* failed the necessity test, *US – Gambling* and *EC – Seals* failed to satisfy the chapeau.

In relation to Article XX(b) and (g), since 1995 two defences have failed the necessity test (*China – Rare Earths, EC – Tariff Preferences*) and five have failed to comply with the chapeau (*US – Gasoline, EC – Tariff Preferences, Brazil – Retreaded Tyres, US – Shrimp (1998 & 2008)*).

The necessity test was failed because of the availability of alternatives (*China – Audiovisual*), the "piece-meal"[23] manner of its application (*China – Rare Earths*) and the fact that there was no relationship between the objectives stated and the measures put in place (*EC – Tariff Preferences*).

Reasons why measures have been deemed not to comply with Article XX's chapeau have included the application of a prohibition to foreign but not domestic service suppliers (*US – Gambling*), the lack "comparable efforts" in enabling one group to qualify for an exception to a ban (*EC – Seals*) and the existence of an exception to a ban for neighbouring countries which ran contrary to the objective invoked for provisionally justifying the measure (*Brazil – Retreaded Tyres).*

Despite the low success rate of Article XX defences, many measures designed to protect the environment and public morals have been deemed provisionally justifiable, satisfying the first part of the two-tier test. For Article XX claims, 9/20 have been deemed provisionally justifiable (45 %). This paper has excluded Article XX (d) from its analysis for thematic reasons. All eight defences under XX(d) have failed the necessity test and in the only case where an analysis of the chapeau was carried out, it was also deemed non-compliant (*US – Thai Cigarettes*). Taking Article XX(d) out of an analysis of provisional justification, 9 out of 12 of the

[22] Appendix 2 provides a more detailed outline of these decisions.

[23] WTO doc. WT/DS431/AB/R, *supra*, n. 1, para 5.116.

measures defended under Article XX(a), (b) and (g) have been found to be provisionally justifiable (75 %). Whether this represents a silver lining for public policy makers is considered in the next section.

5 Has the Right Balance Been Struck?

Section 5 asks whether the right balance has been struck in Article XX's first twenty cases. It considers whether a revised Article XX, or way of interpreting Article XX, is needed given the low success rate for defences. Areas considered include the adequacy of the two-tier test and whether *EC – Seals* has shifted the "line of equilibrium" in interpreting Article XX. In terms of the two-tier test, the necessity test is looked at before turning to the chapeau and whether there is room for improving how it operates.

The *US – Tuna* case (1991) challenged the view that an appropriate balance had been struck between trade and public policy considerations under free trade agreements when an ostensibly environmental measure taken by the US was deemed to be inconsistent with the GATT. Following the inception of the WTO in 1995, greater weight appeared to be given to environmental concerns in 2001 with the *US – Shrimp I* case. This was largely viewed as a positive development but was criticised by Bhagwati who claimed that the Appellate Body had bowed to international environmental pressure.[24] In *US – Shrimp I*, it was found that to ensure a measure is compliant with Article XX's chapeau, a Member must make efforts to find a cooperative solution to the problem. Secondly, a Member needs to consider the conditions in other territories when designing measures. This finding appeared to strike a greater balance and it seemed that in future cases, measures would be able to comply with these standards. This has not transpired and there has not been a successful Article XX defence since *US – Shrimp II*.

On the face of it, the low success rate of Article XX defences may indicate a priority being given to Members' substantive rights over concerns such as environmental protection at the DSB. Other reasons that are systemic to the functioning of the DSB may be put forward in explanation. One reason may be that the environmental measures may be acceptable under GATT Article XX by themselves, but their discriminatory application under the chapeau may not be. Thus even if it is a loss for a specific Member in a case, it may be a win for the public policy objective overall.

Other reasons may be that cases involving discriminatory measures are more likely to be resolved at the consultation stage or may not be appealed to the Appellate Body. Furthermore, for diplomatic reasons Members tend to take cases they believe they have a good chance of winning. The paper analyses Article XX defences once they come before the Appellate Body rather than the steps preceding this.

[24] Bhagwati (2001), pp. 15–29.

While successful defences have been uncommon, the two-tier test has been passed in *EC – Asbestos* and *US – Shrimp II*. This represents two of the twenty cases where an Article XX exception was invoked and the case went to the Appellate Body. In *US – Shrimp II* discrimination was not found once "similar opportunities" were provided to all exporters. This was the case regardless of the outcome of these negotiating opportunities. In *EC – Asbestos,* this decision rightly affirmed the large degree of discretion Members have when regulating public health issues. This case shows that when it comes to measures concerning a grievous potential harm to the health of Members' citizens and a measure is applied consistently, it has no difficulty being exempted under Article XX.

As seen in Sect. 4, there has been a 75 % success rate for measures under Article XX(a), (b) and (g) in terms of being found to be preliminarily justifiable. This reflects the fact that the panels and Appellate Body are often willing to deem measures necessary when the aim is to protect life, the environment and public morals. As the Appellate Body stated in its *Korea – Various Measures on Beef* report: "The more vital or important the common interests or values pursued, the easier it would be to accept as 'necessary' the measures designed to achieve those ends".[25]

Environmental, health and public moral defences have often been deemed preliminarily justifiable. However, this may not be of much consolation to a Member when the balancing of interests under the chapeau has gone against them. Perhaps some of these losses can be reframed as wins for public policy where it was far from certain whether they would constitute a permissible restriction on trade under the subparagraphs in the first place. Although the EU and Brazil's measures on the importation of seal products and retreaded tyres failed to comply with the chapeau, the fact that such measures have been deemed provisionally justifiable under WTO law shows that the Appellate Body has acknowledged a broad range of public policy concerns that permit restrictions on trade.

The *Brazil – Retreaded Tyres* case shows the Appellate Body's willingness to accept environmental and health risks as legitimate and complex concerns that can be tackled by a wide range of measures. When a measure infringes Article XX's chapeau on the basis of discriminatory treatment, it is primarily a question of fairness in the accordance of rights equally to all WTO Members than one of favouring trade over public policy interests. A concern of Members in allowing derogations from the WTO agreements in environmental matters is that these measures will become a new form of protectionism. In enacting environmental or moral measures, ensuring that these measures are not discriminatory in their application should be a starting point for Members in demonstrating that the aim of a measure is environmental rather than protectionist. Showing that a measure is non-discriminatory is a necessary but not sufficient condition for a measure to comply with Article XX.

[25]WTO doc. WT/DS161/AB/R, Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, 11 December 2000, para 162.

Seven of the twelve cases brought under Article XX(a), (b) and (g) have failed to comply with the chapeau. Two have complied (*EC – Asbestos* and *US – Shrimp II)*, while in three cases the second tier of Article XX's test was not reached (*US – Audiovisual, China – Rare Earths* and *China – Raw Materials*). Given the difficulty Article XX defences have had in complying with the chapeau, the suitability of its current formulation has been questioned.

To discard the chapeau would be to deprive the Appellate Body of its ability to look at the discriminatory effects of measures. Removing the chapeau would render the first twenty years of jurisprudence on Article XX questionable in its applicability to future cases. This is not to mention the uncertainty that would surround measures previously found incompatible with the chapeau.

A more plausible proposition would be to relax the requirements of the chapeau and what constitutes arbitrary or unjustifiable discrimination. One way of doing this is to delink the objective for a trade restriction and the reason behind discriminatory treatment under the chapeau. Another way would be for the Appellate Body to look at other "additional factors" that may be considered which would allow it more room in its considerations under the chapeau. This was done in *EC – Seals* where for the first time reference was made to the design, architecture and revealing structure of a measure which was deemed "relevant to consider". GATT Article III has regard to the application of a measure like Article XX, but a differentiated analysis is necessarily applied as the Article has no chapeau. The fact that the Appellate Body referred to *Japan – Alcoholic Beverages*, a GATT Article III case, perhaps shows that they are trying to widen the scope for interpretation under the chapeau. In terms of other additional factors that may be considered in future Appellate Body reports, guidance may be drawn from disputes under the TBT Agreement. In *US – COOL*,[26] the even-handedness of measures was determined based on whether or not they were applied in a manner that "constitutes a means of arbitrary or unjustifiable discrimination". This wording largely resembles the chapeau test and future interpretations of GATT Article XX may make reference to the jurisprudence developed under the TBT Agreement and *vice versa*.[27]

The difficulty with taking *EC – Seals* as an example of a progressive interpretation of Article XX's chapeau is that the infringement of the chapeau was less clear-cut here than in other cases. In *EC – Seals*, the EU was found not to have made "comparable efforts" to allow Canadian Inuit to qualify for the IC exception compared to efforts made in relation to Greenlandic Inuit. The aim of this measure was to support hunts for subsistence, an objective different to the one claimed to provisionally justify the measure. To comply with the Regulation, a certificate from a recognised body was necessary which the Appellate Body deemed to constitute arbitrary and unjustifiable discrimination.

[26]WTO doc. WT/DS384/AB/R, WT/DS386/AB/R, Appellate Body Report, *United States – Certain Country of Origin Labelling (COOL) Requirements*, 29 June 2012.

[27]Asmelash (2013), p. 36.

In certifying products that would qualify under the Inuit exception, establishing a recognised body was deemed burdensome as was the "broad discretion" of recognised bodies in deeming products compliant with the Inuit exception.[28] If the EU aims at protecting subsistence hunting, the establishment of a body to recognise products as such is reasonable even if "cooperative arrangements" have not been actively pursued.[29]

It has been noted that one way for the EU to comply with the chapeau is by removing the Inuit exception, which would be more trade restrictive and would not necessarily benefit Canada or its Inuit population.[30] Removing the Inuit exception would be to enact a more trade-restrictive measure to comply with the chapeau, which is not the ideal outcome for trade or public policy. If a case were to be made to relax interpretation of the chapeau, *EC – Seals* could be a starting point.

6 Conclusions

One of the most delicate tasks faced by the Dispute Settlement Body is striking the right balance between enforcing Members' rights under the WTO agreements and ensuring derogations for public policy objectives can be defended under the general exceptions. These twenty Article XX cases are a small, but vital sample for policy makers wishing to comply with WTO law.

Compliance with Article XX's chapeau has proved a sticking point in some cases, but applying measures in a discriminatory manner without justification is anathema to the WTO system. The chapeau remains integral in obliging Members to show that environmental or moral measures do not discriminate between Members in an unjustified way. The Appellate Body has shown itself willing to deem Article XX(a), (b) and (g) defences provisionally justifiable in most of its cases and where there is no discrimination, such as in *EC – Asbestos* and *US – Shrimp II,* measures have been found to be compliant.

The Appellate Body has shown willingness in recent jurisprudence to consider factors other than the relationship between the reasons for discrimination under the chapeau and the objective of a measure under the subparagraphs. *EC – Seals* shows the Appellate Body will consider additional factors and in this case referred to the design, architecture and revealing structure of a measure when looking at its application. Ultimately it is for the Appellate Body to find the correct balance in interpreting the chapeau and recent jurisprudence is a testament to the fact that its interpretative role is not carried out in an overly rigid manner.

The success rate for Article XX defences may be low, but it is not the aim of the DSB to achieve a 50 % compliance rate for measures. In terms of the cases that have

[28]WTO doc. WT/DS401/AB/R, *supra*, n. 4, para 5.326.

[29]Ibid., para 5.337.

[30]Catti de Gasperi (2015), p. 17.

appeared before the Appellate Body, to increase the compliance rate to 50 % would require a dismantling of Article XX and its two-tier test. If the chapeau were removed from Article XX, such a compliance rate would be achieved. However, this is not desirable as to ignore the way in which the exceptions are applied would be to greatly dilute the substance of the WTO Agreements. Allowing measures to be applied differently to different Members runs contrary to the foundational principles of the WTO.

Measures aiming to protect the environment and public morality can respect WTO law and come under the Article XX exceptions. If the system is to be changed to make it easier for measures to be defended under Article XX, this will come through the DSB, its jurisprudence and the balancing performed by the Appellate Body. If this doesn't develop in a satisfactory manner, change must come multilaterally from the Members themselves, however unlikely this appears to be. This sensitive area involves conflicting values, which are inherent to the WTO system. An attempt to move away from the balancing carried out by the Appellate Body towards a more codified, rules-based approach to interpreting the general exceptions would be counterproductive.

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Appendix 1

Cases where Article XX invoked by defendant	Article XX defence rejected by Appellate Body
US – Gasoline (1996)	X
Canada – Periodicals (1997)	X
US – Shrimps I (1998)	X
Korea – Beef (2000)	X
EC – Asbestos (2001)	
US – Shrimp II (2001)	
EC – Tariff Preferences (2004)	X
Canada – Wheat Exports (2004)	X
Dominican Republic – Cigarettes (2005)	X
US – Gambling (2005)	X
Mexico – Soft Drinks (2006)	X
Brazil – Tyres (2007)	X
US – Custom Bond (2008)	X
US – Shrimp I (2008)	X
China – Auto Parts (2008)	X
China – Audiovisual Services (2009)	X

(continued)

Cases where Article XX invoked by defendant	Article XX defence rejected by Appellate Body
Thailand – Cigarettes (2011)	X
China – Raw Materials (2011)	X
EC – Seals (2014)	X
China – Rare Earths (2014)	X

The 20 cases considered here constitute a relatively small sample. If Panel reports which are not appealed to the Appellate Body are included, a similar trend of non-compliance can be observed. In *Tuna – Dolphin* (1991) the Article XX exception was of course rejected by the panel. In *Tuna – Dolphin II* (2012) the case was taken under the Technical Barriers to Trade Agreement.

Appendix 2

Falling Foul of Article XX

In this section, the reason why defendants have unsuccessfully invoked GATT Article XX before the DSB is considered.

Article XX(a)

US – Gambling (2005)[31]

A US measure affecting the cross-border supply of gambling and betting services was contested in this case. The ban was defended under GATS Article XIV(a) and was found to be designed to protect public morals by both the panel and Appellate Body. Unlike the panel, the AB considered the measure was "necessary" as the US had made a *prima facie* case of necessity and Antigua had failed to give a reasonably available alternative measure.[32] The fact that the US had not entered into consultations did not render the measure invalid. On appeal, it was found that the US prohibition was only applied to foreign and not to domestic service suppliers and so it fell foul of Article XIV's chapeau.

[31]WTO doc. WT/DS285/AB/R, Appellate Body Report, United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services, 7 April 2005.

[32]See para 336.

China – Audiovisual Services (2009)[33]

A Chinese measure seeking to reserve the importation of various forms of media solely for certain Chinese State-owned enterprises was contested in this case.

The ban was defended under Article XX(a). The panel and AB determined that because there was at least one other reasonably available alternative, China's measures were not "necessary" to protect public morals. The AB did not complete an analysis of the chapeau.

EC – Seals (2014)[34]

The EU seal regime,[35] which sought to ban the importation of seal products into the EU, was contested in this case. Norway alleged certain exceptions to the ban were discriminatory and favoured products from the EU certain third countries.

The EU defended the ban under Article XX(a) and as expected, a ban on seal products came under the traditionally broad scope of moral questions. Proving it to be "necessary" to protect public morals was more difficult but the EU succeeded before the panel and at appeal.

The AB corrected the panel's finding that applying the same legal test as was applied to Article 2.1 of TBT Agreement was appropriate in analysing Article XX's chapeau. Ultimately however it found that the EU had not demonstrated that the EU seal regime complied with the chapeau and thus could not be justified under Article XX. The EU had not made "comparable efforts" to allow Canadian Inuits to qualify for the IC exception compared to the efforts it had made in relation to Greenlandic Inuits. Furthermore, to comply with the Regulation, a certificate from a recognised body is necessary. Such a body had been approved in Greenland but not in Canada. The AB deemed this burdensome.

It has been noted[36] that the EU can comply by removing the Inuit exception, which would be more trade restrictive and would not necessarily benefit Canada or its Inuit population.

[33]WTO doc. WT/DS363/AB/R, Appellate Body Report, *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, 21 December 2009.

[34]WTO doc. WT/DS401/AB/R, *supra*, n. 4, p. 3.

[35]Regulation 1007/2009 of 16 September 2009 on trade in seal products, *OJ* 2009 L 286/36.

[36]Catti de Gasperi (2015), p. 17.

Article XX(b) and (g)

US – Gasoline (1996)[37]

This case concerned a US measure seeking to regulate the effects of gasoline on clean air.

The measure was contested as it treated imported gasoline less favourably but the US invoked Article XX(g) in its defence. The measure was deemed to be provisionally justifiable and "related to" conserving exhaustible natural resources. It fell foul of the chapeau however, as it was applied in a way that discriminated between domestic and imported products.

EC – Tariff Preferences (2004)[38]

An EC measure seeking to combat drug production and trafficking was contested in this case. India deemed the treatment received by 12 countries to be preferential and that its "design, structure and architecture" showed no relationship between the objectives stated and the Drug Arrangements. The ban was defended under Article XX(b) but the EC failed to show the measure was "necessary" for the protection of human life or health or that it complied with the chapeau. The EC did not appeal on this point.

Brazil – Retreaded Tyres (2007)[39]

This case involved a measure banning the import of retreaded tyres for environmental and health reasons. The EC contested it under GATT Article XI while Brazil claimed Article XX(b) as a defence. When considering Article XX(b), the panel found that none of the less trade-restrictive alternatives suggested by the European Communities constituted "reasonably available" alternatives to the ban. The measure passed the necessity test at first instance and appeal as its objective was deemed to outweigh its trade-restrictiveness.[40] The measure was also deemed appropriate to achieving its objectives. The Appellate Body acknowledged the difficulty of isolating the contribution of a single policy towards an overarching goal such as tackling climate change. It recognised that the evaluation of such policies can only be done in the long term in some instances.

[37]WTO doc. WT/DS2/AB/R, Appellate Body Report, United States—Standards for Reformulated and Conventional Gasoline, 29 April 1996.

[38]WTO doc. WT/DS246/AB/R, Appellate Body Report, European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries, 7 April 2004.

[39]WTO doc. WT/DS332/AB/R, supra, n. 11, p. 6.

[40]Ibid., para 151.

When the chapeau of Article XX was considered, it was found that the ban on imported tyres didn't extend to Mercosur Members. In light of this exemption, the ban was deemed arbitrary and to infringe Article XX's chapeau. The AB found that whether or not discrimination is arbitrary depends on a measure's rational connection to its objective or whether it would go against that objective.[41] As an exemption for Mercosur tyres would "go against the objective that was provisionally found to justify a measure," the measure was deemed arbitrary. Once again, it is not the measure itself that infringes but the inconsistent manner of its application.

China – Raw Materials (2011)[42]

Chinese export restraints on materials such as magnesium and zinc were at issue in this case. China claimed it could derogate from its Accession Protocol obligations based on Article XX exceptions in furtherance of its aim of conserving an exhaustible natural resource. The panel and AB found that there was no basis for appending GATT Article XX (b) and (g) to the Accession Protocol. Finally, the AB underlined the mutually exclusive natures of Articles XI and XX of GATT.

China – Rare Earths (2014)[43]

Like the above case, this case relates to restrictions on the export of raw materials (in this case tungsten and molybdenum). China sought to defend its measure under Article XX(b) saying it was "necessary to protect human, animal or plant life or health". The US argued that the measures were not necessary for this purpose but more importantly that Article XX was inapplicable to China's Accession Protocol. One panelist took the view that the Article XX exceptions are available to all trade in goods except where this is stated to not be the case. This view seems controversial given the legal maelstrom that would result from its application. Considering Article XX(b) on an *arguendo* basis, the panel found the measure to fail the necessity requirement.

The panel found China's export quotas did not amount to conservation within its traditional understanding of Article XX(g). China's interpretation of conservation was tantamount to Chinese control of the international market.

China's appeal primarily sought clarification of the relationship between its Accession Protocol and the WTO Agreements.

The AB found that the panel was correct in focusing on the measures' "design and structure" rather than on their effects on the marketplace.

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[41]Ibid., para 227.

[42]WTO doc. WT/DS394/AB/R, Appellate Body Report, China—Measures Related to the Exportation of Various Raw Materials, 30 January 2012.

[43]WTO doc. WT/DS431/AB/R, *supra*, n. 1, p. 3.

In its analysis of Article XX(g), the AB found the panel was incorrect in suggesting there was a requirement of "even-handedness" when it comes to the burden of conservation under Article XX(g). This error did not taint the rest of the panel's analysis but the idea that conservation efforts must be spread evenly among foreign and domestic producers and consumer was correctly deemed to be erroneous.

The (Only) Two Successful Claims Under Article XX

US – Shrimp II (2001)[44]

The initial *US – Shrimp I* (1998)[45] case was unsuccessful in invoking Article XX and so analysis is given before turning to this second dispute, which concerned its implementation. A joint complaint was brought in this case regarding shrimp imports and their impact upon sea turtles, which were considered an endangered species. The Act required trawlers to use turtle excluder devices (TEDs) when in waters containing such turtles. Imports were also prohibited[46] unless it could be shown that the importing nation had a similar regulatory programme and turtle incidental take-rate to the US or that the environment didn't contain such risks. This had a "coercive" effect obliging other Members to enforce the same measures as the US to ensure compliance. The measure also constituted "arbitrary" discrimination because of the inflexibility in its application.

The US defended its measure under Article XX(g) but was found to have discriminated in applying the measure as advantages were accorded to Caribbean countries that weren't accorded to the complainants thus violating Article XX's chapeau. The US had failed to engage in negotiations towards an international agreement for the conservation of sea turtles with the complainants and was instructed to do so.

In *US – Shrimp II* (2001), the US measure was now deemed to satisfy the chapeau. The US had undertaken negotiations in "good faith" and as the conclusion of these negotiations wasn't a condition of the original report, the implementation panel and Appellate Body deemed the US compliant.

Regarding the "arbitrary" nature of the discrimination, the US amended the measure so that programmes were required to be "comparable" rather than "essentially the same". All exporting countries had been provided with "similar opportunities" and as "comparable efforts" had been made the measure could no longer be deemed discriminatory.

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[44]WTO doc. WT/DS58/AB/R, Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Recourse to Article 21.5 of the DSU by Malaysia, 22 October 2001.

[45]WTO doc. WT/DS58/AB/R, *supra*, n. 7.

[46]US Public Law 101–102 (1989), section 609.

EC – Asbestos (2001)[47]

In *EC – Asbestos*, the EU successfully defended its ban on asbestos under Article XX(b) and both the panel and Appellate Body upheld its claim that no reasonable "alternative measure" could be adopted. This shows that WTO rules can be used to challenge domestic measures protecting citizens against the most dangerous of materials. France placed a ban on both imported and domestically produced asbestos and so the measure complied with Article XX's chapeau. Canada claimed that the measures used by France were more trade-restrictive than necessary and that if used in a safe manner, chrysotile (the type of asbestos it produces) does not pose health risks.[48] Thus chrysotile was "like" other construction products and should be protected under the national treatment clause.

The panel concluded that France had violated Article III.4 of the GATT and that chrysotile and non-asbestos based construction products were like products. In their view, to consider health risks under Article III.4 was "not appropriate" and would be to "nullify" the effect of Article XX(b).[49] This approach would guarantee market access subject to the defendant being able to find a non-protectionist justification under Article XX.

The Appellate Body reminded the panel in its report that Articles III and XX "are distinct and independent provisions" and so a measure may be deemed unjustifiable for public health reasons under both.[50] Considerations of health reasons under Article III do not deprive Article XX(b) of its *effet utile* as different inquiries are made under the different Articles.

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[47]WTO doc. WT/DS135/AB/R, *supra*, n. 19, p. 8.

[48]Chrysotile is considered a human carcinogen by the WHO's cancer agency (IARC), as per its 1998 Monograph: 'WHO IARC Monographs on the Evaluation of Carcinogenic Risks to Humans Overall: Evaluations of Carcinogenicity: an Updating of IARC Monographs,' *Volumes 1 to 42, Supplement 7* (1998).

[49]WTO doc. WT/DS135/R, Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, 18 September 2000, paras 3.450 and 3.512 for the respective quotations.

[50]WTO doc. WT/DS135/AB/R, *supra*, n. 19, para 115.

Remarks on the Practice of Regional Development Banks' (RDBs) Accountability Mechanisms and the Safeguard of Human Rights

Domenico Pauciulo

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Abstract Based on the experience of the World Bank's Inspection Panel, Regional Development Banks (RDBs) have established accountability mechanisms with the aim to control the compliance of their lending activities with their own operational policies and procedures. Notwithstanding different models created, weaknesses and critical issues, RDBs mechanisms are contributing to the promotion and protection of human rights at the universal level, holding RDBs accountable for violations of international human rights law. Since they allow individuals to present claims related to rights and interests affected by an act or omission of the organization, RDBs accountability mechanisms are innovative instruments in the law of international organizations aimed at consolidating objectives related to sustainable development, promotion of fundamental rights and freedoms, protection of cultural heritage and rights of indigenous people, safeguard of environment and biodiversity.

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1 Introduction

Notwithstanding the promotion of economic interests and the safeguard of fundamental rights of individuals have long been considered inconsistent, in the last years the integration of human rights and environmental concerns in international economic law has been one of the most debated topics by international community and scholars.[1]

This issue arose since the emergence of a new concept of "development", which takes into account the close connection between economic growth and the protection of different interests, e.g. the implementation of economic, social and cultural rights; the safeguard of the rights of indigenous peoples; the preservation of the environment and biodiversity. This new approach originated in 1986 UNGA Declaration on the Right to Development[2] and was confirmed by the adoption of several documents by international organizations.[3]

Accordingly, International Financial Institutions (IFIs), of both universal and regional nature, have progressively devoted greater attention to the protection of non-economic values in the implementation of their statutory objectives, widening their functions and responsibilities.

Hence, while the debate on the inclusion of environmental and social concerns in the law and policies of the World Trade Organization (WTO) dates back to the creation of this institution,[4] in the field of international investment law this issue has occurred recently, mostly in order to safeguard these interests in the course of economic activities conducted by private actors operating in Least Developed Countries (LDCs).

Nowadays, international lending activities are also involved in this process. The International Monetary Fund (IMF) and the International Bank for Reconstruction

[1]The literature on this topic is rather large. See Adinolfi (2014); Baetens (2013); Hirsch (2013); Petersmann (2011); Dupuy et al. (2009); Cottier (2005).

[2]See UN doc. A/RES/41/128, Declaration on the Right to Development, 4 December 1986. This Declaration contains two important principles: first, there is subordination of development processes to the effective enjoyment of human rights and fundamental freedoms, from which development cannot be separated (see, for example, arts 4, 6 and 8 of the Declaration). In addition, the importance of international cooperation for the promotion of development on a global scale is emphasized: this second aspect highlights the possible role of international organizations.

[3]The right to development can be rooted in the provisions of the Charter of the United Nations, the Universal Declaration on Human Rights and the two 1966 International Covenants on Civil and Political Rights and on Economic, Social and Cultural Rights. It was reaffirmed in several recommendations adopted by international organizations and evolved in the concept of sustainable development, affirmed in the Report of the Commission on Environment and Development, Our Common Future, http://www.un-documents.net/our-common-future.pdf (accessed 1 February 2016), and by the outcomes of the United Nations Conference on Environment and Development held in Rio de Janeiro in 1992. About the latter, see Viñuales (2015).

[4]This process began in the '40s, when clauses regarding full employment and fair labour conditions standards were proposed for inclusion in the Havana Charter establishing the International Trade Organization (ITO), but it had its high-point during the Uruguay Round of multilateral trade negotiation, which began in 1986.

and Development (IBRD), in the context of the World Bank Group (WBG), developed new approaches in order to take into account non-economic values in their decision-making process, in addition to relevant economic parameters.[5]

Based on the experience of the IBRD, several Regional Development Banks (RDBs)[6] were created since the '60s, in order to promote the development of their Member States through loans and direct participation for specific investment projects with a strong social dimension.

This study intends to examine to what extent RDBs guarantee the safeguard of human rights and environmental concerns in their activities, by highlighting the role of their accountability mechanisms in pursuing these aims.

2 Human Rights and Lending Activities: The Experience of the International Bank for Reconstruction and Development

According to its Articles of Agreement, IBRD main objectives are the reconstruction of the economies disrupted by the World War II; the promotion of private foreign investments; the growth of international trade.[7] These goals are pursued through the provision and implementation of long-term loans and guarantees to Member States. Clearly, the Bank's mandate has an economic and financial nature, as stated by the so-called "political neutrality clause" under Art. IV, Sec. 10, IBRD Articles of Agreement, which prohibits the Organization and its officials to interfere in the internal affairs ("political affairs") of States and to be influenced, in the performance of their duties, by their political orientation ("political character").[8]

Consequently, the Bank has based its action on purely economic factors, without considering human rights and political issues.[9]

Over the years the Bank finalities slowly changed: with the advancement of the economic, political and social agenda of the international community, the Bank became the leading international organization in supporting development and poverty eradication.

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[5]On this topic, see briefly Palacio (2006) and Gianviti (2005).

[6]For the purposes of this paper, RDBs include African Development Bank (AfDB, www.afdb.org), Asian Development Bank (AsDB, www.adb.org), European Bank for Reconstruction and Development (EBRD, www.ebrd.com), Inter-American Development Bank (IADB, www.iadb.org).

[7]See IBRD, Articles of Agreement, art 1.

[8]This rule states that lending decisions must then be taken only on the basis of considerations of an economic character, evaluated impartially and in view of the statutory objectives, so as to avoid discrimination between Members except the ones relating to their different economic conditions. In a complementary manner, in accordance with Art. III, Sec 5(b), the IBRD has to ensure that its loans are used to achieve the purposes for which they were granted, paying attention, again, to "considerations of economy and efficiency" and neglecting factors of a different nature ("political or other non-economic influences or considerations").

[9]Coultier et al. (2009).

In this context, the studies and opinions embraced by General Counsels Shihata[10] e Dañino[11] marked a clear evolution from the pre-existing legal mandate of the Bank, allowing actions in relation to human rights protection and recognizing its role of facilitator in "helping [its] Members realize their human rights obligations".[12]

In its practice, the Bank began to adhere to the modern notion of development as enshrined in several international instruments[13] and expanded its goals through a reinterpretation of its Statute and by the implementation of new actions. This new perspective inspired different initiatives, such as the adoption of the 1999 Comprehensive Development Framework,[14] which proposes a different approach to its activities by the Bank, combining human, social, environmental and structural elements with economic and financial data. This new methodology justified also the Bank's pivotal role in the implementation of the Millennium Development Goals (MDGs) adopted by the UN General Assembly with the Millennium Declaration[15]: this commitment is currently renewed by supporting the post-2015 development agenda and the Sustainable Development Goals (SDGs),[16] which replaced the expiring MDGs.

In any case, the Bank *de facto* developed in a progressive way its mandate and its scope to include new areas such as environmental protection, sustainable development, good governance, democracy and rule of law, cultural development, post-conflict reconstruction, programs to combat corruption and, of course, protection of fundamental human rights and liberties. These issues have become an integral part of the Bank's strategy against poverty and underdevelopment.[17]

[10]Shihata (1995, 2000a).

[11]Dañino (2006a, b), pp. 295–324, affirming that "The Articles of Agreement permit, and in some cases require, the Bank to recognize the human rights dimensions of its development policies and activities since it is now evident that human rights are an intrinsic part of the Bank's mission".

[12]Palacio (2006).

[13]See World Conference on Human Rights, Vienna Declaration and Programme of Action, 25 June 1993, http://www.ohchr.org/EN/ProfessionalInterest/Pages/Vienna.aspx (accessed 1 February 2016), para 10, and the World Conference against Racism, Racial Discrimination, Xenophobia and Related Intolerance, Durban Declaration and Programme of Action, adopted in September 2001, http://www.un.org/en/durbanreview2009/pdf/DDPA_full_text.pdf (accessed 25 January 2016), para 19.

[14]Wolfenshon (1999).

[15]See UN doc. A/RES/55/2, United Nations Millennium Declaration, 18 September 2000.

[16]The 17 SDGs are listed in UN doc. A/RES/70/11, Transforming Our World: the 2030 Agenda for Sustainable Development, 25 September 2015. Previously, in April, the World Bank (in partnership with IMF and other regional institutions) approved a discussion note which proposes a preliminary vision for the collective role of those institutions in the financing of the development agenda post-2015, see Development Committee, From Billions to Trillions: Transforming Development Finance. Post-2015 Financing for Development: Multilateral Development Finance, prepared jointly by the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the International Monetary Fund, and the World Bank Group, DC2015-0002, 2 April 2015, http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23659446/DC2015-0002(E)FinancingforDevelopment.pdf (accessed 1 February 2016).

[17]Mauro (2015), p. 260.

This process culminated in the approval of a series of operational policies and procedures (OP&Ps),[18] adopted by the Bank since the '70s, concerning specific issues of environmental and social nature with the intention of not harming people and the environment affected by its activities.[19] OP&Ps constitute binding internal rules for the Bank's staff.

Therefore, the protection of non-economic values now inspire the practice of the World Bank. This is also established by the creation of an accountability mechanism in 1993, the Inspection Panel (IP), with the mandate of monitoring if the Bank's activity complies with its policies and procedures in the elaboration, evaluation and implementation of a specific project.[20]

The most innovative aspects of the Panel is its competence *ratione personae*: requests for investigations can be presented by individuals (at least two) whose rights and interests may be adversely affected and this is imputable to an act or to an omission by the Bank not complying with its OP&Ps. Hence, on several occasions, the Panel received requests for inspection of projects that affected the rights or interests of people living in the area of the project concerned: most of these requests were linked to the environmental impact of the Bank's activities or to the forcible transfer of population or to indigenous peoples.[21]

Notwithstanding the Panel has rarely considered matters expressly related to human rights violations, its work contributed (and still does) to the protection and

[18]These rules are contained in an Operational Manual, including: Operational Policies (OPs), which set out the mandatory policy requirements for the conduct of Bank operations; and Bank Procedures (BPs), which are statements describing the general mandatory procedural requirements necessary for IBRD staff to carry out the policies explained in the OPs. Moreover, the Bank adopts also Policies (statement of broad substantive policy principles that require, permit or constrain Bank activities to achieve institutional goals), Directives (a statement normally designed to implement a Policy), Operational Memoranda (requirements not yet incorporated in the OPs/BPs) and Good Practices (GPs), as guidance for the Bank and its staff.

[19]Specifically, these OPs are denominated Safeguard Polices (SPs) and are designed to prevent unintended adverse effects on third parties and on environment. Actually, they address: OP 4.01 Environmental Assessment; OP 4.04 Natural Habitats; OP 4.09 Pest Management; OP 4.10 Indigenous Peoples; OP 4.11 Physical Cultural Resources; OP 4.12 Involuntary Resettlement; OP 4.36 Forests; OP 4.37 Safety of Dams; OP 7.50 Projects on International Waterways; OP 7.60 Projects on Disputed Territories.

[20]The Inspection Panel was created by two identical resolutions of IBRD and of the International Development Agency (IDA) on 22 September 1993 (Resolution IBRD 93-10 and Resolution IDA 93-6), which established the basic mandate and structure of the Panel. In 1996 and 1999 some clarifications were added to the resolutions, see IBRD, Review of the Resolution Establishing the Inspection Panel: Clarification of Certain Aspects, 17 October 1996, and Review of the Resolution and 1999 Clarification of the Board's Second Review of the Inspection Panel, 20 April 1999. The two resolutions and the documents containing the clarifications are available at http://ewebapps.worldbank.org/apps/ip/Pages/Panel-Mandate.aspx (accessed 1 February 2016). On the Inspection Panel, see Bradlow (1993); Shihata (2000b); Alfredsson and Ring (2001); Schlemmer-Schulte (2001), pp. 483–548; Del Vecchio (2013), pp. 53–54; Hey (2013), pp. 727–738; Mauro (2015), pp. 262–270.

[21]According to the World Bank, 105 requests were presented before the Inspection Panel: 66 requests concerned issues related to environmental impacts and biodiversity and 63 complaints regarded resettlement and transfer of population. Data available at http://ewebapps.worldbank.org/apps/ip/Style%20Library/Images/Case%20Analysis.png (accessed 1 February 2016).

promotion of human rights. Indeed, the Panel had identified circumstances in which human rights should be taken into consideration by the Bank[22] and adopted reports and recommendations to the Bank's management, aimed at creating forms of redress for affected people or to modify peculiarities of the project-financed.

Although the Panel has been strongly criticised for its limited powers,[23] it has notably contributed to widen the mandate of the World Bank, creating an internal department dedicated to ascertain the compliance of the Bank with its own rules and policies. Moreover, this allowed local people to submit claims related to their rights and interests affected by the Bank-financed projects, and created a system of due diligence that permits to assess the impact of the Bank's activities on a variety of topics of environmental and social nature.[24]

3 RDBs Accountability Mechanisms: An Overview

Inspired by the creation of the Inspection Panel, RDBs established accountability mechanisms in their institutional framework. Precisely:

- The Inter-American Development Bank created its Independent Investigation Mechanism (IIM) in 1994. In 2008, the Mechanism was enhanced, being renamed as Independent Consultation and Investigation Mechanism (ICIM, more commonly known by its Spanish acronym MICI).[25]
- In December 1995, the Asian Development Bank's Board of Directors approved the establishment of an Inspection Function (IF). In 2003, the Board replaced the Inspection Function with a new Accountability Mechanism (AM).[26]

[22]See Inspection Panel, Chad: Petroleum Development and Pipeline Project, Management of Petroleum Economy Project, and Petroleum Sector Management Capacity Building Project, 2002, Case 22, http://ewebapps.worldbank.org/apps/ip/Pages/ViewCase.aspx?CaseId=52, paras 210–217 (accessed 1 February 2016).

[23]The Panel is a body non-judicial in nature, as it lacks enforcement and restitution powers: indeed, investigations shall be authorized by the Executive Directors. Moreover, reports of the Panel are not binding for the Bank: the Board of Executive Directors may decide to follow the recommendations made by the Panel or to ignore the report.

[24]It shall be noted that, in 2012, the World Bank started a review of its environmental and social safeguard policies, including a variety of new issues, such as human rights; gender equality and non-discrimination; occupational and labour issues; safety in workplaces; forced and child labour; climate change; green-house gases emissions; hazardous materials; ecosystem and biodiversity issues; free prior and informed consent of indigenous peoples; cultural heritage. This process is divided into three phases and implies the participation of relevant stakeholders. Actually, phase three is ongoing. For an in-depth analysis, Review and Update of the World Bank Safeguard Policies: Objectives and Scope, https://consultations.worldbank.org/review-and-update-world-bank-safeguard-policies-objectives-and-scope (accessed 1 February 2016).

[25]See http://www.iadb.org/en/mici/home,1752.html (accessed 25 January 2016).

[26]See AsDB, Resolution no. 225–95, Establishment of an Inspection Function, 10 November 1995 (approved 5 December 1995), Manila, and AsDB, Review of the Inspection Function:

– The European Bank for Reconstruction and Development's Independent Recourse Mechanism (IRM) was first created in 2003. The IRM was revised in 2008 and replaced by the Project Complaint Mechanism (PCM).[27]
– The African Development Bank's Independent Review Mechanism (IRM) was created in 2006.[28]

RDBs mechanisms' operational aspects are not identical: specifically, taking apart mere procedural features, the most relevant differences concern eligibility of complainants and the functions performed. However, common characteristics can also be identified in their mandates.

3.1 Eligibility

RDBs accountability mechanisms may differ for their eligibility criteria: the main variation is whether a single individual can file a request for investigation. While in a first phase a single complaint was allowed also before IADB's MICI, nowadays only the EBRD's PCM considers request filed by a single individual or organization.[29] In other RDBs' systems, requests are considered if presented by a group of two or more persons residing or located in the country where the Bank-financed project is implemented.[30] Moreover, request may be filed also by a qualified representative of the affected persons.[31]

Establishment of a New Accountability Mechanism, 2003, http://www.adb.org/sites/default/files/institutional-document/32108/adb-accountability-mechanism.pdf (accessed 25 January 2016). For an in-depth analysis of this mechanism, see McGill (2011), pp. 191–208. For an in-depth analysis of AsDB' functioning and its policy on human rights, see Fujita (2013).

[27]See http://www.ebrd.com/work-with-us/project-finance/project-complaint-mechanism.html (accessed 25 January 2016).

[28]See http://www.afdb.org/en/about-us/organisational-structure/independent-review-mechanism-irm/ (accessed 25 January 2016).

[29]See EBRD, Project Complaint Mechanism, Rules of Procedure, as approved by the Board of Directors on 7 May 2014 (in force as 7 November 2015) paras 1–2, http://www.ebrd.com/downloads/integrity/pcmrules.pdf, (accessed 24 January 2016).

[30]The AfDB's IRM has specified some additional criteria to be fulfilled that might exclude the eligibility of the request, such as cases of corruption handled by other units of the Bank; matters under judicial or arbitral review; anonymous complaints; complaints about procurement decisions; complaints regarding human rights violations other than those involving social and economic rights alleging any actions or omissions on the part of the Bank. See IRM, Resolution B/BD/2015/03 – F/BD/2015/02, Resolution 2015, adopted by the Board of Directors 28 January 2015, http://www.afdb.org/fileadmin/uploads/afdb/Documents/Compliance-Review/Boards_Resolution_on_Establishment_of_IRM_2015.pdf (accessed 24 January 2016).

[31]According to AsDB's AM Policy, non-local representatives may file a request in exceptional circumstances. Moreover, for the compliance review phase, complaints may be filed by one or more AsDB Board Members in special cases involving allegations of serious violations of Bank's operational policies and procedures relating to an ongoing AsDB-assisted project, after having

Generally, the policies regarding the eligibility criteria demand that complainants are directly, adversely and materially affected in their rights or interests[32] by the Bank-financed project and the corresponding harm is attributable to an act or omission by the Bank which resulted in non-compliance with its own operational policies and procedures.

3.2 Functions

RDBs mechanisms are generally aimed at reviewing the compliance of acts and omissions of the Banks' staff and borrowers with all the requirements set by their respective OP&Ps. In addition, these forms of grievance might be addressed to problem-solving, focusing on the harm suffered by affected people, in order to facilitate a resolution of the issues arisen in connection with the implementation of the financed project.[33] In any case, these principal functions are not exclusive, but often performed together, as demonstrated by the practice of these mechanisms.

Nowadays, all RDBs accountability mechanisms are explicitly engaged with problem-solving during the first phase of their procedure: this is the case of the IADB's MICI, where the Consultation Phase enables the parties to address in a voluntary and collaborative manner the questions raised by the complainants. Similarly, the AsDB Consultation Project, which is led by the Special Project Facilitator (SPF), is focused on finding satisfactory solutions to the harms caused by AsDB-assisted projects with the consent and participation of all the parties concerned.[34] As it is generally provided for all RDBs, a problem-solving initiative

raised thse concerns to the Bank Management. See AsDB, Accountability Mechanism Policy 2012, http://www.adb.org/sites/default/files/institutional-document/33440/files/accountability-mechanism-policy-2012.pdf (accessed 25 January 2016) p. 28.

[32]See EBRD, *supra*, n. 29: "One or more individual(s) . . . who has or have an *economic interest, including social and cultural interests*, in an Impacted Area" (emphasis added).

[33]On the problem-solving function, see Suzuki and Nanwani (2005), pp. 220 ff.

[34]After receiving a complaint, within 21 days, the Office of the SPF determines eligibility and consults with complainants, the borrower and the operations department concerned. About 120 days after the determination of the eligibility, the SPF completes the review and the assessment of the complaint, through site visits, meetings between the parties concerned, and reporting any fact-findings to the President, to the complainants, to the borrower and to the operation department. If deemed necessary, the SPF proceeds with problem-solving, facilitating a consultative dialogue between the parties, promoting the resolution of the problem and the establishment of mediation mechanisms. Upon completion of this process, the SPF presents a report to the President and to the complainants, to the borrower, to the Compliance Review Panel and to the Board of Directors, summarizing all the facts and steps taken, and the parties' agreement, if any. The process ends with a phase of monitoring (for no longer than 2 years) of the remedial actions agreed between the parties (if any) and the submission of a final report. See AsDB, *supra*, n. 31.

might also include independent fact-finding, mediation, conciliation, dialogue facilitation, investigation or reporting.

The second function, the compliance review, is generally performed through the creation of an internal department composed of an operational office (in charge of the organization and of the management of the mechanism's activities) and of an investigation unit of independent experts, whose number varies.[35] This is the case of the AsDB, who established a Compliance Review Panel (CRP),[36] but also of the Inter-American,[37] European[38] and African systems.[39]

[35]See Bradlow (2005).

[36]The Compliance Review Panel consists of three members, specifically of a full-time chair and two part-time members. Two Panel members are from regional Member countries, with one of them from a developing Member country, and the third member from a non-regional country. According to its mandate, the CRP, after the determination of the eligibility of the complainant and upon the authorization of the Board Compliance Review Committee, conducts a compliance review consulting all the relevant parties and managing meetings, discussions and site visits: upon completion of the review, the CRP issues a draft report of its findings to the complainants, to the borrower and to AsDB Management for comments and responses, and after 45 days issues a final report to be considered by the Board of Directors. If the report concludes that AsDB's noncompliance caused direct and material harm, the Management, in 60 days, proposes remedial actions to the Board, which then issues a final decision. Generally, for no longer than 3 years, the Panel monitors the implementation of the remedial actions and prepares annual monitoring reports. See AsDB, *supra*, n. 31.

[37]The investigation is carried out by a Panel, whose members are chosen from a Roster of Experts, and the fact-findings are contained in a final report, in order to assess whether an action or omission by the Bank resulted in a failure to comply with one or more OP&Ps and harmed the Requesters. In the final report, the MICI may provide its recommendations or observations on findings that provide the general basis for an eventual decision to be taken by the Board of Directors. See IADB, Policy on the Independent Consultation and Investigation Mechanism, 14 December 2013, http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=39629936 (accessed 25 January 2016).

[38]The PCM is independent from the EBRD's banking operations and is administered by a dedicated PCM Officer who is located within the EBRD's Office of the Chief Compliance Officer (OCCO) and is responsible for the overall, day-to-day operations and external relations of the PCM. Additionally, a roster of independent experts assists the PCM Officer in the process. Their functions include the assessment, together with the PCM Officer, of the eligibility of complaints, the undertaking of Compliance Reviews or Problem-solving Initiatives and follow up monitoring. When a complaint is received and registered, the PCM Officer will appoint an independent expert from the existing roster. Together with the expert, the PCM Officer will assess the eligibility of the complaint and makes a decision on whether or not it should proceed to Compliance Review or to Problem-Solving. See EBRD, *supra*, n. 28.

[39]As with other accountability mechanisms, the African IRM provides a problem-solving function and a compliance review: the problem-solving process involves a dialogue or a mediation between the affected people, the Bank and other interested parties, while compliance review may be initiated at the conclusion of the problem-solving phase and is conducted by three IRM experts that constitute the Compliance Review Panel. The Panel acts with the support of the Compliance Review and Mediation Unit (CRMU), the organizational office that administrates the IRM. The IRM, since its creation, has received a small number of requests for consultation or investigation, all concluded through the recourse to mediation and conciliation procedures. See *supra*, n. 27.

3.3 The Social Dimension of RDBs and Accountability Mechanisms' Practice

In contrast with the institutions of the World Bank Group, RDBs expressly include the intent to finance projects with a strong social dimension in their statutory objectives, with the aim of increasing the well-being of the populations concerned, reducing poverty and improving the status of the most vulnerable, as stated in the Preamble of the Agreement establishing the EBRD ("The Contracting Parties, committed to the fundamental principle of multiparty democracy, the rule of law, respect for human rights...")[40] or by the references to the "social progress" and "social development" contained in the Agreements establishing the AfDB and the IADB.[41]

Accordingly, these institutions started to adopt or modify their OP&Ps in order to promote sustainable development and to protect human rights of the people affected by development projects, even though there is no explicit reference to specific human rights responsibilities in their statutes.

Generally, these policies require RDBs staff and borrowers to comply with a set of standards the Bank expecting to ensure in its activities, with proper peculiarities between RDBs. As an example, while IADB[42] and EBRD[43] have demonstrated greater attention in the adoption of good international practices relating to sustainable development, the AsDB has a unique and comprehensive set of policies

[40]Agreement establishing the European Bank for Reconstruction and Development, http://www.ebrd.com/news/publications/institutional-documents/basic-documents-of-the-ebrd.html%20, (accessed 1 February 2016).

[41]See the Preamble of the Agreement establishing the African Development Bank, http://www.afdb.org/fileadmin/uploads/afdb/Documents/Legal-Documents/Agreement%20Establishing%20the%20ADB%20final%202011.pdf, and the Preamble of the Agreement establishing the Inter-American Development Bank, http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=781584 (accessed 1 February 2016).

[42]The IADB has proved a strong commitment in ensuring sustainability through the adoption of specific environmental safeguard policies. Indeed, OP&Ps include strict requirements on the assessment of environmental and social risks in the financed operations and on the avoidance of negative impacts on natural habits, cultural sites, indigenous traditions, with a special focus on resettlement and consequent relocation issues. See http://www.iadb.org/en/mici/relevant-operational-policies,8166.html (accessed 1 February 2016).

[43]According to the Bank's mandate, EBRD-financed projects are expected to be designed and to operate in compliance with international standards. The Bank adopted numerous set of performance requirements (PRs) and standards in the field of social and environmental issues, which reflected the standards established at international level by several international organizations (such as labour standards established by the International Labour Organization or environmental regulation set by the European Union). It should be noted that the EBRD compliance review is limited to the provisions contained in the EBRD Environmental and Social Policy (ESP). See EBRD, Environmental and Social Policy 2014, adopted by the Board of Directors on May 7th, 2014, http://www.ebrd.com/news/publications/policies/environmental-and-social-policy-esp.html (accessed 1 February 2016), para 14.

contained in an Operations Manual, which collects Bank Policies (BPs)[44], their Operational Procedure (OPs) and a specific Safeguards Policy regarding environmental protection, involuntary resettlement and rights of the indigenous people.

RDBs accountability mechanisms have positively considered human rights and environmental issues in several claims. Indeed, recently, a growing number of requests for investigations were presented in order to safeguard biodiversity and environmental concerns in the area interested by the financed project, for example with regard to the access to water resources[45] or to the adverse effects of pollution.[46] On these issues, the European PCM has evidenced growing consideration, acting "precautionary in its approach to the protection, conservation, management and sustainable use of living natural resources",[47] highlighting the Bank's omissions and harmful actions on these topics in several cases,[48] and therefore reaffirming EBRD's strong commitment to the protection of the natural environment of the areas affected by its projects.

Increasingly, accountability mechanisms are requested to conduct investigations concerning the realization of infrastructural projects that had negative impact not only on the territory but also on human settlements, causing relocations and

[44]The Bank Policies are short and focused statements regarding different aspects of the Bank's activities, such as regional cooperation, financial partnerships, lending policies, technical assistance, projects administration. Moreover, issues such poverty reduction, gender equality, good governance, anticorruption, money laundering and financing of terrorism are also included. The Bank has also adopted a Safeguard Policy Statement, which emphasizes the role of the AsDB in assisting its Member countries in pursuing "environmentally sustainable and inclusive economic growth" and "ensuring the social and environmental sustainability of the projects it supports", see AsDB, OM Section F1/BP, Operations Manual Bank Policies, Safeguard Policy Statement, issued October 1st, 2013, http://www.adb.org/sites/default/files/institutional-document/31483/om-f1-20131001.pdf (accessed 29 January 2016), para 1.

[45]See IADB, MICI, Panama Canal Expansion Program (2011) MICI, PN-MICI002-2011 (MICI), http://www.iadb.org/en/mici/complaint-detail,1804.html?ID=PN-MICI002-2011 (accessed 29 January 2016), where seismic risks but also biodiversity and water management issues were involved, and Pando-Monte Lirio Hydroelectric Power Project (2010) MICI, PN-MICI001-2010 (MICI), http://www.iadb.org/en/mici/complaint-detail,1804.html?ID=PN-MICI001-2010 (accessed 29 January 2016). The Final Panel Report was considered by the Board of Directors in October 2012, which decided to create an action plan containing specific activities, responsibilities and deadlines to solve ecological and water quality issues.

[46]EBRD, PCM, EPS Koulabara Environmental Improvement Project (2012) PCM, Request no 2012/04 (PCM), registered 2 August 2013, http://www.ebrd.com/downloads/integrity/EPS_Kolubara__complaint_17.08.2012.pdf (accessed 1 February 2016).

[47]See EBRD, *supra*, n. 43, para 14.

[48]See the reports regarding the complaints in Paravani HPP Project [2012] PCM, Request no. 2012/010 (PCM), registered 4 January 2012; Ombla HPP Project [2011] PCM, Request no. 2011/06 (PCM), registered 24 November 2011; and Boskov Most Hydro Power Project [2011] PCM, Request no. 2011/05 (PCM), registered 14 November 2011, all available at http://www.ebrd.com/work-with-us/project-finance/project-complaint-mechanism.html (accessed 30 January 2016).

affecting indigenous peoples' rights.[49] Accordingly, the landmark case facing these concerns is considered the *Greater Mekong Subregion-Rehabilitation of the Railway in Cambodia Project*.[50] The financed project was intended to reconstruct, relocate and rehabilitate 594 km of Cambodian railways. The affected people submitted a request for the harms suffered in violation of the Cambodian Constitution and of international treaties and conventions ratified by Cambodia, such as the International Covenant on Civil and Political Rights,[51] the International Covenant on Economic Social and Cultural Rights[52] and the UN Convention on the Rights of the Child.[53] The CRP concluded that the harms alleged by the requesting part existed, recommending to the Bank's Board to consider the opportunity to create a specific compensation fund for the affected people.

In the latter and in all the aforementioned cases, RDBs accountability mechanisms dealt with issues related to human rights of the people located in the area impacted by Banks-financed projects. Compliance reviews found some of these projects to be noncompliant with OP&Ps and, therefore, in close cooperation with the Governments concerned, the Banks took remedial measures to address the issues highlighted.[54]

[49]See AfDB's IRM reports regarding the negative impacts of the construction of roads and highways on property rights of the affected people, which suffered a constraints to their access to land, water resources or social amenities, Construction of the Marrakech–Agadir Motorway, Morocco (2010) IRM, RQ2010/1 (IRM); Dakar-Diamniadio Highway Project, Senegal (2011) IRM, RQ2011/1 (IRM); Road Sector Support Project II, Tanzania (2012) IRM, RQ2012/1 (IRM), all available at http://www.afdb.org/en/about-us/organisational-structure/independent-review-mechanism-irm/requests-register (accessed 29 January 2016). See also AsDB, Accountability Mechanism, Sri Lanka: Southern Transport Development Project [2004] AM, Request no 2004/1 (AM), 2 December 2004, http://www.compliance.adb.org/dir0035p.nsf/alldocs/BDAO-7XVBSH?OpenDocument (accessed 29 January 2016).

[50]AsDB, Accountability Mechanism, Greater Mekong Subregion—Rehabilitation of the Railway in Cambodia Project (2012) AM, Request no 2012/2 (AM), 28 August 2012, http://www.compliance.adb.org/dir0035p.nsf/alldocs/RDIA-8XT5DA?OpenDocument (accessed 28 January 2016). This case was object of a supplementary complaint (request no. 2015/1) received on 7 September, 2015. Complaints were related in particular to the prohibition of forced evictions, the right to adequate housing, the right to water, the right of every child to an adequate standard of living, the right to health, and the right to an effective remedy. All these rights were recognized in the OP&Ps adopted by AsDB.

[51]International Covenant on Civil and Political Rights, 16 December 1966, UNTS, vol. 999, p. 171.

[52]International Covenant on Economic, Social and Cultural Rights, 16 December 1966, UNTS, vol. 993, p. 3.

[53]Convention on the Rights of the Child, 20 November 1989, UNTS, vol. 1577, p. 3.

[54]In RDBs practice, remedial measures include: upgrading and restoring the standard of living of resettlement sites; paying compensation; performing supplemental environmental and gender studies to minimize any risks of economic, social and environmental nature.

4 Remarks on the Weaknesses of RDBs Accountability Mechanisms

The recent practice demonstrates that RDBs are taking into consideration human rights and environmental issues in their lending activities and policies: consequently, RDBs have fixed high standards for States and private contractors, requesting the respect of social and environmental concerns in the realization of financed projects.

The most interesting trend regards RDBs accountability mechanisms, which have become effective form of grievances for the redress of harms suffered by people affected by Banks' financed projects, as showed by the growing number of requests received.

Nevertheless, these bodies appear to have limited effectiveness. Indeed, RDBs' mechanisms have a narrow mandate: they are entitled to review the consistency of the Bank's activities with its policies and procedures only on a case-by-case basis, without being enabled to evaluate the general adequacy with a specific OP&P. Hence, they are not able to assess good governance and respect of human rights obligations by a borrower State, as also stated for the IBRD Inspection Panel.[55]

The most significant limit, however, affects the independence and impartiality of RDBs accountability mechanisms: if critical issues emerge from the investigation process, the Bank's management still maintains relevant influence. Indeed, Banks' Boards or Presidents retain the power to authorize (and neglect) the conduct of an investigation and (more importantly) the right to decide on the follow-up of the recommendations issued by the mechanism. Hence, only the Executives can implement remedial actions if a violation is found, adopting proper initiatives or acting as recommended by the inspection function. This is complicated by the provisions that the Banks' management and the departments involved in the project have the right to present observations, clarifications and responses in different phases of the investigation process, whereas the complainants lack of *ius standi*, strongly reducing their participation (and limiting their rights). Additionally, no appeal procedure is established. Therefore, it is evident the non-judicial character of RDBs' accountability bodies, which do not conform to due process standards but that also lack any power of enforcement, restoration or full compensation.

Furthermore, it should be highlighted that these mechanisms are not able to review complaints raising international law issues unless these arise directly from RDBs' operational policies, which contain commitments in specialized and limited areas, for example in environmental protection: as precisely stated, RDBs have developed their own rules on specific themes that do not reflect related and accepted international human rights standards.[56] Undeniably, RDBs "choose their own definitions and standards of human rights, influenced by but rarely based

[55]See IBRD, *supra*, n. 27, para 215. On the Inspection Panel and human rights' issue, see Schlemmer-Schulte (1998).

[56]Crippa (2010).

directly on internationally agreed norms. Those choices have as much to do with what is politically acceptable within and among the participating entities than with the objective human rights needs".[57] Thus, the legal principles applicable to RDBs' operations are not neutral, but heavily influenced by the interests and objectives of the Banks in international and regional economic governance: practically, RDBs' are determining by themselves what standards apply to their operations.[58]

Another critical issue regards OP&Ps' uncertain legal value. While it is undoubted that OP&Ps are administrative and procedural rules concerning the implementation of development projects, their normative significance is still discussed, in particular if they rise to the level of international obligations of these institutions (which means that they can be used to hold RDBs responsible for their actions) or if they are mere internal norms aimed at promoting a better standards in RDBs operations and activities.[59]

In any case, the establishment of the IBRD Inspection Panel and the subsequent institution of similar mechanisms in regional contexts constitute an important innovation in the law of international organizations with regard to the issue of accountability of IFIs,[60] considering that for the first time individuals have the right to present claims against an international organization for actions that amounted to a violations of basic human rights.

The essential principle is that, as subjects of international law, international organizations are "bound by any obligations incumbent upon them under general rules of international law, under their constitutions or under international agreements to which they are parties".[61] While RDBs (but also IFIs) have not accessed to any international human rights treaty, customary human rights norms are binding upon RDBs. Compliance and inspection mechanisms are therefore means to hold

[57] See UN doc. E/CN.4/2006/97(2006), UN Special Representative of the Secretary General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, Interim Report on the Promotion and Protection of Human Rights, para 53.

[58] Recent developments with respect to RDBs' policies relating to labour rights and the rights of indigenous peoples suggest that RDBs are adopting definitions and standards recognized by international legal instruments, incorporating conventional legal obligations in their policies and agreements with public and private borrowers. See, for example, the references to specific ILO Conventions in the AfDB Operational Safeguard 5—Labour Conditions, Health and Safety, http://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/December_2013_-_AfDB%E2%80%99S_Integrated_Safeguards_System__-_Policy_Statement_and_Operational_Safeguards.pdf (accessed 1 February 2016).

[59] On the legal value of OP&Ps, see Shelton (2000) and Boisson De Chazournes (2000), pp. 281–303. Concerning the "hardening" of IFIs' OP&Ps, see Bradlow and Naudé Fourie (2011).

[60] See International Law Commission, Draft Articles on the Responsibilities of International Organizations (2011), with commentaries, adopted at 63rd session, http://legal.un.org/ilc/texts/instruments/english/commentaries/9_11_2011.pdf (accessed 2 February 2016). See also International Law Association's report at Berlin Conference 2004, Accountability of International Organizations, http://www.ila-hq.org/en/committees/index.cfm/cid/9 (accessed 2 February 2016). Specifically, on the accountability for human rights violations, Wouters et al. (2010).

[61] ICJ, Interpretation of the Agreement of 25 March 1991 between WHO and Egypt, Advisory Opinion, ICJ Reports 1980, p. 73, 20 December 1980, para 37.

international organizations accountable for any violation of human rights which they commit or contribute to.

5 Conclusions

The growing practical significance of RDBs accountability mechanisms cannot be ignored. The most recent practice shows that through these bodies thousands of people received compensation for the adverse impacts on their rights, also in early stages of the complaints procedure. This was favoured by the provision of a problem-solving initiative for the negotiation of agreed and amicable solutions between the parties, which constitutes undoubtedly one of the major innovation introduced by RDBs accountability mechanisms, Indeed, very recently, this provision inspired also the IP, that developed a new *pilot approach* with the purpose to address and resolve any issue prior to the registration of the request by the Panel, offering the possibility to consider claims for compensation in an early phase of the investigation procedure, to be concluded in 3 months.[62]

This evolution is clearly the result of the experience gained by RDBs mechanisms, which, despite strong limitations in their powers, have achieved considerable success among people affected by the Banks-financed projects.

However, it deems necessary to rethink also the structure and powers of RDBs accountability mechanisms, allowing these bodies to adopt binding decisions in case of violations of OP&Ps. This would create an effective remedy to those harmed, ensuring impartiality and independence from the managements of the organizations.

Apart from these remarks, it is unquestionable that RDBs accountability mechanisms are nowadays contributing to enforce sustainable development and to create a new system of IFIs' governance. Indeed, these bodies were set up to ensure the transparency and control of Banks' operations and their accountability towards beneficiaries of the economic assistance, in order to consolidate the objectives enshrined in international treaties and conventions or in documents adopted by international organizations. This is evidence of the recent tendency to guarantee the affirmation of human, social and environmental concerns in the pursuit of economic development in the international context and also at regional level. In conclusion, since RDBs operate in a broad range of countries and projects, the standards set out in their policies, safeguards and procedures might influence the behaviour of other subjects: as a result, they have the potential to establish "functional benchmarks that are then incorporated by other actors—private corporations and States—into their

[62]See World Bank, Inspection Panel, Piloting a new approach to support early solutions in the Inspection Panel process, 6 November 2013, http://ewebapps.worldbank.org/apps/ip/PanelMandateDocuments/PilotingNewApproach.pdf, (accessed 6 February 2016).

laws, policies, and procedures",[63] having a broader and positive impact on development.

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[63] Bradlow (2010), p. 26.

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A Waiver for Europe? CETA's Trade in Services, and Investment Protection Provisions and Their Legal-Political Implications on Regulatory Competence

Amalie Gjødesen Thystrup and Güneş Ünüvar

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Abstract The Comprehensive Economic and Trade Agreement (CETA) is a bilateral agreement between Canada and the EU that aims at providing a broad set of incentives in order to promote trade and business, and bears important legal and political consequences for trade and foreign investment policies of the parties. This paper aims at exploring CETA's trade in services and investment provisions on fair and equitable treatment and indirect expropriation. In the section on cross border services, the paper discusses the scheduling modality and the adjustments introduced, with a view to the parties' regulatory competencies. In the section on investment provisions, it delves further into whether or not it bears the potential

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to live up to parties' promises of further clarity, coherence, addressing public expectations relating to unhindered sovereign regulatory authority.

1 Introduction

The Comprehensive Economic and Trade Agreement (CETA)[1] is an ambitious trade and investment deal between Canada and the EU, aiming to "increase bilateral trade and investments flows and contribute to growth in times of economic uncertainty".[2] The negotiations had lasted 5 years between 2009 and 2014. On 29 February 2016 the legal review of CETA was completed, and the same day the parties released the final text of the treaty. In their joint statement, the European Commissioner for Trade and Canada's Minister of International Trade declared that

> Once finalized, we will focus on the swift ratification of CETA so that individuals and businesses, both large and small, are able to benefit from the opportunities offered by this gold-standard agreement. We are confident that CETA will be signed in 2016 and will enter into force in 2017.[3]

Both Canada and the EU attest great importance to CETA. As is repeatedly reflected by the parties during negotiations, protection of foreign investors is tantamount and adjacent to free trade. In a broader perspective and despite the parties' systemic efforts to highlight the socio-economic appeal of the deal, it has been criticised along with its contemporaries such as the TTIP[4] and the TPP.[5] One prominent criticism was that the impending clash between the economic goals pursued through mega-regional agreements like CETA, namely more trade, and an elaborate, articulated framework for foreign investment, might come at the expense of regulatory authority in the public interest. Another characteristic is their widespread publicity, with TTIP being called "an inherent assault on

[1] See, Comprehensive Economic Trade Agreement EU-Canada (CETA), final text, published on 29 February 2016, http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf (accessed 29 February 2016).

[2] European Commission, Country Report on Canada http://ec.europa.eu/trade/policy/countries-and-regions/countries/canada/ (accessed 6 February 2016).

[3] EU Commission, Joint Statement http://europa.eu/rapid/press-release_STATEMENT-16-446_en.htm (accessed 29 February 2016). An earlier draft, dated September 2014, is also publicly available.

[4] Transatlantic Trade and Investment Partnership between the United States of America and the European Union. The EU negotiation text on investment available via the European Commission, TTIP Negotiation text, http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf (accessed 6 February 2016).

[5] Trans-Pacific Partnership. Among its signatories are Canada, the US, Australia, New Zealand and Japan. Full text available via the Office of the United States Trade Representative website https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text (accessed 6 February 2016).

democracy" due to its "introduction" of investment arbitration.[6] During its negotiations and following its completion, CETA also has attracted significant attention with regard to its legal-political implications.[7]

As stated by the European Commission, an open and fair international trading system is one of the foundations of Europe's competitiveness.[8] According to the Canadian Government, CETA is by far Canada's most ambitious trade initiative, broader in scope and deeper in ambition than the North American Free Trade Agreement (NAFTA), seeking to open new markets to Canadian exporters throughout the EU.[9] CETA will support trans-Atlantic bilateral trade between Canada and the EU by opening new markets for the benefit of the parties and by providing for deeper provisions "behind the border" on important issues such as regulatory cooperation while maintaining a harmonized domestic regulatory structure.

CETA's provisions on the promotion and protection of foreign investments are considered to provide for a stronger investment protection mechanism than previous EU Member States' bilateral investment treaties (BITs). The Commission is confident that "the EU has introduced strong additional guarantees to make sure that the investment protection provisions fully preserve the right of governments to regulate, implement public policy objectives and avoid any abuse of these rules".[10] With the latest legal review, the parties have also agreed on an investment court and appeal mechanism.[11] The core question of this paper is therefore, whether the economic goals pursued through CETA conflict with the objective of retaining regulatory competencies. In answering this question, it discusses certain key services trade and investment provisions.

The first section will focus on CETA's trade in services regime. This is important for understanding the legal-political implications of CETA because liberalisation of trade in services is subject to both Canadian and European sensitivities, and is of great potential for economic gain in accessing new markets and increasing trade given the size of the services sector as a proportion of GDP in both jurisdictions.[12]

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[6]Williams (2015).

[7]For a recent example, see Canada moves a step closer to ratifying "gold-plated" trade deal with EU, CBS News, 29 February 2016, http://www.cbc.ca/news/politics/canada-europe-trade-deal-amended-1.3468802 (accessed 1 March 2016); Mas (2016) and for an earlier example, see The Canada–EU trade deal: Atlantic accord, The Economist, 26 October 2013, http://www.economist.com/news/americas/21588418-landmark-agreement-could-show-way-future-deals-atlantic-accord (accessed 6 February 2016); Wagstyl (2014).

[8]European Commission, Accessing Markets http://ec.europa.eu/trade/policy/accessing-markets (accessed 12 March 2015).

[9]Government of Canada, CETA http://international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/understanding-comprendre/overview-apercu.aspx?lang=eng (accessed 12 March 2015).

[10]European Commission Memorandum (2014) http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf (accessed 6 February 2016).

[11]CETA, *supra*, n. 1, arts 8.23–8.45.

[12]Ibid.

Examples of often-traded services between both parties include travel, financial services, communication, and transportation services. In focusing on CETA's chapter on Cross-Border Trade in Services, the section builds on the strong bond between services and investment as frontiers of international trade, in a Trans-Atlantic context and globally. The second section addresses CETA's investment regime, and analyses two of its core protection principles (arts 8.10 and 8.12 concerning the Fair and Equitable Treatment (FET) and expropriation respectively) compared to the parties' previous investment treaties. The paper discusses the FET and Expropriation clauses specifically due to their non-contingent nature, or so-called "objective" interpretation, as opposed to contingent protection provisions such as the Most-Favoured Nation (MFN) and National Treatment (NT). It is their vague nature and consequential divergent interpretation in arbitral awards that lead to their consideration as the most controversial principles in the investment arbitration practice.[13]

2 Cross-Border Trade in Services Under CETA

With CETA, the EU and Canada are establishing a free trade area consistent with art XXIV of the General Agreement on Tariffs and Trade (GATT) 1994 and art V of the General Agreement on Trade in Services (GATS).[14] The impasse at the World Trade Organisation (WTO) in advancing the Doha Round of multilateral trade negotiations has resulted in many WTO Members negotiating bilateral and regional trade agreements.[15] Along with the TPP, signed on 4 February 2016, and the TTIP being negotiated between the USA and the EU, CETA is such an example of this shift. Operating on a large scale across the Atlantic, CETA may even be regarded as a pre-cursor for the TTIP. As opposed to traditional FTAs and Preferential Trade Agreements (PTAs), this development sees mega-regional agreements come to life, shaping economic growth within these sub-sets of participants in world-trade and the narrative in world trade at large. Another characteristic of recent developments in trade negotiations is the rise in so-called "deep" FTAs. This group of FTAs count the EU-Singapore Free Trade Agreement and CETA as prominent examples. Ongoing trade negotiations pursuing the "deep" FTA approach include TTIP, the Trade in Services Agreement (TiSA), and the Regional Comprehensive Economic Partnership (RCEP) between the ten Member States of the Association of Southeast Asian Nations (ASEAN) and the six States with which ASEAN has existing FTAs.

CETA is an ambitious undertaking that combines regulatory aspects of trade like regulatory cooperation with a comprehensive scope covering trade in all major

[13]Dolzer and Schreuer (2012).

[14]CETA, *supra*, n. 1, art 1.4.

[15]On new markets for trade in services in a bilateral and multilateral context, see Marchetti and Roy (2008).

areas.[16] The 2008 joint study carried out by Canada and the European Commission that supported the launch of negotiations found that "[parties] can expect to gain from a closer bilateral trade relationship".[17] The stakes are high—the Canadian market holds 34 million consumers, while the size of the EU market is almost 500 million consumers.[18] The Commission attributes great economic significance to CETA stating that, "[o]nce implemented, the agreement is expected to increase two-way bilateral trade in goods and services by 23 % or €26 billion, fostering growth and employment on both sides of the Atlantic".[19]

2.1 Services; Modalities

With services being important for EU-Canadian trade and with services attracting more attention in general, with TiSA as case on point, CETA had to deliver on this issue. It has been said that the services chapters of CETA form "the most sophisticated packages ever negotiated by the EU and Canada".[20] Complimenting or extending the central chapter 9 on Cross-Border Trade in Services, CETA's services regime consists of chapters on temporary entry of workers, mutual recognition of professional qualifications, domestic regulation, chapters on specific service sectors (including financial services and maritime transport), regulatory cooperation, and domestic transparency as well as the chapter on investment.[21]

GATS applies to measures by Members affecting trade in services, and for purpose of GATS, art I.2, defines trade in services as the supply of a service

[16]For an (EU) overview see European Commission, CETA—Summary of the final negotiating results http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf (accessed on 26 February 2016); European Commission (DG Trade), Public Procurement http://ec.europa.eu/trade/policy/accessing-markets/public-procurement/ (accessed on 14 February 2016); European Commission Country Report on Canada *supra*, n 2.

[17]European Commission and Government of Canada (2008), Joint Study, Assessing the Costs and Benefits of a Closer EU Canada Economic Partnership, http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141032.pdf (accessed on 14 February 2016). Also see European Commission Country Report on Canada.

[18]Chaitoo (2012), p. 2.

[19]European Commission Country Report on Canada *supra*, n. 2. Also, Europe is the world's largest exporter of manufactured goods and services, and is at the same time the biggest export market for around 80 countries, according to the Commission, see the European Commission, EU's Position in World Trade http://ec.europa.eu/trade/policy/eu-position-in-world-trade/ (accessed on 18 March 2015).

[20]Sauvé (2015), p. 2.

[21]Also see Sauvé (2015), p. 3. Except for briefly touching on the chapter on temporary entry of workers, these CETA chapters, their interconnectedness, and their wider implications on services are beyond the scope of this section. See Hoekman (2015) for a recent contribution on one of the main innovations in CETA (its framework for regulatory cooperation, including CETA's Regulatory Cooperation Forum), extending this discussion to the rise of global value chains.

(a) from the territory of one Member into the territory of any other Member (mode 1); (b) in the territory of one Member to the service consumer of any other Member (mode 2); (c) by a service supplier of one Member, through commercial presence in the territory of any other Member (mode 3); (d) by a service supplier of one member, through presence of natural persons of a Member in the territory of any other Member (mode 4).[22] GATS-like PTAs adopt these modalities and deal with them in separate chapters. However, a NAFTA-type PTA will typically deal with modes 1, 2, and 4 in a chapter on cross-border trade in services while disciplines relating to mode 3 form part of a chapter on investment.[23]

CETA's services regime builds on the NAFTA model for scheduling modalities in providing that the chapter on cross-border trade in services applies to "measures adopted or maintained by a Party affecting cross-border trade in services by service suppliers of the other Party …". In conjunction with the definition of cross-border supply of services as "the supply of a service (a) from the territory of a Party into the territory of the other Party; or (b) in the territory of a Party to the service consumer of the other party", excluding "the supply of a service in the territory of a Party by a person or an enterprise of the other Party", it is clear that the chapter covers mode 1 and 2, but not mode 4.[24] Thus, CETA differs from the NAFTA model for cross border services supply by dealing with mode 4 issues in separate rules on temporary entry and stay of natural persons for business purposes, or so-called "fitting rules", in chapter 10.

This chapter supports trade in goods and services regimes by facilitating a strong mode 4 component. The chapter provides for so-called "fitting rules", allowing for installers, repair/maintenance personnel, and other such persons possessing specialised knowledge to supply services based on services contracts incidental to the sale or lease of equipment and machinery without requiring the issuing of work permits issued by or prior approvals from the party where the fitting will take place, if the workers' stay is for a limited period.[25] While on the outset CETA's modalities resembles NAFTA-like agreements, CETA did adjust this model somewhat to the parties' own needs, and CETA's fitting rules exemplify this.

2.2 Market Access, National Treatment, and MFN

Unlike NAFTA itself, the new generation of NAFTA-like agreements include a provision on market access, as does CETA's chapter 9 on cross-border trade in services in art 9.6. Neither Canada nor the EU may adopt or maintain, either on the basis of its entire territory or on the basis of the territory of any level of government,

[22]GATS, art I:1.

[23]Roy et al. (2007), p. 158.

[24]CETA, *supra*, n. 1, art 9.2 and art 9.1.

[25]CETA, *supra*, n. 1, chapter 12, art 9.

measures that impose limitations on market access.[26] Canada's NAFTA-based FTAs negotiated since the NAFTA include a GATS market access policy space reservation that allows Canada to reserve the right to adopt or maintain any measure that is not inconsistent with Canada's obligations under art XVI of the GATS. However, Canada did not include this in CETA.

The National Treatment (NT) obligation stipulates how each party shall accord to service suppliers and services of the other party treatment no less favourable than that it accords, "in like situations", to its own service suppliers and services.[27] The wording is different from the GATS provision[28] which provides that in the sectors inscribed in its schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to "its own like services and service suppliers". However, CETA's cross border services regime's NT is also different from NAFTA's NT obligation[29] which compares to treatment accorded "in like circumstances" to the party's own service suppliers.[30] As the comparator is different, the wording of CETA's NT seems like a compromise on the substance of the obligation between the GATS and the NAFTA, though closer to the NAFTA language. This resonates with the substance of the MFN obligation, too. The MFN provides that each party shall accord to service suppliers and services of the other party treatment no less favourable than that it accords, "in like situations", to service suppliers and services of a non-party.[31] In contrast, the GATS art II on MFN is framed with the words "its own like services and service suppliers" while NAFTA's MFN compares to treatment accorded "in like circumstances".[32]

It has been argued that if the substance of the obligations is the same, the difference in forms between NAFTA-like agreements and GATS-like agreements with regard to scope and modalities carries no significance.[33] Indeed, CETA shows how the modality of a FTA/PTA does not itself determine the quality or the commitments made by its parties. Here, CETA encapsulates negotiations changing the language as a manifestation of the political will to reach agreement suggesting its legal-political implications. Beyond this, often the modality does matter for transparency in the commitments made and for future-proofing commitments.

[26] Ibid., art 9.6.

[27] Ibid., art 9.3.

[28] GATS, art XVII.

[29] NAFTA, art 1202.

[30] Roy et al. (2007), p. 158.

[31] CETA, *supra*, n. 1, art 9.5.

[32] NAFTA, art 1203.

[33] Roy et al. (2007), p. 158.

2.3 Clarifications

Characteristic for CETA, the cross border services NT obligation is followed by a second paragraph stipulating what this means in the context of Canada's governance levels and with EU Member States. Likewise, the MFN provision is followed by stipulations outlining what this means, "for greater certainty". Additionally, the NT obligation is followed by a clarification in Annex 9-A outlining what Canada and the EU understand by NT with respect to the Cross-Border Provision of Services, with reference to Canada's Internal Trade Agreements. The parties agree that treatment no less favourable than the most favourable treatment accorded, in like situations, by that government to its own service suppliers and services, does not extend to more favourable treatment accorded to service suppliers from other EU Member States. As for Canada, the same is applicable for any other governing level of Canada where such more favourable treatment is accorded pursuant to specific mutual rights and obligations applicable between these governments. This clarification carves-out EU and Canadian sensitivities from the scope of the NT. CETA also provides for clarification on new services not classified in the CPC, 1991, relating to CETA's chapter on domestic regulation and the Cross-Border Trade in Services provisions on NT, MFN, and Market Access, in Annex 9-B.[34] In CETA's cross border services regime, clarifications contribute to ensuring regulatory competencies in areas parties are sensitive to and in new services sectors while also mitigating potential ambiguity over the scope of obligations.

2.4 Scheduling Approach and Reservations

NAFTA and GATS encompass two different approaches to liberalization and so the chosen approach is a key element in distinguishing services FTAs as either GATS-like or NAFTA-like.[35] GATS is based on the concept of progressive liberalization and characterized by a positive listing of commitments in scheduling approach, in that Members take commitments "bottom-up" in sectors listed. However, CETA negotiators applied the top-down scheduling approach associated with NAFTA. These FTAs build on a negative-list scheduling modality whereby everything within the scope is liberalised, unless the parties have indicated otherwise in lists of reservations in the form of annexes. Typically, parties to a NAFTA-like agreement will have an Annex 1 for existing non-conforming measures that are subject to a standstill, whereby they freeze the legislative and regulatory *status quo* and a ratchet clause which captures autonomous liberalisation for the future. These mechanisms help future-proof the results and provide certainty. In addition to the Annex I, NAFTA-like agreements will typically have an Annex II for future

[34]CPC (1991), Annex 10.

[35]For this paragraph see Roy et al. (2007), p. 158; Adlung and Mamdouh (2014).

non-conforming measures where the parties require wide policy flexibility for present and future measures.[36] Canada and the EU are allowed to derogate from the liberalisation disciplines or special provisions to be made when specifically listing the reservations made in the schedules in the additional two annexes accompanying CETA.[37]

In CETA's cross border services regime, art 9.7 on reservations stipulate how NT, MFN, and Market Access do not apply to what the parties have set out in their schedules to Annex I, and here the parties list all the existing non-conforming measures and restrictions that Canada and the EU maintain, which cannot be made more restrictive.[38] Like other top-down FTAs adopting the North American model, in Annex I CETA's services regime includes a stand-still clause to bind the legislative and regulatory *status quo* in specific sectors upon accession to the agreement. It also employs a ratchet clause to bind subsequent easing or removal of regulatory restrictions. Article 9.7(2) provides that the liberalization disciplines do not apply to measures that a party adopts or maintains with respect to sectors, subsectors or activities,[39] i.e. future non-conforming measures that Canada and the EU want to maintain, as set out in its schedule to Annex II listing reservations on the right to adopt different, even more restrictive measures in the future, even if said measures are increasingly restrictive. This annex includes those sectors where the parties maintain even greater policy sensitivity than those listed in Annex I.

With CETA, the EU has for the first time abandoned its own bottom-up GATS-like European model for the North American model. However, the NAFTA-like scheduling approach is known for providing a high degree of transparency.[40] In CETA, the Commission itself makes a strong case for the transparency that the NAFTA-like scheduling approach provides for when arguing that "[t]he clear and comprehensive listing of the reservations provides unprecedented transparency on existing measures, in particular on provincial level".[41] Beyond this, the stand-still and ratchet clauses embodied in CETA and typical for NAFTA-like agreements future-proof the negotiated results. Thus, in CETA's cross border services regime, the parties maintain their regulatory competencies to maintain harmonized domestic regulation of services in sensitive service sectors such as health care, public education, other social services, and culture, by listing these areas in Annex I and Annex II.[42] What matters on a substantive level are the commitments made by the parties, and where the parties make such commitments and show the political will,

[36]Roy et al. (2007) p. 158.

[37]Ibid.

[38]CETA, *supra*, n. 1, art 9.7 on reservations and arts 9.3 (NT), 9.5 (MFN) and 9.6 (Market Access).

[39]CETA, *supra*, n. 1, art 9.7(2).

[40]Roy et al. (2007), p. 158.

[41]Ibid.

[42]This resonates with the preamble which outlines how, in pursuing their economic policies by means of CETA, Canada and EU commit to preserving the right to regulate and their flexibility to achieve legitimate policy objectives, *supra*, n. 1, Preamble.

the different scheduling approaches are of less importance though they embody different approaches.[43] However, in CETA, the scheduling approach provides certainty in pursuing these goals, while also taking sensitivities into account with a view to the parties' regulatory competencies.

2.5 Regulatory Competencies

Maintaining regulatory competencies have been a priority for Canada and the EU that they have incorporated into a NAFTA-like agreement encapsulating the North American model but adjusting this model to their own needs, e.g. the separate chapter on mode 4. In the case of CETA's cross-border trade in services, it delivers in providing for strong market access. As for the provisions, the adjustments introduced in the wording of the NT suggests a compromise between the NAFTA and the GATS models. Further, it is noteworthy that CETA includes several clarifications, even annexing clarifications to the provisions that discipline cross-border services trade. When listing reservations to their obligations in the two annexes "top down", Canada and EU pursue their economic interests, and lock-in existing and future liberalisation while maintaining their regulatory competencies, taking sensitivities into account. This framework provides for transparency in the commitments made, and is the result of a number of adjustments to the parties' needs and sensitivities in committing to uphold their regulatory competencies to maintain harmonized domestic regulation of services. Thus, the economic goals pursued by the parties do not seem to conflict with the objective of retaining regulatory competencies. Though it is yet difficult to foresee the legal-political implications of CETA's services regime on Trans-Atlantic trade, the negotiated result in this mega-regional context seems balanced.

3 CETA's FET and Expropriation Provisions

During the CETA negotiations, Canada and the EU had shown remarkable efforts to highlight prescribed remedies in the treaty aimed at addressing perceived shortcomings embedded in the investment protection system. The European Commission, for instance, pointed out that the CETA would address "public concerns" by defining "clearer and more precise investment protection standards".[44]

The emphasis on clearer rules relates, *inter alia*, to the interpretation of vaguely drafted protection provisions under the CETA's investment chapter, such as FET

[43]For an analysis suggesting that the scheduling approach is less significant and boiling it down to political impetus, see Adlung and Mamdouh (2014), p. 17.

[44]European Commission, Negotiation summary *supra*, n. 16.

and expropriation. This vagueness is famously linked with alleged inconsistencies related to their interpretation and application. This lack of consistency seems to have caused perturbation for respondent host States, for it is known that FET and indirect expropriation claims have given rise to unanticipated claims against certain regulatory measures.[45] While some States attempt to clarify the content of FET, to which the CETA serves as an example; some others, such as India and Indonesia,[46] omitted FET provisions entirely from their model BITs due to this interpretative uncertainty. In line with this vagueness and a variety of State responses, critics of the system also maintain that States, wishing to avoid foreign investor claims, could refrain from regulating for the public good. This phenomenon is referred to as *regulatory chill*.[47]

While CETA is not yet in force (and therefore its precise applicatory consequences are not yet certain), it is possible to make predictions in retrospective by facilitating previous North American or European IIAs and past arbitral awards. A number of draft texts of the CETA were released (or leaked) in the course of its negotiations. They are, when examined collectively, useful in demonstrating the parties' input to final text CETA. Below sections will scrutinize the FET and expropriation clauses to determine whether they inject any clarity to their prospective interpretation and grant any level of certainty to States with regard to the legal consequences of their regulatory acts and undertakings with regard to foreign investor claims.

3.1 FET

Article 8.10 of the CETA incorporates a lengthy FET provision which elaborates on what is meant by "fair and equitable" in unprecedented specificity. The article states that "[e]ach [p]arty shall accord in its territory to covered investments of the other

[45] *Methanex Corporation v. United States of America*, NAFTA Case, UNCITRAL Rules of Arbitration, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005; for more recent arbitral disputes see *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12 (pending) and *Philip Morris Asia Limited v. Australia*, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, 17 December 2015 (case rejected due to lack of jurisdiction).

[46] See, Indian Model BIT (BIPA) http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/Indian%20Model%20Text%20BIPA.asp (accessed 6 February 2016). New Indonesian Model BIT has not been made public.

[47] UNCTAD (2010). See *Ethyl Corporation v. Canada*, NAFTA Case, UNCITRAL Rules of Arbitration, Award on Jurisdiction, 28 June 1998, as an illustration of regulatory chill within the NAFTA context. Also see, generally, Footer (2009); Beharry and Kuritzky (2015) pp. 383–429. More recently, *Bilcon et al. v. Canada*, PCA Case No. 2009-04, Award on Jurisdiction and Liability, 17 March 2015. See also Behn and Letourneau-Tremblay (2015) for a concise analysis of regulatory chill discussions concerning the Bilcon case.

[p]arty and to investors with respect to their covered investment fair and equitable treatment . . . in accordance with paragraphs 2 and 6".[48] The referenced paragraphs contain a negative list of acts that the parties deem to be in breach of FET. They include denial of justice; fundamental breach of due process; lack of transparency; manifest arbitrariness; targeted discrimination on manifestly wrongful grounds (gender, race and religious belief are given as examples to manifestly wrongful grounds); and finally, abusive treatment such as coercion, duress and harassment.[49] In addition to these elements, CETA also includes a progressive clause in its FET provision so that the FET provision, despite this list of exhaustive considerations, can capture "[a] breach of any further elements of the [FET] obligation adopted by the parties". The article also states that "specific representation[s]" made by parties to an investor to induce investment *may* be taken into account.[50] This allows the arbitral tribunal to take into account legitimate expectations of an investor, as long as these expectations have prompted the investor to make the said investment. In this line, it could be argued that a simple 'frustration' at investors' end will not suffice to invoke a legitimate expectations argument.[51]

Earlier drafts of the FET provision reveal that the parties had intended to draft a non-exhaustive set of considerations, and furthermore, Canada had attempted to add a customary international law (CIL) qualifier. Both attempts were eventually discarded.[52] In the final CETA text, the FET subsets are bound to an exhaustive list as to give arbitrators more guidance and less discretion with regard to what constitutes FET.[53]

The explicit reference to the subset is important for clarity of the content of FET. Numerous arbitral tribunals, before pinpointing the constituent elements of the FET had remarked on the relationship between the CIL rule of international minimum standard of the treatment of aliens (IMS)[54] and FET. Despite different positions on the question of whether FET is an autonomous standard (or whether it is the extension of the equally vague IMS)[55] the application does not seem to differ significantly. An early NAFTA tribunal, *Pope and Talbot Inc v. Canada*[56] ruled that art 1105 NAFTA incorporated an autonomous reading of the principle, and contended that fairness elements were *additive* to IMS rather than *inclusive;*

[48]CETA, *supra*, n. 1, art 8.10.

[49]Ibid.

[50]Ibid.

[51]A broad reading of legitimate expectations is effectively prevented. See Nyer (2015).

[52]Bernasconi-Osterwalder (2013).

[53]UNCTAD (2012).

[54]International Minimum Standard refers to a CIL rule with regard to how foreigners should be treated abroad. Root (1910), Borchard (1940), p. 445.

[55]Mann (1981).

[56]*Pope & Talbot Inc v. Canada*, NAFTA Case, UNCITRAL Rules of Arbitration, Award on the Merits of Phase 2, 10 April 2001, para 111.

implying that art 1105 included an obligation for the host State broader than that required under CIL.[57] As a result, the NAFTA parties perceived such broad reading as a threat to their domestic regulatory authority. Therefore, the Free Trade Commission (FTC) of the NAFTA released an interpretative note in 2001 which maintained that FET should not require any treatment beyond what was required under CIL.[58] Despite this seeming delimitation, neither *Pope and Talbot* tribunal, nor the FTC interpretation elaborate on the actual content of CIL in this regard.

Mondev award,[59] rendered slightly after the FTC note, acknowledged the NAFTA parties' interpretation. In its reasoning however, there are no visible applicatory divergences from *Pope and Talbot* case and it does not explicitly articulate the practical difference between a CIL reading and an autonomous interpretation of FET. On top of all, the *Mondev* award extended the list of features and emphasized on the dynamic nature of the FET principle and CIL, underlining that CIL on the issue is not limited, as had been occasionally claimed, to the *Neer* case rendered in 1920s.[60]

This dynamism, embedded within the inherent vagueness of FET and IMS, attests to the unreliability of CIL as a qualifier which allegedly sets a threshold for the FET analysis. The acceptance of such an evolutionary character also seems to have found its way into the CETA, which incorporates a possibility for the parties to further agree on other, additional acts which can be added to the provision in the future, as evident by art 8.10(3). However, this dynamism acknowledged by the parties builds upon an articulated subset, instead of an undetermined threshold.

A "list" approach may be useful to tackle the controversies linked to vague, non-contingent principles such as FET. Arbitral practice has consistently demonstrated that there exists uncertainty as to the content of the FET principle, which stems to a large extent from the absence of any tangible elaboration on the principle in any treaty up until CETA. This being said, arbitral tribunals have also produced a roughly framed and partially consistent set of considerations which seem to stem from substitutable elaborations. The oft-cited *Waste Management*[61] award, interpreting art 1105 of NAFTA on the treatment of foreign investors (which, according to its parties, was limited to the IMS), articulated what it considered to be the subset of the FET principle: the treatment should be arbitrary, grossly unfair, unjust or idiosyncratic. Discrimination, sectional and racial prejudice and lack of due process were also counted among constituent elements of what would be deemed unfair treatment. Other tribunals, interpreting varying (IMS-linked or autonomous) provisions, either articulated the same list of subset or identified comparable elements according to which the tribunal would apply the principle to

[57] Ibid., para 113.

[58] FTC Interpretation (2001).

[59] *Mondev International Ltd v. United States of America* ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002.

[60] *L. F. H. Neer and Pauline Neer (U.S.A.) v. United Mexican States* (1926). IV RIAA 60.

[61] *Waste Management, Inc. v. United Mexican States* ICSID ARB(AF)/00/3, Award, 30 April 2004.

the facts of the case. For instance, in *Saluka* award, the tribunal adopted the *Waste Management* formulation mentioned above despite the Netherlands—Czech Republic BIT being unqualified (i.e., being silent on whether FET stems from IMS).[62]

In addition to this accumulated evidence from arbitral practice, prominent scholars, most notably Vandevelde, claim that "virtually all" tribunals had reached the same legal reasoning as to what constituted FET, and counted (a) reasonableness, (b) non-discrimination, (c) consistency, (d) transparency and (e) due process as the subset of FET principle regardless of their qualification or association with the IMS. He maintains that "differences in the contexts in which the standard appears have made little difference to tribunals interpreting the standard".[63] The identified subset under the CETA seem to largely overlap with what arbitral tribunals have identified over the years. CETA's FET provision embraces arbitral experience, effectively pinpoints FET elements, and consolidates these considerations under an exhaustive list. Some claim the draft codifies CIL subset.[64] More accurately, it distances itself from the largely hollow and unsubstantial FET–IMS discussion which plays little or no substantive role in the application of the principle to the facts of a case.[65]

3.2 (Indirect) Expropriation

Indirect expropriation requires a higher threshold than FET: the investment needs to be rendered worthless or completely destroyed; or alternatively, the investor should lose control of her investment through an arbitrary State act.[66] In practice, most cases that do not qualify as indirect expropriation may still qualify under the FET provision,[67] as the latter does not necessarily require the total destruction or complete loss of control of the investment.

Article 8.12[68] *by itself* is a vague, open-ended provision which excludes the definition or the limits of expropriation from the wording. The CETA provision, however, goes beyond the article itself. When read in conjunction with its Annex 8. A,[69] the influence of the North American method is visible, and it does not differ greatly from post-2000s North American practice.[70] This aside, there is a stark

[62] *Saluka Investments B.V. v. The Czech Republic,* UNICTRAL Rules, Partial Award, 17 March 2006; Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, 1991.

[63] Vandevelde (2010), p. 47.

[64] Dumberry (2015).

[65] Berman (2013).

[66] Lopez Escarcena (2014).

[67] Ibid.

[68] CETA, *supra*, n. 1, Annex 8.A.

[69] Ibid.

[70] Model US BIT (2012); Canadian Model FIPA (2004). Also see, Singapore–US FTA art 15.6 and letter exchange on expropriation; Canada–Peru FTA, art 812 and Annex 812.1; Colombia–US FTA, art 10.7 and Annex 10-B; Oman–US FTA, art 10.6 and Annex 10-B.

divergence from the European States' practice which, in contrast, had generally refrained from annexes.

The annex aims at clarifying "indirect" expropriation by delimiting its scope and carving out certain measures. It reads that indirect expropriation covers acts which "substantially deprive the investor of the fundamental attributes of property in its investment ... without formal transfer of title or outright seizure". Furthermore, "the economic impact of the measure", despite its adverse effect, will not by itself establish an indirect expropriation.[71] This view makes the application of pro-investor analysis methods such as *sole effects* doctrine[72] (which largely disregards the reasoning behind a regulatory measure as long as the investment in question is destroyed) less likely, and gives way to analyses invoking a balance with regard to the regulatory competences of the host State and the economic interests of investors. Arbitral tribunals, even in cases of expropriation provisions which do not include a clarification annex, have a growing inclination to take into account the purpose and nature of challenged regulatory acts.[73] Other important considerations are listed as the duration, the extent and the character of the measure.

The third and final sub-paragraph of the Annex reads as follows: "For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, [non-discriminatory] measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations".[74]

The paragraph explicitly carves out regulatory measures from the scope of expropriation, provided that they are to realize legitimate public purposes. Health, safety and environment are non-exhaustively listed; therefore, it is possible to extend this list in arbitral practice.

Annexing clarifications to expropriation provisions are a relatively new method in IIA drafting. They appeared after 2004, when the US and Canadian Model BITs were prepared and used in subsequent trade and investment agreements. Due to its relatively recent appearance, there are only a few such expropriation clauses that appeared in arbitral proceedings. Given the CETA provision largely resonates from North American practice and provisions already in force, examination of *pari materia* provisions and awards can shed some light on how the CETA expropriation provision may be applied to future disputes. Such awards demonstrate the streamlined expropriation analysis, as opposed to analyses conducted pursuant to provisions without annexes.

A CAFTA-DR[75] dispute, *RDF v. Guatemala*[76] is the first case available to the authors' knowledge which stemmed from such annexed expropriation provision.

[71]CETA, *supra*, n. 1, Annex 8.A.

[72]Its application is "quite infrequent" according to some scholars. Brower and Blanchard (2014), p. 729; also see Kriebaum (2007).

[73]Brower and Blanchard (2014), p. 730.

[74]CETA, *supra*, n. 1, Annex 8.A.

[75]Central America–Dominican Republic Free Trade Agreement (CAFTA-DR).

[76]*Railroad Development Corporation v. Guatemala*, ICSID Case No. ARB/07/23, 29 June 2012.

The tribunal examines challenged acts with regard to the annex, excluding arguments whether the purpose of the government act is relevant *vis-à-vis* its effects: "[The tribunal] will . . . proceed to analyse the nature of the [act], its public purpose, whether the Government interfered with reasonable investment backed expectations and their economic impact on Claimant's investment". The significance of the award is the visibly streamlined expropriation analysis.

Second example is *Al Tamimi v. Oman*.[77] While the tribunal found no expropriation, it briefly referred to several elements of the Annex 10-B of the US–Oman FTA,[78] and skipped discussions as to how legitimate regulatory acts for public goods relate to the fact that an investment may be expropriated. The tribunal asserted that "[A claim] for indirect expropriation based on the Respondent's actions . . . would also have to confront the express stipulation in Annex 10-B.4 (b) of the US–Oman FTA that non-discriminatory regulatory actions by a State designed and applied to protect legitimate public welfare objectives . . . do not constitute indirect expropriations".[79]

In the light of these cases, CETA's expropriation clause will likely streamline the expropriation analysis and largely discard arguments on the subset of indirect expropriation. This being said, it does not guarantee coherence, as the treaty language retains a high number of subjective criteria for the arbitrators to shape based on the facts of the case. Although the provision clearly reflects the importance of regulatory competences of its signatory parties (including the EU Member States as well as the EU itself), it does not guarantee the exclusion of all regulatory measures from its scope: the criteria of the legitimacy of public purposes are not clear, and the general mention of the object, context and intent of the regulation as a part of the analysis do not prescribe in what manner these considerations shall be taken into account. This very junction is arguably where the delimitation ends and arbitral discretion begins.

4 Conclusions

In CETA, Canada and EU have agreed to a NAFTA-like agreement that delivers on strong market access while introducing adjustments to the North American model. This was found in the cross-border services regime's modalities and obligations. Further, the cross border services regime quite interestingly adopts several clarifications, even annexing clarifications on the substance of the obligations and the commitments. In this framework, the economic goals pursued by the parties do not seem to conflict with the objective of retaining regulatory competencies because of

[77] *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, ICSID Case No. ARB/11/33, Award, 3 November 2015.

[78] US–Oman FTA.

[79] *Railroad Development*, *supra*, n. 75, para 368.

the adjustments introduced to the framework ensuring new market access while building-in the parties' regulatory sensitivities by means of reservations and clarifications. The negotiated result seems balanced and though it is yet difficult to foresee the legal-political and economic implications of CETA's services regime, the new market access and the transparency regarding commitments made seems encouraging for a closer bilateral trade relationship in services. Having abandoned the European model, still, the EU would be advised to tread carefully, especially in the TTIP negotiations, as the USA will accept no less than what Canada secured under CETA.

The picture does not seem disappointing for investment protection provisions either. As far as (indirect) expropriation is concerned, CETA's promise of "better" protection will probably remain highly hypothetical from a North American perspective, given similar provisions have already been put in place in a number of North American FTAs currently in force. However, on the other side of the Atlantic, the implications are noteworthy. With one of its first FTAs to include an investment protection chapter, the EU has opted in for a more streamlined expropriation analysis as to what constitutes indirect expropriation, and how regulatory measures and takings interact with the public good.

FET provision includes a fairly new approach to the drafting of this clause. By incorporating an exhaustive yet expandable list of elements to be taken into account while determining a possible breach, it can be said that the CETA parties have, to a certain extent, ensured that arbitrators do not employ excessive interpretative discretion. Overall, both provisions entail a streamlined, clear analysis to be facilitated by arbitral tribunals.

Whether or not the policy shift in the EU towards the North American model, with adjustments and clarifications, will result in increased trade, investment and arbitral coherence across the Atlantic is yet to be seen. In effect, there are as many political implications in CETA's trade in services and investment provisions as there are legal consequences. In short, there seems to be a regional policy spill-over from North America to Europe towards further regulatory protection, and caution with regard to clear interpretation and consistent application of investor protection principles.

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The Human Right to Health: Reflecting on the Implications of IPRs as Endorsed by the Trans-Pacific Partnership Agreement

Sunita Tripathy

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Abstract With the aim of technology innovation, transfer and capacity building, the World Trade Organisation established a new regime for harmonizing the laws related to intellectual property which included certain flexibilities in the nature of compulsory licensing and parallel imports. At the same time a progressive concept of development which includes a mandate for Member countries to adopt a "right to health" within the economic, social and cultural rights framework emerged. The Agreement on Trade Related Aspects of Intellectual Property Rights required Member States to include relevant amendments to the existing laws within its policy space to ensure adherence to the minimum agreed criteria of intellectual property protection. The Trans-Pacific Partnership (TPP) agreement seems to be shifting this regime towards extreme privatization of R&D and stronger protection of intellectual property rights. The author analyses the implications of the TPP while focusing on chapters pertaining to intellectual property and reflects on the right to health as a human right in such context. It is argued that stringent intellectual property protection in the TPP will disadvantage trade, economic development and patient welfare objectives. The TPP should be revised to include

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suggestive changes for consensus building and dispute resolution that can aid in developing modern international economic law and practice.

1 Introduction

A study on the trends in compulsory licensing of pharmaceuticals since the inception of the World Trade Organisation (WTO) Agreement on Trade Related aspects of Intellectual Property Rights (TRIPs) explains that 24 verified compulsory licenses in 17 nations have been reported until 2012.[1] These include licenses granted to incentivize control of the communicable diseases caused due to Anthrax by High Income Countries (Canada and United States of America). The flexibilities accorded within TRIPs have evidently not only benefitted Low and Middle Income Countries (LMICs) but also advantaged High Income Countries. This clearly identifies access to healthcare as a global problem awaiting effective resolution.[2] In the Indian context specifically, the National Health Policy 2015 aims at achieving universal health coverage since over 63 million persons are faced with poverty due to healthcare costs alone.[3] Even the post-TRIPs judicial decisions of *Bayer v. Natco*[4] leading to the issuance of the first compulsory license in favour of a generic company, as well as that of *Novartis v. Union of India*[5] where the application for a mere improvement in an already patented drug was struck down as a non-patentable invention by the Supreme Court, are indicative of India experiencing high healthcare costs. As a prime exporter of generic versions of branded pharmaceuticals in several countries, India's exclusion from the seven yearlong trade negotiations of the Trans-Pacific Partnership agreement[6] can have serious

[1]Beall and Kuhn (2012), p. 9. The study specifically describes the classification of compulsory license episodes by outcome, disease and national income groups. Panel C which is devoted to income groups explains that High Income Countries (HICs) allowed 3 compulsory licenses, Upper Middle Income Countries (UMICs) allowed for 13, Low Income Countries (LICs) allowed for 5 while the Least Developed Countries (LDCs) allowed only 3 such compulsory licenses during the same period of time.

[2]Correa (2011), p. 12. See also UNAIDS, UNDP and WHO (2011). For report discussing dire consequences of unpaid medical bills in US, see Hamel et al (2016).

[3]The National Health Policy 2015 draft (2015) para 2.10; see also Planning Commission of India High Level Expert Group on Universal Health Coverage for India Report (2011).

[4]Intellectual Property Appellate Board, Chennai (IPAB), *Bayer v Natco*, 14 September 2012.

[5]Supreme Court of India, *Novartis v Union of India* 1 April 2013, AIR 2013 SC 1311. As also the decision in *Roche v. Cipla* (Delhi High Court, *Roche v. Cipla*, 19 March 2008, I.A 642/2008 IN CS (OS) 89/2008) upholding the generic manufacturer's public interest defence of having served patient needs by ensuring that affordable versions of the patented drug are available as a ground for not awarding any interim injunction but only account for profits so made to compute damages.

[6]The Trans-Pacific Partnership Agreement is part of a triad of free trade agreements led by US. The triad comprises of the Trans-Pacific Partnership Agreement (TPP), Transatlantic Trade and Investment Partnership Agreement (TTIP) and Trade in Services Agreement (TiSA).

implications for healthcare related expenditure worldwide. The agreement which grew from secret negotiations amongst an initial four countries to eventually include a dozen Pacific Rim nations[7] was joined by the US in 2008 and Japan in early 2013, to have now grown to encompass nearly 40 % of the global GDP thereby presenting a tremendous opportunity to effectuate medical progress and health related innovation at the global level by foreign direct investment.[8] Described as a "new generation agreement for the 21st century" seeking to expand trade agendas from traditional tariff regulations to increased protection and enforcement of intellectual property across signatory countries, the TPP will in all likelihood impact the law and policy related to the production and distribution of medicines and the overall market pertaining to health services worldwide.[9] It is the author's contention that the provisions pertaining to enhanced protection and enforcement of intellectual property rights (IPRs) in the agreement in their current form will aggravate healthcare cost-related concerns not only in countries such as India, but also Canada and US.

The chapters pertaining to "intellectual property" and "investment" in the TPP have overlapping implications for public health. Arguably, public goods such as healthcare and commodities such as textiles are treated under same measurable standards and need analysis.[10] This paper traverses these provisions as available in the US country proposal and the final text of TPP, to especially outline its influence on the access and availability of medicines in countries which are consumers of live-saving drugs and those that are manufacturers and exporters of generic versions and biosimilars.

For the sake of brevity, this paper is structured into three parts: the first part contextualizes the "right to health" as a human right in the international discourse to

[7]This paper limits its scope to discussing relevant provisions in the TPP only, mainly because access to the other two agreements were not made available to any other save the multinational firms for review, scrutiny or critical comments. They will be traversed as future work by this author.

[8]The negotiations include 12 States of the Asia Pacific region, including Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam, with South Korea considering its incorporation. See TPP Full text as available on USTR.

[9]For references, see Rajagopal (2015). According to Kajal Bhardwaj of India's Lawyer Collective, other negotiations such as the Regional Comprehensive Economic Partnership which involves India and 16 ASEAN countries are also likely to be impacted by the TPP.

[10]See Oxfam Briefing Paper (2011). This Author finds it unsuitable for the US to rely on World Bank's income classification to judge a country's capacity to afford costly medicines; for two specific reasons. Firstly, it is an old classification drawn in 1980s and secondly, it only deals with a country's per-capita average of total income. In the last three decades the poverty map has changed considerably and world's poor people no longer live in poor countries, but rather in rich countries with high inequalities. The US social health programme (Medicaid) defines poverty line at $21.50 per person/day. The research by Doctors-without-Borders and Oxfam reveals that more than a quarter of a billion people will live below this line in eight Member countries of TPP. Accordingly, the high-income countries of TPP which have to adopt all the provisions of the agreement will have huge percentage of population living under poverty line. Following this flawed method will cause increased poverty.

harmonize economic interests and public policy imperatives of Nation States. The middle part explains the relevant provisions of TPP and reflects on the probable implications of patent extremism and standardized treatment of IPRs in the healthcare sector for countries such as India. Finally, the last part concludes the Chapter by suggesting ways that TPP could be made more accommodating and fair. It is submitted that the international norm-setting agenda be based on consensus that enhances capacity for domestic production and distribution of pharmaceuticals with cost-saving benefits.

2 The Right to Health as a Human Right

The World Intellectual Property Organisation (WIPO) has reported previously that incentivising inventions through patents has not materialised in favour of public interest in the pharmaceutical sector.[11] The TRIPs Agreement promoted by the WTO has preserved some policy space for countries to tailor intellectual property protection to their domestic policy priorities, as affirmed in the 2001 Doha Declaration on TRIPs and Public Health.[12] TRIPs which was negotiated in the 1986–1994 Uruguay Round led to the culmination of international efforts to reduce and manage IPRs for public health, through rules into the multilateral trading system for the first time. The rationale for such negotiations is implementing stricter IPR regimes in low and middle income countries (LMICs), so as to incentivize research into their disease burden. TRIPs lays down the minimum requirements for IPR protection to enable such implementation, which focuses on four broad areas: (1) how basic principles of the trading system and other international intellectual property agreements should be applied; (2) how to give adequate protection to IPRs; (3) how should Member countries enforce these IPRs adequately in their own territories; (4) how to settle disputes on intellectual property between Members of the WTO. The Members can adopt higher and extensive levels of IPR protection so long as they apply the general principles of *national treatment* and *most favoured nation* as per Articles 3 and 4 of the TRIPs Agreement and subject to relevant exceptions thereto.

[11]See specifically WHO Report (2006) "[W]hile developing countries (excluding least developed countries) with little technological and innovative capacity are bearing the cost of implementing the TRIPs Agreement, there are no documented cases of positive impact on innovation in the medical field yet". For references on previous discussion on difficulty in accessing pharmaceuticals in developing countries, see WHO (2001). See also UNDP (2010), p. 9 ("However, since the signing of the TRIPs Agreement in 1995, consumers have not witnessed a significant increase in the output of new medicines, despite the substantially higher levels of IPR protection on a global scale"). See, Economist (2015) in "Time to fix patents". Arguably, the patent system could benefit from a shortening of its term of protection depending on the nature of inventions in specific sectors of innovation.

[12]It is to be conclusively proven whether every increase in intellectual property protection, especially in developing countries, necessarily leads to increase in investment, innovation or well-being which can be understood as indicators of development. For references, see Fink and Braga (1999), p. 21; Su (2000); Raghavan (2004), p. 777.

It was the Doha Declaration in 2001 that affirmed the right of the WTO Members to interpret and implement TRIPs in a manner supporting the protection of public health.[13] The 30 August decision of the TRIPs Council in 2003 clarified the safeguards in the TRIPs Agreement so that LMICs and other importing countries were able to invoke provisions related to compulsory licensing and parallel importation in the interest of public health.[14] The 6 December 2005 decision further adopted a protocol amending TRIPs to include specific provisions for compulsory licensing viz Article 31bis along with a descriptive annex and an appendix to the annex for guidance in assessment of manufacturing capacities in the pharmaceutical sector of developing and least developed economies.[15] In 2007, the WIPO Development Agenda further highlighted the need to fully integrate the development dimension into intellectual property and these have led to emergence of a human rights based perspective to accessible healthcare and development.

2.1 A Human Rights Approach to Health Care

Historically, right to health is not found to be part of the human rights discourse. It first found mention as part of the general comments of the Committee on Economic, Social, and Cultural Rights.[16] The three main components to this special right include: right to the highest attainable standard of physical and mental health, access to care and obligation of the Nation State to address specific health issues through an adept healthcare delivery system. Within these core obligations on a Nation State lie the contents of a *per se* "right to health," which are availability, accessibility, acceptability and quality. Measures that WTO Members must undertake towards progressive realization of a "right to health" within the economic, social and cultural rights came to be deliberated.

The Members ought to undertake such measures to the maximum extent of their available resources and where needed, within the framework of international cooperation.[17] The "right to health" does enjoy a superior and sanctified status

[13]WTO doc. WT/MIN(01)/DEC/2, Ministerial Declaration on the TRIPS Agreement and Public Health, 14 November 2001.

[14]Ibid. WTO doc. WT/L/540 and Corr.1, Implementation of paragraph 6 of the Declaration on the TRIPS Agreement and Public Health, 30 August 2003, also known as "August 30th Decision".

[15]WTO doc. WT/L/641, Amendment of the TRIPs Agreement, 6 December 2005, https://www.wto.org/english/tratop_e/TRIPs_e/wtl641_e.htm (accessed 6 February 2016).

[16]UN doc. E/C.12/2000/4 (2000): Committee on Economic, Social and Cultural Rights, General Comment 14, The right to the highest attainable standard of health (Twenty-second session, 2000). This can be read with Article 12 of the International Covenant on Economic, Social and Cultural Rights.

[17]Marks (2012).

within Constitutional aims of several Nation States.[18] Articles 42 and 47 of the Indian Constitution restate the importance of "right to health" as Directive Principles of State Policy.[19] The idea that health must be a justiciable fundamental right (similar to education) is also mooted.[20] The legal status of such a right is reinforced through judicial reasoning. In *Francis Coralie Mullin v. The Administrator, Union Territory of Delhi*, the Supreme Court of India held that the right to life includes: "The right to live with human dignity and all that goes along with it, namely, the bare necessities of life such as adequate nutrition, clothing and shelter. . .[more than mere animal existence]".[21] In *Bandhua Mukti Morcha v. Union of India*,[22] it was held that right to live with human dignity also involves right to "protection of health". The Court has in *Consumer Education and Research Centre v. Union of India*,[23] for the first time read the fundamental right to life guaranteed under Article 21 with the directive principles guaranteed under Articles 39(e), 41 and 43 of the Indian Constitution to explicitly hold that, [t]he right to health and medical care ... is an integral fact of [a] meaningful right to life".[24] Courts have also observed that failure on the part of public health centres to provide timely medical treatment can be construed as being violative of the patient's right to life.[25] As per the study conducted by Hans V Hogerzeil et al:

> [Out of the 71 essential medicines cases] in 59 cases, access to essential medicines as part of the fulfilment of the right to health could indeed be enforced through the courts, with most coming from Central and Latin America. Success was mainly linked to constitutional provisions on the right to health, supported by the human right treaties. Other success factors were a link between the right to health and the right to life, and support by public-interest non-government organisations.[26]

Evidently, access to healthcare and related concerns have come to be included in the international human rights discourse as also national statutes in slow but definite terms. The official draft of the national intellectual property (IP) policy of India also

[18]Research findings indicate that 1/3 to 2/3 of world's constitutions include health rights/access to health care. See also Backman et al. (2008), pp. 2047–2085 and Todres (2014).

[19]Articles 42 and 47 of the Part IV of the Constitution of India.

[20]Ramachandran SK (1 January 2015).

[21]Supreme Court of India, *Francis Coralie Mullin v. The Administrator, Union Territory of Delhi*, 13 January 1981, AIR 1981 SC 746, pp. 752–753. Other examples include the matter of *Minister of Health and Others v. Treatment Action Campaign and Others* (No 2), 2002 (5) SA 721, 2002 in South Africa.

[22]AIR 1984 SC 802.

[23]*Consumer Education and Research Centre v. Union of India* (1995) 3 SCC 42.

[24]Ibid.

[25]Supreme Court of India, *Pachim Baga Khet Mazdoor Samiti v State of West Bengal*, 6 May 1996, AIR 1996 SC 2426. See also Supreme Court of India, *Parmanand Katra v. Union of India*, 28 August 1989, 4 SCC 286, where the Court held that no procedure as prescribed under the CrPC should hinder a medical practitioner from treating an emergency case, saving a patient's life should be the primary action and other legal formalities ought to be secondary in such cases.

[26]Hogerzeil et al. (2006), pp. 305–311.

identifies "protect[ing] public health" as one of the missions that will establish a dynamic, vibrant and balanced intellectual property system in India.[27] Therefore, health is a main socio-economic goal for India and needs careful policy making and implementation.

3 TPP and the Maximalist Intellectual Property Agenda: A Primer

Since 2000, regional trade agreements signed by USA, European Union and Japan have contained substantial IPR provisions that exceed the TRIPs minimum standards requirements and are often referred to as TRIPS-plus obligations.[28] These obligations have had serious implications for drug pricing and severely disfavour public health imperatives to the advantage of State Owned Enterprises (SOEs).[29] For instance, in Jordan the prices of medicines increased by 20 % in 5 years after TRIPs-plus provisions were implemented through US-Jordan FTA.[30] In Costa Rica the TRIPs-plus provision of CAFTA is expected to increase the cost of medicines by 50 % until 2030.[31] TPP similarly goes beyond trade and tariff negotiations and makes explicit reference to IPRs as a form of investment.[32] Being a mega FTA, signed between developed economies and resource rich developing economies, it is bound to have wider cross-border implications which may countervail concerns related to health and human rights as a non-issue on the global setting.[33] Effectually, when Article 31(2) of the Vienna Convention on the Law of Treaties is applied

[27]See specifically p. 5 of the India's draft National IPE Policy 2015, and for comments see Tripathy et al. (2014). See also Government of India, "The National IPR Policy" (2016) http://dipp.gov.in/English/Schemes/Intellectual_Property_Rights/National_IPR_Policy_12.05.2016.pdf (accessed 30 January 2016).

[28]Liberti (2010).

[29]UNITAID's Policy brief (2014), p. 101. To retain the benefits of TRIPs flexibilities, countries at a minimum should avoid entering into FTAs that contain TRIPs-plus obligations that can impact pharmaceutical price or availability.

[30]http://www.oxfam.org/en/files/bp102_jordan_us_fta.pdf/download (accessed 10 January 2016).

[31]Pharmacotherapy Department of the Costa Rica Social Security System, 2003.

[32]The TPP includes 29 chapters ranging from issues of market access, technical barriers to trade, sanitary and phytosanitary measures, rules of origin, customs cooperation, investment, services and legal and institutional aspects of the negotiation, and it further includes government procurement, competition, intellectual property, labour and environment issues.

[33]PSI Strategic briefing (2014). In order to achieve "competitive neutrality" TPP advocates restricting the type and number of advantages such as subsidies, low cost credit, preferential access to government procurement, and trade protection available for SOEs. These advantages which are not enjoyed by private companies, when restricted will threaten public health care institutions leading to degradation and eventual removal of government health insurance programs. See also Doctors Without Borders (2012), p. 1. TPP will increase the price of medicine for nearly 800 million people across the Pacific Rim region.

to interpret the non-exhaustive asset-based definition of investment under the TPP to include IPRs, it protects rights of investors who use IP as a mode of investment. Therefore, although TPP does not set specific high standards of protection for IP it makes way for privileges favouring foreign investors (also known as IP right holders) which can strengthen IPR protection through the unqualified operation of *most favoured nation* and *national treatment*[34] and expropriation provisions triggering wider impact for IPR protection. Relevant provisions are analysed hereinafter.

3.1 The TRIPs-Plus Provisions of the TPP That Affect Public Health

The final text of TPP includes only one objective (out of the many mentioned in the earlier drafts) as stated in Article 18.2 of the agreement. The article states:

> [t]he protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.

The previous list of objectives expressly included references to maintaining balance across all IP rights and ensuring that they do not create barriers to legitimate trade or hinder access to affordable medicines. Downsizing of the objectives considerably tilts the balance in favour of the right holders prioritizing their profit motives over those of the patients who are the consumers of health related goods and services. Thus timely access to affordable medicine is likely to be blocked.[35] TPP requires Nation States to accede to at least nine international IP treaties and significantly alter their IP laws in compliance to them. Article 18.7 especially requires ratification to the Patent Cooperation Treaty as amended in 1979, the Paris Convention as revised in 1967 and the Berne Convention as revised in 1971; six more treaties are identified, such as the Protocol relating to the Madrid Agreement Concerning the International Registration of Marks of 1989, the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure as amended in 1980, the International Convention for the Protection of New Varieties of Plants as revised in 1991 (UPOV Convention); the Singapore Treaty on the Law of Trademarks of 2006 and the two WIPO

[34]TPP Article 2.3 provides for the principle of national treatment. In the international context, a State must provide equal treatment to those citizens of other States that are participating in the agreement. Imported and locally produced goods should be treated equally—at least after the foreign goods have entered the market. When TRIPs-plus provisions in the TPP outweigh corporate interests over better access to medicines and healthcare for the patients, it will lead to an incorrect application of this principle.

[35]Geist (2016). Developed economies such as Canada have opposed the alteration. For reference, see the Early versions of the draft IP Chapter of TPP (2016) and Later drafts of the IP Chapter of TPP (2016). See also, TPP Investment Chapter (2015).

Internet treaties of 1996 (WCT and WPPT). These provisions clearly indicate that the agreement seeks to harmonize and standardize the regulatory framework and compliance requirements for IPRs for all Nation States. Over and above these treaties, all TPP countries are required to amend and include patent term extensions as well. This would limit the competition given by generic manufacturers, increase drug prices and hinder innovation in Asia-Pacific region.[36] Article 18.6 in the IP chapter contains a list of understandings regarding public health measures. This article is applicable to the IP chapter alone and not to the other TPP chapters on investment. Such disjunction is impractical in this author's view, as an overlap as regards implications consequent of the two sets of chapters when looked at from a holistic perspective for public health is inevitable. In fact, the cumulative effects of the provisions pertaining to various forms of IPR, data exclusivity, patent linkage, pharmaceutical pricing, financing and reimbursement of medicines along with IP enforcement are expected to negatively influence access to healthcare in importing countries with severity. The following section discusses consequences of such disjunction that will lead to embracing patent extremism within the TPP.

3.2 Public Health and Patent Extremism: Analysing the TPP

Patents have a monopolistic market effect which can dictate the nature of public health policies and healthcare related pricing mechanisms in a country.[37] One of the primary challenges in driving down high mortality rates of cancer patients in LMICs and addressing the issue of access to cancer medication in those regions has been the difficulty to reconcile small, incremental and significant improvements in the management of cancer with increasing costs of new treatments. A 2013 study on access to cancer treatments in India finds that generic substitution for commonly used originator (mainly patented) chemotherapy drugs has enormous potential to generate significant cost-savings to the extent of Rs. 4,700 crore per year.[38] Evidently, Bayer's patented medicine (Nexavar) for renal and liver cancer is priced at Rs 2,80,428/- per month and the generic version by NATCO Pharma (Sorafenib Tosylate) is available for Rs. 8,800/- per month in India.[39] With such stark differences in drug pricing, lack of balance within TPP is bound to burden the public exchequers. Important ramifications are spelled out herein below.

[36]See generally Bharadwaj et al. (2014).

[37]For references, see Managing IP (May 2006).

[38]Lopes (2013).

[39]*Natco Pharma Limited v. Bayer Corporation*, Compulsory License Application No. 1 of 2011; and as directed by the Controller of Patents in *NATCO Pharma Limited v. Bayer Corporation*. Similarly, in (2013) 6 SCC 1, while Novartis's patented medicine (Gleevec) for blood cancer care is priced at Rs. 1,20,000/- per month, the generic version (Imatinib Mesylate) is priced at Rs. 10,380/- per month by NATCO Pharma and Rs. 9,000/- per month by Cipla in India.

3.2.1 Increased Scope of Patentability

The TRIPs Agreement allows countries to determine their own patentability standards such as the degree of novelty, inventive step, utility as also subject-matter of a patentable invention. These flexibilities check instances of evergreening of patents, wherein pharmaceutical companies could enjoy a new term of patent grant for an existing invention by making minor changes (which may not be clinically efficacious) into the composition of their existing patents. This would further delay entry of generic versions of pharmaceuticals in the market. TPP provides opportunities for terminating such flexibilities. Canada along with eight other Member countries have opposed it, as this leads to evergreening of already existing patents and subsequently increases the cost of medicines.

3.2.2 Patent Term Adjustment

TRIPs Agreement allows protection of 20 years for a patent. The US country proposal identifies the delays caused due to the tedious process for patent prosecution and grant by the patent office as being an "unreasonable curtailment" of the term of patent. Article 18.48 of the TPP mandates countries to allow patent term adjustment in favour of pharmaceutical patentees, so as to accommodate for such delays in regulatory approval.

According to Article 18.46

> an unreasonable delay at least shall include a delay in the issuance of a patent of more than five years from the date of filing of the application in the territory of the Party, or three years after a request for examination of the application has been made, whichever is later.

It means that if the drug regulatory authority of a nation extends a certain period (specified in the provision above), then the term of such patent is extended. Pre-grant opposition proceedings in patent prosecutions in TPP countries will be restricted, making opposition of patents and the process of pharmaceutical patent procurement costlier. This proposal has been opposed by New Zealand, Japan and Canada. The extension of patent term beyond 20 years, referred to as "adjustment", will delay the entry of low cost medicines into the market which will severely affect government health programs. The adjustment provision will lead to legislatively amending Patent Acts to include additional market exclusivity in favour of pharmaceutical patentees. The use of pre-grant opposition safeguard has resulted in rejection and at times withdrawal of patent applications on vital HIV/AIDS medications, which has allowed generic companies in India to continue to manufacture, supply and export essential medicines to other developing countries at affordable rates.[40] The new process will stifle generic entry and competition in the pharmaceutical sector. TPP further enables originator companies to claim infringement

[40]For references on the Indian pharmaceutical sector, see Gopakumar (2010).

action and prevent parallel importation of drugs which is expected to delay market entry of competing generics as well.[41] Overall, hike in medicine prices, low investment in research and development and the ever increasing demands for future patent protection and increased instances of infringement actions is expected.

3.2.3 Data Exclusivity

Article 18.52 of the TPP provides at least 8 years of protection or 5 years of biologic specific data protection plus other measures to facilitate comparable outcome in the market. This would reduce market incentives that support biologic competition and innovation as also formulation of alternatives in the nature of biosimilar versions.[42] Furthermore, the proposal of 5 years data exclusivity for new chemical entities and 3 years for drugs containing already approved active compound will establish a data monopoly period, forcing generic manufacturers to conduct their own clinical trials of which the outcome is already known.[43] This provision will lead to delayed entry of generic medicines into the market and increase their cost when they finally enter into market. This provision has been opposed by eight Member countries.

3.2.4 Marketing Authorization and Regulatory Review for Devices and Data Collection

Chapter 8 of TPP which is devoted to technical barriers to trade imposes data restriction barriers upon national regulators. The restriction entails disclosure of certain information as part of the regulatory review process for pharmaceutical products and medical devices. Annex 8-C 11 of the agreement requires each party to make its determination on whether to grant marketing authorization for a specific pharmaceutical product on the basis of factors such as clinical data, manufacturing quality, and labelling information. It provides, "[n]o Party shall require sale or related financial data concerning the marketing of the product as part of such a

[41] See specifically Articles 4.2 and 4.6 of the US proposal (TPP Article 2.12) which extends the term of copyright to "life of the author plus 70 years" or "not less than 95 years from the first publication or 120 years from creation". At the International trade level, this implies that even if the patent rights are exhausted by the importing country's exhaustion regime, if the copyright over the product information and labels of a pharmaceutical product subsists within the packaging material, the originator company can sue for copyright infringement, prevent parallel importation and consequently delay market entry of competing generics. Similarly, TPP reformulates the justification for trademark protection and term extensions from being consumer centric to being a return on the investment made by the originator company in advertising and promoting its pharmaceutical products and services (TPP, Article 2.3 read with Article 2 and its sub-clauses Articles 2.1 and 2.4 especially and Article 2.5). These provisions will impair the effectiveness of trademark regimes and increase the instances of originator companies suing generics for trademark infringement.

[42] For references, see WHO SEARO WPRO (2006).

[43] For references, see Baker (2008), pp. 303–344; For discussion concerning ambiguity in investment clauses of TPP, see also Baker (2012) p. 8.

determination. Further, each Party shall endeavour not to require pricing data as part of the determination". Annex 8-E 12 for the approval of marketing of medical devices is similar: "[n]o Party shall require sale, pricing or related financial data concerning the marketing of the product as part of such a determination". This provision will influence regulatory transparency as regards grant of marketing rights. Given its stringency, it may prevent the use of *bolar* provision for marketing approval in other countries which means that a generic company would have to manufacture the medicine locally in every country where it seeks early marketing approval. Establishing quality-assured manufacturing sites in all developing countries is not economically feasible, therefore in sum this proposal will lead to late entry of generic medicines into export markets.

3.2.5 Patent-Linkage Provision

TRIPs does not provide for patent linkage system.[44] The inclusion of such a provision will require drug regulating authorities of TPP countries to conduct assessments of whether a generic drug could potentially infringe existing patents before approving its registration. The traditional patent system allows the patent owner to identify and pursue potential patent infringements through the court of law. That practice ensures that the validity of a patent can be publicly questioned and held up to scrutiny before it is enforced. However, this new provision requires drug regulatory authorities of TPP countries to perform a role akin to (patent) police, which would mean that they will be evaluating patent validity in addition to their original task of judging the safety and effectiveness of a drug. The drug regulatory authorities are not qualified, trained or well-versed to undertake such evaluations, which will in all definiteness delay the process and consequently lead to unnecessary delay of affordable generics into TPP markets.

3.2.6 National Pharma Care Program

Chapter 26 of TPP, when read with Annex 26-A discusses "transparency and procedural fairness for pharmaceutical products and medical devices"[45] and prescribes that mandatory requirements for a national pharma care program be established to address high cost of drugs and develop efficient systems in consultation with the healthcare community. This requirement for establishing a national pharma care programme is a carefully drafted budget-friendly provision which will establish transparent systems for allocating resources for enlisting newer pharmaceutical products, services and devices. However, a good reformatory measure can

[44]For references, see Bouchard et al (2010), p. 174.

[45]TPP Transparency and Anti-corruption Chapter https://ustr.gov/sites/default/files/TPP-Final-Text-Transparency-and-Anti-corruption.pdf (accessed 2 January 2016).

be severely effected as TPP includes within its dispute settlement mechanism a foreign investor privilege clause that allows foreign companies to challenge national laws meant to protect public healthcare services, which can have a serious bearing on the national pharma care programme expenditure.

3.3 IP Enforcement and Dispute Settlement Under the TPP

The TPP allows excessive opportunities for IP enforcement, by including IPR as an "investment" in clear definitional sense, to favour big investors such as the drug companies. Chapter 9, Article 9.1 of the proposed TPP text defines "investment" to mean "[e]very asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include ... (f) Intellectual property rights ..."

Extensive private enforcement rights that right holders already have, in addition to administrative remedies at borders and judicial remedies for infringing conduct have been provided for; these remedies are to enhance drug companies' proclivities to bring suits against governments (for expected profits as well). The enhanced nature of remedies available can heavily burden the Nation States and serve to impede domestic production of drugs. Furthermore, the bracketed limited exception to IP-related investment rights for compulsory licenses does not provide the security against investor claims that TPP parties might need to safeguard TRIPs-compliant measures. Finally, the investment chapter prevents certain performance requirements that in the IP context might give developing countries the opportunity to develop domestic pharmaceutical manufacturing capacity in order to ensure a self-sufficient, uninterrupted supply of medicines and to legitimately promote their own industrial development.

Article 18.76 of TPP mandates that applications to detain goods with confusingly similar trademarks as well as procedures for right-holders to suspend the release of those goods as "special requirements related border measures" be allowed. The provision establishes enhanced border measures which can lead to seizure and detention of generic drugs upon cross-border transit on the basis of mere suspicion of being confusingly similar trademark goods. This detention is to be carried out by custom officers or border guards who are not skilled to distinguish genuine from counterfeit. Enforcing provisions with lack of court oversight in respect of border measures will add to delays in generic entry in TPP markets. The IP chapter additively expands private IP enforcement mechanisms via mandatory injunctions, enhanced damages and imposition of newer obligations in terms of border measures and criminal enforcement against infringement of IPR. TPP sets out newer risks in the nature of newer enforcement strategies. Chapters 9 and 28 of the TPP which include the dispute settlement mechanism under the investment chapter (known as the ISDS clause) provide investors (IP right holders) the right to

submit an arbitration claim under the International Centre for Settlement of Investment Dispute (ICSID), or the United Nations Commission on International Trade Law (UNCITRAL), or any other arbitration institution, thereby allowing for a private supranational arbitration procedure to be instituted outside the country's judicial system. IPR holders now IP "investors" will have new substantive "investment rights" which enable them to base ISDS claims against sovereign governments' regulations and adjudicatory decisions. This could even result in private arbitration proceedings to supersede national laws and policies that are important for enabling accessible and affordable healthcare. Foreign firms can sue and claim for reasonable expectation about future profits arising from IP filings and any changes to IP laws or standards that impact their expectations of profits. This is clearly a fair and equitable treatment (FET) violation. Therefore, international economic laws require revisiting.

4 Conclusions and Positive Steps for the Future

The stringent intellectual property rules and lack of implementation flexibility within the TPP is a major concern. Globally, generic competition has reduced prices for first-line antiretroviral medicines for HIV/AIDS by 99 % in developing countries over the course of a decade, which has scaled up to more than 12 million people.[46] Medicine prices have tripled in the US since 1987, outpacing consumer prices, which have only doubled in such time.[47] The incidence of pharmaceuticals price escalation in the US market can also be viewed as what could follow if TPP is not revised.

Futuristically speaking, in a real time sense for treaty making which relies upon international custom, the investment chapter of the TPP has the potential to be the baseline for international trade. The ISDS safeguards which allow corporations to sue governments in private supranational arbitration over pro-public health regulations which interfere with anticipated profits can sideline the importance of healthcare objectives and become a burden on the public exchequer.[48] A case in point is when the Canadian government was sued by Eli Lilly to the tune of $500 million,[49] based on similar provisions in North American FTA (NAFTA), because the corporation objects to a Canadian Supreme Court ruling rejecting the patent for two blockbuster drugs.

This author advocates that constructing a full positive agenda is required, characterized with a complementary process at the national and international

[46]Ibid.

[47]Doctors Without Borders (2014).

[48]For reference, see Lester (2015), p. 1. Also see Weisman (2015).

[49]*Eli Lilly and Co. v The Government of Canada*, Notice of intent to submit a claim for arbitration under NAFTA Chapter Eleven, 7 November 2012.

level. Transparency, data driven policy making and evaluation of public welfare objectives can be made possible by means of a transparent norm-setting process that welcomes and solicits the input of academics, public interest organizations and a full range of public and private stakeholders. As a systemic reform, the evaluation process and information brokerage can begin by means of consultative participation from the academia, industry, reputed civil society groups and policy regulators at a national level. At the international level, arbiters and experts can be enjoined to form a cohesive advisory set up that functions as a specialist small claims arbitration forum as well as resolves concerns related to price regulation and competition. Stakeholder participation through *amici* before the forum will encourage fairness in this new system.[50] For policy reform and legislative amendment, the TPP can provide for small and medium enterprises and start-ups in the pharmaceutical sector who will be beneficiaries of the new ISDS regime. Procedural rules with low administrative costs can be tailored to encourage their participation.

Finally, intellectual property protection is an important policy area and its scope needs to be examined in a robust, value-based public debate from a micro to macro scale. Global norm setting demands a higher degree of transparency and accountability which will further the interests of international trade and economic law in a more sustainable manner. For the purposes of India, Shamnad Basheer advises that it will serve the interest of countries such as India to endorse a "compensatory patent commons" regime as a government measure to meet the growing concerns related to affordable and accessible healthcare.[51] Such alternatives when adopted can bring objectivity into the pressing issue of access to healthcare for all stakeholders. In conclusion, it is submitted that if the TPP can be revised to uphold public welfare objectives more, it can reform the dynamics of manufacture, distribution and sale of essential drugs to make way for new international economic laws that merit compliance and consensus.

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[50]For a set of principles that might guide such a fuller agenda, see Washington Declaration on Intellectual Property and the Public Interest (2011).

[51]Basheer (2015).

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Part II
International Trade Law

Can (and) Should the WTO Tame Private Standards? Antitrust Mechanism as an Alternative Roadmap: Lessons from the WTO Telecommunications Reference Paper

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Abstract The question of private standards within the WTO has gradually developed from a mere theoretical and academic discussion to a full blown policy and legal debate. This debate however is still far away from reaching consensus. First of all, it is still unclear whether the issue of private standards should be discussed within the WTO framework. Second there are still plenty of confusion on the manner of approaching the discussions and regulating the trade externalities of private standards and the future shape of any WTO discipline in this regard, if any. The objective of this contribution is to develop an alternative roadmap towards private standards within the WTO framework. In doing so it examines the role that market power plays in private standard-setting and the possibility of adopting comparable competition law governance mechanisms incorporated within the WTO, such as the WTO Telecommunications Reference Paper.

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1 Introduction

> [P]rivate standards have become the prime determinants of access to most western food markets. In light of these evolutions, the logic behind the SPS Agreement appears somewhat flawed, and the latter is increasingly regarded as having lost its grip . . ..[1]

The issue of private standards has become one of the highly debated and unsettled issues in the global trade and development policy discussion. Of course, despite its recent resurgence, the issue is an old phenomenon, especially in the area of product safety.[2] Food safety represents a historical example of self-regulation by foodstuff producers, often combined with some degree of public regulation.[3] Meanwhile, in the recent years we have seen an explosive growth in private standard setting and certification schemes for virtually every product in the world; goods or services. Assessment studies by the European Commission prepared more than a decade ago indicated the existence of around 400 different schemes.[4] Today, private standards are seen as the norm rather than the exception.[5]

In line with these market place developments, private standards have grabbed the attention of trade policy makers, Nation States and international trade organizations such as the WTO as it shades its effects on the global trade regulation instruments. Within the WTO framework, the question of private standards has now developed from a mere theoretical and academic discussion to a full blown policy and legal debate. This debate however is still far away from being distilled. First of all, there is no consensus on whether the issue of private standards should be discussed within the WTO framework or the ways of approaching the discussions. Regulating the trade externalities of private standards is numerous, diversified and dynamic and there is uncertainty on future shape of any WTO discipline in this regard, if any.[6]

Within the above framework however various developments have now started to surface and research in the area has grown significantly. In the same context two of the most relevant WTO committees, both the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) committee, have also devoted a number of their formal and informal sessions to discuss the issue at hand. Among the most important in this area is the contribution of the WTO SPS Committee commissioned work by the WTO Secretariat on the "possible actions that could be taken by

[1] Wouters et al. (2008), p. 29.

[2] Cafaggi (2010), p. 1.

[3] Ibid.

[4] European Commission, Impact Assessment Report for a Communication on Agricultural Product Quality Policy, Annex D, Certification Schemes for Agricultural Products and Foodstuffs, 8 April 2009, http://ec.europa.eu/agriculture/quality/policy/com2009_234/ia_en.pdf (accessed 13 November 2015), p. 3.

[5] Wolff and Scannell (2008), p. 25.

[6] For instance, "No consensus had been reached by the e-WG on a working definition" (WTO doc. G/SPS/R/74, Summary of the Meeting of 25–26 March 2014, 26 September 2014).

the SPS Committee and/or Members to enhance the benefits of private standards and address their negative effects on market access, especially for producers/exporters in developing countries".[7] The Secretariat's Note recommended, *inter alia*, seeking clarification as to whether the SPS Agreement applies to private SPS standards, to develop guidelines on the implementation of art 13 of the SPS Agreement and/or develop a Code of Good Practice which would function similar to the TBT Agreement. Yet, despite its attempt to be comprehensive, the Secretariat's note is short of being complete. Among many others, the note is entirely restricted in its scope referring to private SPS standards and most of its recommendations fail to show why a pragmatic and legal link should be drawn between the efforts to "regulate" private standards and the legal nature of existing instruments within the WTO framework.

The objective of this Chapter is to contribute to these recent efforts by developing an alternative roadmap of discipline towards private standards within the WTO framework. In doing so, the research examines the role that market power plays in private standard-setting and the possibility of adopting comparable governance mechanisms incorporated into the WTO, in particular the WTO Telecommunications Reference Paper. The Chapter raises three background questions; first, whether there should be a case for the regulation of private standards within the WTO framework; second, whether WTO Members could develop an objective discipline regulating private action; and if so, third, whether there exists political and legal precedent to show positive State action in this regard. In order to address these questions, this Chapter builds a comparative analysis that shows how the theoretical and legal notions and underpinnings laying behind the WTO Telecommunications Reference Paper can also be logically adopted to develop a theoretically stable and a common institutional framework for understanding and further regulating private standards within the WTO framework.

2 Private Standards and the WTO

It is clear today that the large number of private standards evolved in response to regulatory developments and, more directly, consumer concerns in the market.[8] High profile food scares and the raise in consumer awareness levels have served to erode confidence in the prevailing mechanisms of food safety or environmental and human right protection which is predominantly focused on public regulation.[9] Indeed a major drawback of public standards is their lack of flexibility. Public standards do not adjust, at least in time, to changes in consumer preferences or

[7] WTO doc. G/SPS/W/247, Possible Actions For The SPS Committee Regarding Private SPS Standards, Note by the Secretariat, 20 October 2009, p. 2.

[8] Henson and Humphrey (2009), p. 11.

[9] Henson (2008), p. 75.

social and environmental concerns. To this extent it can be argued that the failure of public regulation to provide the desired level of protection and confidence to consumers has been part of the cause for stimulating private standards.[10]

Meanwhile, like any other non-tariff barrier to trade, the proliferation of private standards can have various trade and consequently development challenges. Most standard setting organs are seldom participatory, transparent or scientific.[11] The immediate implication of this is that the introduction of private standard regimes that are not adapted to the needs and capacities of the various stakeholders in the industry will tend to reinforce the already existing imbalance of the terms of international trade.[12] This challenge is greater for those producers and exporters of mostly primary and light manufactured goods in developing countries.[13] In general, private standards can be trade-impeding as any other public standards.[14] It is therefore imperative that one investigates the relevance of multilateral trade organizations such as the WTO to this concern.

The TBT Agreement is one of the most important WTO agreements which is relevant to investigate the multilateral regulation of private standards. The TBT Agreement applies to three major types of technical barriers to trade; technical regulation, standards and conformity assessment procedures.[15] In order to make sure Members bear the responsibility concerning non-governmental entities, Art 4 of TBT Agreement provides WTO Members are to ensure that non-governmental standardizing bodies accept and comply with a Code of Good Practice.[16]

Meanwhile, it can be said that majority of observers would agree with the general proposition that WTO rules are imposed on WTO Members rather than on individuals. Thus "recognized body" under the Agreement refers to those organs which are delegated with standardization function which traditionally is part of the function of State organs.[17] Unfortunately, while various WTO dispute settlement cases have raised important issues relevant to the question of the legal regime over private standards, the scope of the analysis by the WTO dispute settlement panels and the Appellate Body has not yet directly addressed the WTO consistency of any private standard in question.[18]

Of course there have been important dispute settlement cases, most of which have dealt with labelling and marking requirements, which examine substantive

[10]Henson and Humphrey (2009), p. iv.

[11]Liu (2009), p. 1.

[12]Ibid.

[13]Ibid., also see Graffham (2007), p. 7.

[14]Martinez and Poole (2004), p. 230.

[15]WTO Agreement on Technical Barriers to Trade (TBT Agreement), Annex 1 A of the Agreement Establishing the World Trade Organization, 15 April 1994, https://www.wto.org/english/docs_e/legal_e/legal_e.htm, Annex 1.

[16]Ibid., art 4.1.

[17]Ibid., Annex 1, para 8.

[18]Gandhi (2007), p. 4.

provisions of the TBT Agreement. Yet, according to Samir R. Gandhi, "WTO panels have been reluctant to extend the scope of State responsibility under the GATT Agreement to actions of private parties".[19] He mentions *Argentina Hides* dispute in which a "WTO Panel chose not to hold a State responsible for the trade restricting activities of private parties within its territories".[20] This seems to have been confirmed by the panel in *China – GOES*, which held that "the WTO covered agreements are international agreements between the WTO Members" and that "the obligations embodied in them are binding only upon Members and not upon private actors".[21] The Appellate Body has also emphasized in *US – COOL* the importance of identifying the underlying link between the actions of the State *vis-à-vis* the underlying measure taken by private actors.[22] The most recent dispute, *US – Tuna II* has addressed the issue of what a standardizing body is for the purpose of the TBT Agreement.[23]

Another essential centrepiece for the discussion in this section is the question about the interaction between private standards and the WTO SPS agreement. Simply put—does the SPS Agreement apply to private standards? One can start by saying that the SPS Agreement establishes disciplines that ensure various SPS measures implemented by WTO Members are not applied unfairly or discriminatorily.[24] The underlining principle under the Agreement is that such measures can be undertaken only with the objective of addressing justified health measures and only to the extent necessary.[25] In the same line the SPS Agreement mandates Member States to take "reasonable" measures to ensure that "non-governmental entities" comply with the SPS Agreement.[26] Yet, given that the SPS Agreement was negotiated before private sector standards became widespread, it is not surprising that the SPS Agreement contains no direct mention of private standards. This, hence, opens the door to questions over the application of the Agreement to measures that are adopted by private entities.[27] Again, the question here is not whether private actors engaged in standard formulation can be directly bound by the

[19]Ibid., p. 16.

[20]Ibid., WTO doc. WT/DS155/R, Panel Report, *Argentina – Measure Affecting the Export of Bovine Hides and the Import of Finished Leather*, 19 December 2000.

[21]WTO doc. WT/DS414/R Panel Report, *China – Countervailing and Anti-Dumping Duties on Grain Oriented Flat-Rolled Electrical Steel from the United States*, 16 November 2012, upheld by WTO doc. WT/DS414/AB/R Appellate Body Report, para 7.50.

[22]WTO doc. WT/DS384/AB/R WT/DS386/AB/R, Appellate Body Report, *United States – Certain Country Of Origin Labelling (COOL) Requirements (US – COOL)*, 29 June 2012, para 291.

[23]WTO doc. WT/DS381/AB/R Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna Products (US – Tuna II)*, 16 May 2012, paras 365 ff.

[24]WTO Agreement on the Application of Sanitary and Phytosanitary Measures, Annex 1 A of the Agreement Establishing the World Trade Organization, 15 April 1994, https://www.wto.org/english/docs_e/legal_e/legal_e.htm, Preamble.

[25]Stanton (2007), p. 3.

[26]SPS Agreement, art 13.

[27]Prévost (2008), p. 6.

SPS Agreement. The SPS Agreement, like other WTO agreements or general principle of international law, binds only WTO Members. Therefore, only actions (or omissions) by WTO Members can be challenged. The inquiry rather is about the circumstances under which WTO Members can be held responsible for the actions of private parties in their territory.[28]

Unfortunately, in the absence of any WTO jurisprudence, Members have divergent and conflicting opinions about the issue. The debate is mainly centred on the scope of art 13 of the SPS Agreement.[29] The issue was formally raised within the WTO SPS Committee in June 2005 when St. Vincent and the Grenadines complained about the requirement for EurepGAP certification in exporting bananas.[30] In the same meeting, Jamaica expressed its concerns with respect to EurepGAP standards for fresh fruit and vegetables.[31] Further support was also given to these concerns by a number of other developing countries. The significance of the issue was markedly reflected by Argentina:

> [T]he international community had generated international agreements to ensure that trade standards were not unnecessarily stringent so as to act as barriers to international trade and countries had devoted time and financial and human resources to attend all the international meetings where standards were discussed, developed and implemented. If the private sector was going to have unnecessarily restrictive standards affecting trade and countries had no forum where to advocate some rationalization of these standards, twenty years of discussions in international fora would have been wasted.[32]

Since then, a number of developing countries expressed their concerns that "private standards could undermine the disciplines negotiated in the SPS Agreement".[33] Yet, on the other side of the debate, the EU relied on the purely private character of such standards. In particular the EU upholds;

> [W]ithout any dispute ruling to provide legal interpretation, it remains unclear whether the SPS Agreement obliges governments to take responsibility for private standards. Therefore Members should focus on the costs of complying with the standards and ways to deal with this, such as through aid to help suppliers meet the requirements.[34]

While various discussions concerning the impact of private standards and the legitimacy of the WTO TBT and SPS committees to have a discussion on these issues have been made, there is still no formal determination within the WTO on

[28]Ibid.

[29]Wolff and Scannell (2008), p. 5.

[30]WTO doc. G/SPS/R/37, Summary of the Meeting Held on 29–30 June 2005, 11 August 2005, p. 6. Also see Henson (2008); and Gascoine and O'Connor Company (2006), p. 23. EurepGAP is a European wide certification for farm management practice organized by supermarkets within Europe. GAP stands for Good Agricultural Practices.

[31]Ibid.

[32]Ibid., p. 7, also See Wouters et al. (2008), p. 18.

[33]WTO (2010).

[34]WTO (2007b).

whether the issue falls under the jurisdiction of the TBT and SPS agreements.[35] For the moment, one can say that private standards fall within a markedly contested and at best *grey area* territory of the TBT and SPS Agreements. But one should expect, at least in the near future, private standards will have a greater impact on trade terms than public standards.[36]

3 The Nature of WTO Obligations and the Limits of State Responsibility

The preceding section highlighted how private standards might affect world trade. This can have serious implications to the current multilateral trading regime. Meanwhile the underlying ideological question as analysed by one author is:

> [W]hether private companies can be forced to contract with entities, which they do not wish to contract with for some reason ... and whether they can be forced to distribute products that they simply do not want to distribute. ... Even putting all elements of costs and efficiency aside, the question is whether it would be acceptable for governments to determine what types of consideration private companies may or may not use when procuring goods or services.[37]

Indeed, at first glance any "imposition or interference" from the side of the government on the freely working setup of the market and argument furthering any such intervention appears insensible. Especially if one considers that the concept of market access in the WTO should be limited to formal access to markets against State intervention that might contravene basic WTO obligations. According to the above author:

> [T]he controversy between both camps is about the meaning of market access that WTO membership was to guarantee: a formal access (i.e., the ability to offer imported product to importers, distributors and customers, who may decide to distribute or buy it), or actual increased market share (e.g., guaranteed sales) ... in a very concise summary.[38]

Despite the above argument, pre-existing WTO practice shows that such trend has already been both politically and legally acceptable to WTO Members. This is the case of the WTO Telecommunications Reference Paper that essentially regulates the practice of private enterprises in terms of protectionist and discriminatory trade practices against foreign competitors. The Reference Paper was essentially a response to the concern that domestic/internal dynamics of the telecommunication sector needs further disciplines and guidance so as to make the market access commitments effective and to ensure that major suppliers do not abuse their

[35]WTO doc. G/SPS/53, Review of the Operation and Implementation of the SPS Agreement, Report adopted by the Committee, 18 March 2010, p. 23.

[36]Disdier et al. (2008), p. 13.

[37]Włostowski (2010), p. 210 (emphasis added).

[38]Ibid. (emphasis added).

dominant position. This document laid down important competition policy concepts; such as essential facilities and market dominance.

It is within this framework one can notice many theoretical and practical similarities between telecommunication services and private standards. Like telecommunication services, today, the retail sector has become a sector with high level of market concentration and hence power. Additionally, a characteristic shared by both sectors, besides the presence of large incumbents, is their dependence on networking and economies of scale. Considering this similarity, it is thus logical to inquire whether the WTO should "regulate private standards". This is particularly the case if—due to the omnipresence of a particular private standard—it is difficult or impossible to enter the distribution chain without adopting the standard. This fact would support the argument that private standards undermine WTO market access commitments. For these reasons, it seems appropriate to raise an argument that the Reference Paper on Telecommunication services can be a guiding example for future efforts to create pro-competitive rules to discipline private standards in the WTO regime.

4 Market Dominance Approach: Lessons from the Framework of the WTO Telecommunications Reference Paper

The WTO Basic Telecommunications Agreement (BTA) is an Annex incorporated to GATS through which certain WTO Members liberalize their markets for telecommunications services.[39] The result of this agreement lays the distinction between "basic" and "value-added" telecommunication services. Before the WTO Telecom Agreement was conceived, "basic" and "value-added/enhanced" telecommunications were essentially concepts used by US regulatory agencies.[40] It was used by the Federal Communication Commission (FCC) to make distinction between what it considered competitive part of the industry which is to be left for market competition and others that were considered in need of public regulation.[41]

In doing so the Agreement aimed at improving market access for telecommunications service providers by ensuring that "all service suppliers seeking to take advantage of scheduled commitments are accorded access to and use of public basic telecommunications".[42] While the results of the negotiation are to be multilateralized through the most-favoured nation (MFN) clause, the system allowed Members to add a list with exceptions.[43] Most importantly, over 80 Members have committed

[39]Magallanes (2012).

[40]Bronckers and Larouche (2008), p. 324.

[41]Ibid.

[42]WTO (1997).

[43]Ibid.

to abide by the rules and principles underlined under the "Reference Paper" to the Telecommunications Agreement, described as "a blueprint for sector reform that largely reflects best practice in telecoms regulation".[44] This mainly has to do with the fact that the Basic Telecoms Agreement also addresses concerns related to the establishment of a regulatory environment conducive to market entry. This concern is of course vital and topical for its time. Since its inception the telecommunication services industry has been operated under monopolistic tendencies whether in the hand of private sector or the State.[45] But in late twentieth century the forces of liberalism, free market, and privatization reinvigorated the political economy of the services sector in most part of the world especially in the more developed economies.[46]

For this reason, many participants of the telecommunications negotiation suggested that the establishment of provisions on regulatory discipline "as a way of safeguarding the value of the market access commitments undertaken".[47] The result was a unique multilateral agreement that included important principles for the trading regime such as competition safeguard principles, interconnection, transparency in licensing, and the independence of regulators, i.e. the Telecommunications Reference Paper.[48] GATS art XVIII provided the framework for undertaking commitments with regard to measures not falling under market access or national treatment.

In doing so, the Telecommunications Reference Paper provided principles that serve as a guide on domestic regulation. Hence, the Reference Paper does not address detailed specifications on how WTO Members will carry out their obligations. Mainly aimed at accommodating the different economic, political, legal and administrative differences that exist between Members, the Reference Paper left sufficient level of flexibility to accommodate policy variances among the various participants. In particular, Members have flexibility to decide how to manage their obligations.[49] "The objective was to ensure certain results, a level playing field for new entrants, not to determine the means by which the results would be achieved".[50] It generally imposes an obligation on Member States: (a) to take necessary measures that domestic telecom providers do not engage in anti-competitive practices; (b) to make sure that interconnection is not denied by service providers[51]; (c) transparency in licensing conditions[52]; and (d) guaranteeing the fairness and independence of the regulator.

[44]WTO (2016).
[45]Noam (1998).
[46]Ibid.
[47]See WTO (1997).
[48]Ibid.
[49]Sherman (1998), p. 72.
[50]Ibid.
[51]Reference Paper, para 2.1.
[52]Ibid., para 4.

4.1 Comparative Analysis of Private Standards Within the Framework of the WTO Telecommunications Reference Paper

As it can be seen from the preceding paragraphs, one of the most important contributions of the WTO Telecommunications Reference Paper is a change in the perspective and the sphere of international trade regulation. Specifically, it changed the WTO from being an exclusive public sector instrument towards becoming a tool for regulating private conduct that would interfere with international trade. This approach is different from the aforementioned discussion with respect to WTO agreements that contain certain obligations on WTO Members with respect to non-governmental entities.

On the contrary, experience from the same participating Member States shows that the Reference Paper has provided clear obligations on Member States in terms of regulating, disciplining and overseeing the conduct of private entities and markets within their jurisdiction. Generally, the Reference Paper obliges Members to follow rules on private market competition of telecommunication service and on abuse of dominant positions, discriminatory practices and transparency. In this sense, two experiences come out as lessons learned from instrument and practice in the area of basic telecommunications services: one, defining major suppliers as subjects of discipline under the Reference Paper and second, an obligation of competitive safeguards. The following paragraphs discuss these issues one by one.

First, there is now ample evidence that private standard-setters dominate the food safety, environment protection and various other regulatory environments and thus "have become the prime determinants of access to most western … markets".[53] Thus, although often labelled as "voluntary" standards, in that they are not imposed by regulatory authorities, such requirements often act as "entry tickets" into the market—producers must comply with the standards, and be able to demonstrate that they have done so, or their products will not reach the supermarket shelves.[54] As indicated by a joint UNCTAD/WTO Session on Private Standards, "the term 'voluntary' may be misleading".[55] Some private standards, although not legally mandatory, are *de facto* mandatory as large buyers require compliance with them. Accordingly, "although not legally binding in a regulatory sense, private-sector standards are, de facto, increasingly becoming mandatory because of the market power of certain large, globally acting retailers and importers".[56]

[53]Wouters et al. (2008) [emphasis added].

[54]Vorley and Fox (2004).

[55]UNCTAD, Joint UNCTAD/WTO informal information session on private standards Geneva, 25 June 2007, http://www.unctad.org/trade_env/test1/meetings/wto1/Background%20info%20for%20website.pdf (accessed 1 August 2013).

[56]Ibid.

Second, it is also cognizable that private standards and their certification schemes may completely rely on specific local conditions and circumstances.[57] "At the local level, many of these schemes have also become a *de facto* market standard against which local consumers judge all other similar goods".[58] This has effect on the market access opportunity of foreign goods.[59] In particular, some standards have been criticized for operating to protect "western" industries against imports from developing countries".[60] In this sense various interest groups argue that private standards, just like public regulations, may be "used to gain strategic trade advantages for domestic firms over foreign competitors".[61]

Accordingly, the very process through which private standards are developed is valuable to interest groups.[62] Lack of transparency and accountability will give to the sponsors of the various private standards setting schemes the opportunity to abuse their strategic location in the overall global value chain. There are various evidences that show "certification is highly influenced by previous trade relationships".[63] The growing influence of such non-State actors and the potential for capture has thus resulted in what some call the "privatization of [food safety, environmental and social] governance".[64] Accordingly, there is at least a potential risk that private standard setting organs will fall victims of industry capture.[65] For example, according to Appleton, while the Bio Suisse scheme appears neutral on its surface, "it emphasizes on a sensitive portion of a product's life-cycle that appeal to local agricultural producers".[66] Hence, "the Bio Suisse scheme favours Swiss farmers and their neighbours, to the detriment of more distant developing countries".[67] Moreover, "in addition to being shrewd marketing schemes, these private labelling and certification schemes often have protectionist motives".[68]

Equally, trade disturbing protectionist pressures are also visible in broader labelling schemes such as environmental labelling, eco-labelling and food mile.[69] According to Wilson, "if food miles campaigners were genuine in their concern for reducing food production's CO2 footprint, they would focus on the CO2 footprint of the life-cycle of production".[70] In doing so the trade repercussion of some of

[57]Vitalis (2002).
[58]Ibid.
[59]Ibid.
[60]World Growth (2011), p. 24.
[61]Otieno and Ogalo (2009), p. 13.
[62]Gandhi (2006), p. 3 (emphasis added).
[63]Herzfelda et al. (2011), p. 25.
[64]Generally, see Konefal et al. (2005) and Higgins et al. (2008).
[65]Vitalis (2002), p. 6.
[66]Appleton (2006), p. 10.
[67]Ibid.
[68]Ibid.
[69]Wilson (2007), p. 41.
[70]Ibid.

these standards is immense and runs counter to the established principles under the WTO.[71]

4.2 A Role for WTO Reference Paper

The preceding paragraphs highlighted that access to the telecom supply infrastructure is key in order to access markets. In the absence of a right to connect to existing standard and distribution chains, competition can hardly be safeguarded, hence the similarity between the telecommunication services and other sectors in trade in goods. As simple market access remains useless without access to distribution chains that may grant access to the large consumer group. This access is a necessary complement to the liberalization of trade in goods.

Hence a regime can and should be conceivable which will mandate WTO Members to regulate domestic private standard-setting organs. This can be designed in the form of legally binding principles to regulate major private standard-setting schemes and major suppliers which administer or implement the standards. Major suppliers can affect the market by control of "essential facilities" and "substantial market power". The discipline towards private standard setting schemes should put restrains against anti-competitive use of market power and should promote competitive market-like outcome. In terms of the aspired WTO framework, this obligation can be put as a requirement that WTO Member countries maintain appropriate measures for preventing certain anti-competitive practices in these sectors.

After incorporating this linkage between the activities of private standard-setting organs and the WTO, the details of the disciplines can be tailored to the current and factual circumstances of the standards. As an illustration, one option is the adoption of an approach similar to that of "non-governmental organizations" under the WTO TBT Agreement.[72] Annex 3 to the TBT Agreement provides a Code of Good Practice for the Preparation, Adoption and Application of Standards. Article 4.1 TBT Agreement obliges WTO Members to take reasonable measures to ensure that non-governmental and regional bodies accept and comply with the Code. In doing so, just like its TBT counterpart, the "Code" could require national private standardizing bodies and major players to follow principles and rules that are comparable to those specified under the TBT Agreement. Thus it may require WTO Member countries to encourage the use of international standards as a basis for private standardization schemes within their national jurisdiction. It imposes on Member States and thus private standards-setters to acquaint foreign producers and their national governments with their work and on the standardization being undertaken. At the time of publication, the national private standard-setting bodies

[71] Appleton (2006).

[72] Wouters and Geraets (2012), p. 10.

can also be required to notify the WTO of information regarding the newly developed private standards and indication as to where further information can be obtained. The "Code" could also require private standardizing organs to allow and make available a reasonable period of time for the submission of comments on draft standards by interested parties from other WTO Members.

4.2.1 Tackling Certification Bias: Access and Costs of Certification to Private Standards

One area that the proposed "Code" could be useful is in the issue of tackling biases related to certification activities by private standard-setting bodies. Today, it is not an overstatement to say that the private standard-setting and certification regime has become a lucrative business.[73] According to Washington and Ababouch "the big winners in the proliferation of private standards are undeniably certification bodies that conduct audits and certify against private standards".[74] Developing country Members to the WTO have raised concerns about the costs of certification. Among others, the limited availability of accredited certification institutions and the high cost of certification, which in large part is covered by producers in developing countries, has brought an important challenge.[75]

According to a survey by the WTO Secretariat, a growing number of developing country exporters consider compliance with private standards as a prerequisite to accessing valuable supply chains.[76] However, compliance costs to these requirements is excessively high, mainly because of the costs of certification.[77] This has negatively affected developing country exporters "who are frequently small and medium-sized enterprises where margins are 'razor thin'".[78] It is debatable, however, whether the WTO should in principle be involved with private standard-setting decisions, such as prices. In so doing the same debate on the normative scope of international trade regulation could be raised. Yet as duly reflected above, past experience and precedent set by WTO Members with the example of the WTO Telecommunications Reference Paper has very well illustrated that WTO law and practice of Member States could and should regulate the activities of private parties to the extent that the latter unreasonably distorts the free flow of international trade.

As discussed in the preceding sections, one of the main objectives of the Reference Paper is to regulate the pricing practices of incumbent telecom service providers in terms of access to newcomers. For instance, in the provision of telecommunication services, the determination of what is a reasonable amount of

[73] See Lee (2006), p. 27.

[74] Washington and Ababouch (2011), p. 116.

[75] Ibid., p. 105. Also see Otieno and Ogalo (2009), p. 22.

[76] WTO (2012), p. 148.

[77] Ibid.

[78] See Vitalis (2002), p. 7.

charge to be imposed as an interconnection fee can be a major factor determining the level of participation by entrants in the downstream market. Hence the Reference Paper incorporated a principle that mandates Members to make sure that interconnection charges are aligned to the cost of rendering the service. This can bring us to a logical premise to argue that costs of access to certification and labelling rates in the private standard-setting realm should be transparent, cost-oriented and reasonable having regard to economic feasibility. Thus just like its telecommunication services counterpart, it will not be unjustified or unprecedented if a WTO instrument obliges Members to cast a watchful eye on the pricing and implementation practices of private standard setting and certification institutions access to which is essential to access national or regional markets. Furthermore, prohibition on discrimination and abuse of the conformity assessment procedures should be central to the discipline. This can among others be achieved by adopting similar instruments as art 8 of the TBT Agreement that provides relevant obligation with the aim to discipline the conduct of conformity assessment procedures by non-governmental bodies.

4.2.2 Transparency, Accountability and Legitimacy

Like any other regulatory regime affecting trade, transparency in the development, administration and follow up of private standards is a key to making sure that the standards do not end up being discriminatory, abusive or arbitrary. Henson explains that, a major concern in the development of private food safety and quality standards is its impact on transparency.[79] Various private standard-setting initiatives have been criticized for their lack of transparency and accountability in standard-making process. This is of particular concern to the WTO given that transparency and accountability are key objectives of both the SPS Agreement and the TBT Agreement.[80] These concerns were clearly expressed in various committees and working groups of the WTO.[81] One of the primary reasons what makes transparency a trade factor has to do with its economic and trade implications. Lack of transparency in private standards plays a key role in trade and competitiveness. According to Wouters et al., "the criticism is that these standard-setters do not use a transparent procedure which contains several criteria with which private standards should comply and which is open to independent review".[82]

The Reference Paper essentially imposes obligations in terms of making information available on a timely basis, even when this has to do with purely private entities operating in a market independently of government control. In this sense, the experience of the Reference Paper has plenty to share to the other corners of the

[79]Henson (2008).
[80]Casey (2007), p. 73.
[81]WTO (2007a).
[82]Wouters et al. (2008), p. 16.

WTO legal regime. Under the Reference Paper examples of such information subject to transparency disciple include among others; an obligation on major suppliers to make public information on the availability and terms "interconnection agreements or a reference interconnection offer".[83] It also contains provisions in relation to anti-competitive practices such as "not making available to other services suppliers on a timely basis technical information about essential facilities, commercially relevant information"[84] and public availability of licensing criteria.[85] It also contains provisions on the allocation of scarce resources. It obliges Members that clear, objective, non-discriminatory and timely procedures are articulated with respect to allocation and use of scarce resources.[86]

5 Conclusions

This Chapter examined the trade and development implication of private standards in an effort to raise a normative argument towards the possibility of incorporating a regulatory agenda within the WTO multilateral trade framework. In doing so, it briefly analysed the causes of the emergence of private standards and existing legal challenges and its *status quo* within the WTO framework. As highlighted above, there seems to be broadly irreconcilable differences on the view of some WTO Member States with respect to the issue, while the large part of observers of the system argue that the two relevant agreements, TBT and SPS, are not designed to regulate the activities of private standard setting organs.

Accordingly, this contribution has raised a more forward looking question as to whether WTO Members should and could come up with an objective discipline regulating private action to be incorporated as part of the WTO legal framework. In addressing this issue, it initially approached the question by investigating if there has been the political and legal precedent to show positive action by WTO Members in this regard. It has found that the historical and unprecedented achievement of the WTO Telecommunications Reference Paper can be used as a comparative instrument to show how theoretically similar market governance challenge as private standards has been addressed by the system. The introduction of the Reference Paper has vividly reflected a change towards a more dynamic norm of State responsibility within the framework that makes sure that WTO Members will bear certain obligations imposed by WTO law to discipline private behaviour within their jurisdictions.

Without doubt, it will take a bitter negotiation and stiff political struggle if such proposal is ever to be put to use. However, it may not be completely out of support

[83]Telecommunications Reference Paper, para 2.4.

[84]Ibid., para 1.2(c).

[85]Ibid., para 4.

[86]Ibid., para 6.

as we have seen similar developments in the internal jurisdictions of some of WTO Members to regulate the supply chain dynamics and relationship between major retail and distribution networks vis-à-vis small and medium enterprise (SME) suppliers.[87]

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[87]One example of such experience is to see how a number of both developed and developing countries have employed various legal instruments, such as those called "unconscionable contract doctrine" or "abuse of superior bargaining position (ASBP)" to protect the interests of SME subcontractors. This describes a situation where a business enterprise with a "superior bargaining position" imposes "unreasonable" contractual terms against another business counterpart and takes advantage of its superiority. It is most frequently used to address contractual relationships between large retail and distribution enterprises and their supplier counterparts of goods and services. See ICN, Task Force for Abuse of Superior Bargaining Position, ICN Special Program for Kyoto Annual Conference Report on Abuse of Superior Bargaining Position, (7th ICN Conference, Kyoto Japan April 2008) Note that the list is either incomplete or now outdated as for instance Australia has one of the strongest ASBP jurisprudence.

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The Twenty-First Century Regionalism: Brazil and Mercosur in the New International Scenario

Belisa Esteca Eleoterio and Alebe Linhares Mesquita

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Abstract The present paper intends to investigate the main characteristics of regionalism in the twenty-first century as well as the role played by Brazil and Mercosur in this new global scenario. This discussion is analysed through the perspective of the third wave of regionalism. Therefore, this article is divided into three main sections. Firstly, the theory of the regionalism waves will be explained. Secondly, the process of regional integration in Latin America will be analysed. At last, the insertion of Brazil and Mercosur in the context of the new regionalism will be investigated. This discussion is very important for developing countries, since it is directly linked to the prospects and challenges of their integration into the global economy. In conclusion, it can be asserted that the deep economic transformations observed in recent years have caused the breakdown of the stability of various economic blocs, including Mercosur. The search for new models of integration may solve common problems between neighbouring countries that often go beyond the merely economic domains. Hence, regional development depends not only on economic integration, but it is also often associated with physical integration and infrastructure improvement.

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1 Introduction

The interaction between sovereign States has always been marked by different forms of integration. From cooperation initiatives to models of deep political, economic, financial, and infrastructure integration, many factors link the States' decision-making process to the international circumstances in which they are found. Recent changes in the world production structure combined with the recognition of multiple issues that overpass State boundaries are redefining the role of Nation-States, and consequently their strategic performances internationally.

It is, for instance, usually recalled that technological advances have reduced physical distance in the world and contributed to overcome many differences among countries. This phenomenon may be observed, for example, in international conferences, such as the G20 and BRICS summits, in which countries are brought together in order to discuss topics of common concern. Currently, there are some global problems that can only be solved with the cooperation of all countries. In this regard, regional integration is also seen as an important tool to boost economic growth and promote development among States.

In this context, although not intending to exhaust such a vast theme, the present paper intends to analyse the main characteristics of regionalism in the twenty-first century as well as the role played by Brazil and Mercosur in this new global scenario. The importance of this article resides in the relevance of regionalism for the developing countries' successful integration into the global economy.

2 The Waves of Regionalism: From Regional Integration to Multidimensional Interdependence

In order to understand the phenomenon and the relevance of regional interaction, one needs to revive the meaning of the concept of *region*. Traditionally, a region may be understood as a part of the Earth's surface with one or many similar characteristics that make it unique from other areas, and these characteristics may be related to climate, environmental factors, economy, culture, politics, etc.[1]

Nevertheless, recent interaction movements not directly connected to the physical location of each country could suggest that geographical proximity may be losing importance. This is a misconception, since regional proximity still plays an important role in the international relations. However, one should also bear in mind that a region may also be the result of political coordination.[2]

The expressions *regional integration*, *regionalism*, *regionalisation*, *regional governance* and *regional cooperation* have been used in a somewhat loose manner

[1] Haesbaert (2010).

[2] Haesbaert (2010).

in the literature.[3] The lack of accuracy in the use of these terms and the lack of a systematic approach in the analysis of different types of integration may lead to a misconception, limiting the results of comparative studies in the field. Since the European model of integration is usually the one used in comparative process, the main elements used in the comparison may not take into consideration the peculiarities of a given region and therefore may not permit that these characteristics are the ones responsible for defining its nature.[4]

Regarding the process of regionalism, the great majority of the scholars recognize two well defined waves.[5] The first one, dating back to the post-war period (1950s and 1960s) corresponds to the earliest integration movements of the then European Economic Community.[6] The success of the European integration gave rise to multiple analyses of the community formation at the international level. The renowned theory proposed by Bela Balassa that defines the economic evolution of regionalism from a free trade area to customs union, common market, economic union and complete economic integration is an example of the academic effervescence of that period.[7]

Simultaneously, developing countries observed the outbreak of preferential arrangements among themselves as a mean of fostering their national growth and reducing the costs of their import-substitution industrialization. The regional experience of the previous years was reduced during the 70s and the early 80s, notably due to the growing efforts made in the multilateral arena in order to promote the reduction of trade barriers among countries.

The main driving force of the second wave of regionalism was the decision of the United States of shifting from multilateralism to regionalism with the negotiation of North American Free Trade Agreement (NAFTA) and its Enterprise for the Americas Initiative. The proliferation of regional trade agreements was also observed in Latin America (Andean Community of Nations, Mercosur), Asia (ASEAN Free Trade Area—AFTA and commitments to achieve trade liberalization in Asia-Pacific Economic Cooperation—APEC), and Africa (negotiations for the creation of an economic and political union).

Product of a post-hegemonic period in which new and important actors emerged in the international scenario, the definition of the so-called third wave of regionalism is not a unanimous concept in the literature. Still, many scholars emphasize some aspects that can affirm this new tendency of regional integration.[8]

In this sense, the concept of regional integration adopted in the first wave could be described by Nye's view as: a limited number of States linked together by a

[3]Hameiri (2013), p. 316.

[4]De Lombaerde (2012), p. 32.

[5]Bhagwati (1993), p. 28.

[6]Balassa (1961).

[7]Ibid.

[8]See, for example: Hameiri (2013); De Lombaerde (2012); Matthews (2003); Lloyd (2002); Mansfield and Milner (1999).

geographical relationship and by a degree of mutual interdependence.[9] This definition, although not entirely old-fashioned, no longer keeps up with the new idea of regionalism. The *old regionalism*, characterized mainly by State-based regional organizations of the post-war period, has been expanded to include new organizations, actors and issue areas.

Amidst the new international conformation, in which the States' role in the regional integration process must be performed in order to converge their interests and those of new actors with the capacity of national and international action, one must overcome what Agnew called *territorial trap*, that is, the conventional idea that States are fixed sovereign spaces; that the political and economic aspects of a nation have clear separation between the national and international levels; and that both economy and society are defined by national boundaries.[10]

In order to address the changes recently observed and the flexibility of the concept of regionalism, De Lombaerde proposed what should be an updated definition of the phenomenon:

> A multi-dimensional process of social transformation whereby actors, associated with (sub) national governance levels and belonging to a limited number of different states, intensify their interactions through the reduction of obstacles, the implementation of coordinated or common actions and policies, and/or the creation of regional institutions, thereby creating a new relevant (regional) space for many aspects of human behaviour and activities.[11]

When comparing both definitions, it may be noticed that the latter contains, indeed, elements that emphasize the features of new regionalism: its multidimensional nature, the multiplicity of actors and the difference between regional interdependence and the construction of regional institutions. Other features may be also included, such as public-private partnerships; differences between the concepts of government and governance; and the increased focus on negotiation and cooperation processes, including their informal and not institutionalized aspects.[12] These elements reinforce the idea that neither the government nor the non-governmental sector has the necessary characteristics for isolation when dealing with issues of contemporary governance and regional integration. Therefore, both must act jointly.

In order to explain the variations in the concept of regional integration, several authors have attempted to distinguish between what is considered *regionalism*—formal policies and projects where State and non-State actors seek strategies of coordination and cooperation within a certain region, which may result in some degree of institutionalization—and *regionalization*—processes of cooperation, integration and cohesion on specific or general subjects. It is noteworthy that there is no hierarchical relationship between the two modalities, i.e., the absence of formal institutions of the regionalization process does not imply inferiority

[9] Nye (1971), pp. 16–17.
[10] Agnew (1994).
[11] De Lombaerde (2012), p. 32.
[12] Sagan (2009), p. 95.

regarding what is called regionalism; on the contrary, there is constant intersection between the policy objectives of regionalism and regionalization process, as parts of the same system.[13]

By proposing a broad definition that comprises the components of new regionalism, De Lombaerde asserts that a region can be characterized by different kinds of boundaries: geographic or not; jurisdictional or not; open, closed or porous. He also states that a region may be also characterized by the occurrence of internal and extra-bloc transactions at the same time. At last, the scholar highlights that all forms of integration should be included in the concept of region, whether shallow or deep, formal or informal, institutionalized or not institutionalized, legal or illegal, micro or macro, endogenous or exogenous, confirming, once again, the dynamic characteristic of this social phenomenon.[14]

Hence, the third wave of regionalism represents the integration process of countries in the twenty-first century. As noted by Baldwin, twenty-first century regionalism is not primarily about preferential market access as was the case for twentieth century regionalism; it is about disciplines that underpin the trade-investment-service nexus.[15] In other words, regionalism is driven by a different set of political economy forces and it is largely about regulation rather than tariffs.

In the light of the regionalism waves' theory above described, it is important to analyse the regionalism processes in Latin America, its development's strategies, its achievements and its new challenges. Thus, the next section intends to investigate these and other relevant aspects of the integration process in Latin America.

3 Regionalism in Latin America: An Overview

Over the last decades, several attempts of regional integration have been observed in Latin America. The influence of the Economic Commission for Latin America and the Caribbean—(ECLAC) is remarkable and makes important contributions to a better understanding of the regionalist phenomenon in Latin America.[16] The Commission perceives regional integration as a strategy to promote social and economic development among Latin American countries.

In this sense, Amado Cervo called *development paradigm* of Latin American international relations some shared characteristics of the foreign policy of Latin American countries from 1930s up to the late 1980s.[17] These characteristics encompassed concerns with the external national vulnerability and the way Latin American countries were inserted in the global markets. Amid an import

[13]Hameiri (2013), p. 318.

[14]De Lombaerde (2012), p. 34.

[15]Baldwin (2011).

[16]Economic Commission for Latin America and the Caribbean (1994).

[17]Cervo (2003).

substitution policy, such a paradigm would make foreign policy responsible for raising the necessary resources to enhance internal development through: (1) opening markets for export products; (2) obtaining foreign investment to sustain growth of the national economy; and (3) transferring technology.[18]

Also during the 1980s, the debt crisis has made regional integration blossom again: the recognition of structural weaknesses meant that integration became an outlet for the recovery from the crisis. According to Baumann, regional integration at that time began to understand the need for coordination of production structures. It has become a platform for increased exports and turned the coordination in the international scene into a priority.[19] A hallmark of this period is the pursuit of productive complementarity between Brazil and Argentina, in what would be the embryo of Mercosur.

In the early 1990s, there was progressive trade liberalization in Latin American countries and the decline of US hegemony in the post-war period. Integration was then understood as a means of introducing Latin American economies into the international economy. In this context, emerged the concept of *open regionalism*, as defined by ECLAC as:

> A process of increasing interdependence at the regional level, promoted by preferential integration agreements and other policies in the context of liberalization and deregulation able to strengthen the competitiveness of the region and, insofar as possible, allow the formation of blocs for a more open and transparent global economy.[20]

By combining the phenomena of growing regional interdependence and the tendency to promote trade liberalization, it is understood that the new theory proposed by ECLAC school does not see regional integration as an obstacle, but as a step in the liberalization process, combining deepening regional integration in the international integration of neoliberal strategies of States in a world of global flows.

The market came to be understood as the means of overcoming the model of industrialization already exceeded by diversifying the production structure and reducing external vulnerability. The *open regionalism* promoted a structural break with historical thinking presented by ECLAC hitherto, since, instead of promoting ingrowth, it started to turn out with the aim of ensuring international competitiveness. Mercosur comes amid this context, as a result of the rapprochement between Brazil and Argentina that took place in the previous decade.[21]

In 1986, Puig identified challenges posed by the regional integration model adopted by Latin American countries that still can be verified nowadays. In accordance with the scholar, the concept of integration can be defined as the social phenomenon whereby two or more human groups adopt a permanent regulation of certain matters which until that moment belonged to its exclusive jurisdiction.[22]

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[18]Cervo (2007).

[19]Baumann (2005).

[20]Economic Commission for Latin America and the Caribbean (1994), p. 8.

[21]Scheibe (2013), p. 45.

[22]Puig (1986), p. 41.

As previously mentioned, De Lombaerde, when analysing the evolution of the concept of integration, found that, traditionally, attempts to define this phenomenon were based primarily on regional aspects, in which there were a limited number of States linked by a geographical relationship that sought a certain degree of interdependence. On the other hand, De Lombaerde found that the most current definitions take into account the multidimensional process of social transformation, where there is a multiplicity of actors interacting with the goal of creating a relevant regional space for various aspects of human behaviour.[23]

In order to clarify the definition proposed, Puig points out that the *human groups* to which he makes reference encompasses many actors beyond the State. The author also explains that integration should make these social groups abandon their individual action in certain matters in order to act together and permanently with the other participants of integration.[24] Thus, it can be stated that the concept of regional integration by Puig back in the 1980s has very modern aspects in accordance with the definition suggested by De Lombaerde.

According to Puig, when the Institute for the Integration of Latin America and the Caribbean (INTAL) was created in 1965, it had the intention to carry out the integration in Latin America in a broader sense, encompassing economic, social, historical, political, legal and institutional aspects. However, the socio-political aspect of integration was gradually abandoned by Latin America according to changes in the political orientation of governments, which began to focus its efforts on economic integration based on interdependence and complementarity of national markets.[25]

In addition to interdependent integration, Puig highlights the path of integration through solidarity, most likely between countries with large disparities in potential. In this case, there are two possible scenarios. In the first one, the solidarity integration relates to the status that States have before the international community, such as similar positions, comparable social structures and shared perspectives and interests. In the second scenario, solidarity integration refers to the values that States have in common, such as autonomy in the case of Latin America.[26]

It should be noted that the featured integration modalities are not mutually exclusive. The Cartagena Agreement, which gave birth to the Latin American Integration Association (LAIA),[27] was created as a sub-regional economic integration agreement based on interdependence, but with supportive objectives among which predominates the search for greater autonomy of the signatory countries. With respect to autonomy, Puig describes as an optimal situation one in which

[23]De Lombaerde (2012).

[24]Puig (1986), p. 41.

[25]Ibid., p. 42.

[26]Ibid., p. 44.

[27]LAIA includes Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Panama, Peru, Uruguay and Venezuela.

government resolutions correspond to the potential margin of autonomous decision of the State: increasing national autonomy means increasing the margin of the decision itself.[28]

On this view, the next section aims to investigate the insertion of Brazil and Mercosur in the context of the twenty-first century regionalism. This issue is analysed through the perspective of the regionalism waves regarding how it impacted the Latin American integration process.

4 The Insertion of Brazil and Mercosur in the Context of the Twenty-First Century Regionalism

Historically, Brazilian foreign policy favours multilateral sphere as the main forum for negotiations because it is believed that multilateral negotiations offer the best conditions for developing countries to ensure more balanced results in their areas of interest. It is also worth noting that the attempts to strengthen South-South cooperation at the expense of North-South relations has been a priority of the Brazilian government in the last decade.

Since the early 1990s, Brazil has been privileging an integration plan focused on South America. Mercosur, an economic integration agreement that includes Brazil, Argentina, Paraguay, Uruguay and Venezuela, rises from the exhaustion of the import substitution policy, at a time when it was needed to reverse protectionism and open up national markets. As noted above, this moment was called open regionalism.

The creation of Mercosur was driven by the intention of forming a common market that would cover the free movement of goods, services and factors of production; the elimination of tariff and non-tariff trade restrictions; the establishment of a common external tariff; the adoption of a common trade policy; and the coordination of macroeconomic and sectorial policies.

However, more than 20 years after its foundation, the success of Mercosur has been regularly questioned. Brazilian Ambassador Rubens Barbosa[29] has declared in several opportunities that the Mercosur is facing a critical moment regarding its primary objective, in other words, to consolidate a full economic integration through the creation of a common market.[30] Even though the bloc was able to promote a significant increase in trade flows among its Members in its beginning, nowadays, its advancement lies prevented by the adoption of protectionist barriers, schedule slippage, lack of compliance with the goals initially established and political unwillingness in order to intensify integration.

[28]Puig (1986), p. 51.

[29]Barbosa (2013).

[30]See, for example Thorstensen (2013a); Thorstensen (2013b).

Already in the 1980s, Puig had predicted that integration based on a broad market among nations with significant asymmetries, especially when one of them has a developed industrial market and strong pressure groups, without taking into account the non-State integrationist demands that follow economic integration, would be doomed to failure.[31] This seems to be the current situation faced by Mercosur's Member States.

Besides, it is important to stress that Brazil is isolated from the new international economic trend of entering into Preferential Trade Agreements (PTAs). In the last decades, the world has witnessed the increasing proliferation of PTAs concluded in parallel to the World Trade Organization (WTO) system. At the beginning of the 1990s, there were only 70 PTAs in force. In 2013, 546 PTAs have already been reported to the WTO, of which 256 are currently in force.[32] These numbers demonstrate a shift in how trade is being regulated and negotiated internationally.

According to Baldwin, this new wave of agreements can be understood as a response to the demands of the twenty-first century regionalism that has as its core the trade-investment-service nexus.[33] On the opposite direction of this new trend, Brazil presents only few PTAs. On continental sphere, the country is a founding Member of Mercosur, embedded in the Latin American Integration Association (LAIA), and it has PTAs (all currently in force) with Chile, Bolivia, Mexico (general and for the automotive sector), Peru, Cuba, Guyana and Suriname (only rice) and Colombia, Ecuador and Venezuela. On the extra-continental sphere, Brazil, jointly with Mercosur, has signed PTAs with India, Israel, Egypt, Palestine, the Southern African Customs Union (SACU),[34] of which only the first two are currently in force. Besides, it important to stress that Brazil has also recently gotten back the PTA's negotiation with the European Union.[35]

Compared to other countries actively engaged in the world trade, Brazil is practically isolated from this new dynamic of negotiation and rule setting. In this sense, the proliferation of PTAs constitutes one of the major challenges faced by the country. It is extremely important to understand its consequences to the Mercosur's system and analyse its consequences for the development of its Member States.

As already explained, regional integration initiatives are a complex and multi-faceted phenomenon, and often a complete economic and political integration may prove unachievable in the short and medium term. This, however, does not mean that other forms of integration are also unfeasible. According to Celli:

> Perhaps, this rethinking could allow the perception of a model under which integration is not circumscribed to market mechanisms, but, on the contrary, it also employs instruments

[31]Puig (1986), p. 44.

[32]Thorstensen and Ferraz (2013).

[33]Baldwin (2011).

[34]The Southern African Customs Union (SACU) is formed by Botswana, Lesotho, Namibia, South Africa and Swaziland.

[35]Thorstensen and Ferraz (2013).

> and procedures that could conduct to an autonomous and sustainable development for the benefit of the participating populations.[36]

In a similar vein, the joint integration described by Puig could represent a way out so that Mercosur's Member States can achieve sectorial objectives based on shared values.[37] The integration through infrastructure serves as an example of possible alliances within the joint integration. At the regional level, this type of integration may have strategic value and would be of great importance to leverage growth and achieve higher levels of development in the region.

When dealing with the physical integration, also known as *silent integration*, the ECLAC lists some characteristics that show the importance of this mode of integration, such as: (1) it leads to the effective realization of economic, business and political integration; (2) it allows the progressive and joint problem solving, e.g., physical bottlenecks, while stimulating the creation or reorganization of supply chains, provides decentralized development and decreases the commercial and distribution costs; (3) it has great potential to foster unity, peace and development and to achieve greater social equity and reduce disparities between countries and within countries; (4) it undertakes the long and medium term, making investments in the infrastructure sector safer and allowing execution of projects continuously, including in times of crisis; (5) it may incorporate participation and decision of local governments and the private sector through the development, financing, construction and operation of works of physical integration, etc.[38]

From the perspective of physical integration, we can address the issue of energy integration. The benefits of establishing an energetic link between two or more countries to form a regional energy market are numerous, both for countries with surplus energy as for importing countries. Among this advantages, it can be highlighted the markets expansion, the optimization and complementarity in use of natural resources, the exploitation of shared resources, the increase in the security of supply and other environmental benefits.

As we have seen before, regionalism and regionalization is not only a matter of economics. This is just one of the many possible alternative paths for Mercosur. As described above, the economic bloc is not experiencing its best moment. However, new perspectives can be delineated through a multidimensional view of the integration process. Only then, the goals once envisaged can be achieved.

[36]Celli (2006), p. 21.
[37]Puig (1986).
[38]Tomassian (2009), p. 2.

5 Final Remarks

The points discussed herein represent only a small portion of the immense universe of issues related to the new regionalism. Thus, the complexity of regionalism/regionalization processes should continue to be studied in order to achieve a better understanding of the topic.

The profound economic transformations observed in recent years have caused the breakdown of the stability of various economic blocs, including Mercosur. Hence, it is necessary to rethink its regional integration process in order to adapt it to the new global reality. This could provide more economic competitiveness and development for its Member States.

As can be observed, Brazil is isolated from the new world economic trend of entering into PTAs. This foreign policy could be rethought so that the country may have a voice in the way trade is being regulated internationally. Besides, the search for new models of integration may solve common problems between neighbouring States, problems that often go beyond merely economic perspectives.

In this particular sense, it is important to stress that regional development depends not only on economic integration, but it is also associated with physical integration and infrastructure improvement. One can even say that the economic and physical integration are two sides of the same coin, i.e., complementary and indispensable to integration's goals.

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Regionalization Within the SPS Agreement: Recent Developments

Anna G. Micara

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Abstract The SPS Agreement includes a significant provision according to which SPS measures are to be adapted to regional conditions (art 6). However, its implementation faces several problems, especially concerning complex and slow administrative procedures and the obtaining of recognition of international organizations' standards. This Chapter will examine the process of adoption by the SPS Committee of the "2008 Guidelines to Further the Practical Implementation of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures" and will then focus on the interpretation of art 6 in the very recent WTO case law, so as to assess to what extent it gives more guidance. Finally, given the relevance of Free Trade Agreements, it will be appropriate to analyse SPS-plus measures in those agreements, especially the EU context as it includes regionalization's provisions going far beyond art 6.

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1 Regionalization Within the SPS Agreement

The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) of the World Trade Organization (WTO) aims at regulating the right of WTO Members to take measures for the protection of human, animal or plant and to provide their appropriate level of protection (ALOP) while ensuring that these measures do not result in disguised restrictions to free trade or are applied in a discriminatory manner.[1] In the event of risks arising, for example, from animal or plant diseases, Members may adopt sanitary and phytosanitary (SPS) measures such as import bans, testing or certification procedures or labelling requirements related to food safety, which may therefore affect international trade.[2] In order to assess the consistency of these "obstacles to trade" with the SPS Agreement it is crucial to evaluate whether they are "based on scientific principles" (art 2.2). The scientific evidence criterion is specified in art 5.1 according to which "Members shall ensure that their sanitary and phytosanitary measures are based on an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health". Another main feature of the Agreement is that it encourages harmonization through a requirement for Members to base their SPS measures on international standards, guidelines and recommendations adopted by the so-called "sister organizations" e.g. the International Office of Epizootics (OIE), now World Organization for Animal Health, the International Plant Protection Convention (IPPC) and the Codex Alimentarius Commission. SPS measures that conform to those international standards are presumed to be consistent with the Agreement.[3]

It may occur that, due to a case of Bovine Spongiform Encephalopathy (BSE) in livestock in a WTO Member, other Members ban imports of meat from that country in order to prevent the spreading of that disease within its own territory.[4] However, the disease may be localized only in a little part of a big exporting country so that exports of animals and meat from other regions of that country are restricted but in principle they may be safe and restrictions may not be justified by scientific evidence. Therefore, restrictions based on political borders could cause enormous losses to food industries and could be a problem for many WTO Members such as the EU, the US, China, Canada, Brazil, as well as for smaller countries which are net food exporters. Furthermore, in certain circumstances it may be too costly for the exporting country to have the whole country free of a disease. Acknowledging this, the SPS Agreement includes a provision concerning adaptation to regional

[1] WTO Agreement on the Application of Sanitary and Phytosanitary Measures, Annex 1 A of the Agreement Establishing the World Trade Organization, 15 April 1994, https://www.wto.org/english/docs_e/legal_e/legal_e.htm.

[2] On the notion of SPS measures see Annex A of the SPS Agreement and see, among others, Scott (2007), pp. 10 ff.

[3] For a general overview of the SPS Agreement see, among others, Gruszczynski (2010), pp. 35 ff. Marceau and Trachtman (2014), pp. 351 ff. Alemanno (2007), pp. 239–290.

[4] Loppacher and Kerr (2005), pp. 427 ff.

conditions, so-called "regionalization" or "zoning", which establishes the obligation for WTO Members to ensure that SPS measures are *adapted* to the SPS characteristics of the areas of origin and destination of the products (art 6.1). Regionalization "may be seen as a specific reflection of the necessity test provided by Article 2.2 and the least-trade-restrictive obligation of Article 5.6"[5] and it is a much significant provision since it makes possible to enhance health protection at national level while improving market access for products from regions which meet the ALOP.

In order to adapt their SPS measures, Members assess the SPS characteristics of a region (in the exporting or importing country) taking into account a non-exhaustive list of factors such as "the level of prevalence of specific diseases or pests, the existence of eradication or control programmes, and appropriate criteria or guidelines which may be developed by the relevant international organizations" (art 6.1). Article 6 then specifically refers to the so-called pest- or disease-free areas (PDFAs) and areas of low pest or disease prevalence (ALPDPs). PDFAs are defined as areas "whether all of country, part of a country, or all parts of several countries, as identified by the competent authorities, in which a specific pest or disease does not occur" (Annex A(6) SPS Agreement); while ALPDPs are areas "whether all of a country, part of a country, or all parts of several countries, as identified by the competent authorities, in which a specific pest or disease occurs at low levels and which is subject to effective surveillance, control or eradication measures" (Annex A(7) SPS Agreement). Indeed importing countries are required to recognize the concept of PDFA and ALPDP and, in order to determine them, they must consider factors such as geography, ecosystems, epidemiological surveillance, and the effectiveness of sanitary or phytosanitary controls (art 6.2), while exporting countries claiming PDFAs and ALPDPs "shall provide the necessary evidence thereof in order to objectively demonstrate to the importing Member that such areas are, and are likely to remain, pest- or disease-free areas or areas of low pest or disease prevalence, respectively" (art 6.3).

At the beginnings of 2000s several exporting countries complained within the SPS Committee about the lack of implementation of this provision.[6] After examining the issues raised by WTO Members and the Guidelines on implementation adopted in 2008, the paper will focus on the interpretation of art 6 of the SPS Agreement in the recent WTO case-law in order to assess to what extent it gives more guidance, therefore improving implementation. Finally, since nowadays WTO-plus measures are concluded through Free Trade Agreements (FTAs), it will be interesting to analyse the provisions on regionalization in the FTAs of the EU because, compared to other FTAs, they often include SPS-plus measures on this aspect.

[5] Gruszczynski (2010), p. 251.

[6] The SPS Committee was established "to provide a regular forum for consultations" and carries out "the functions necessary to implement the provisions of this Agreement and the furtherance of its objectives" (SPS agreement, art 12).

2 The Adoption of the Guidelines to Further the Practical Implementation of Article 6 of the SPS Agreement

Already in the 1999 review of the SPS Agreement, only 4 years after its entry into force, the SPS Committee noted that implementation of regionalization proved to be difficult due to

> divergences in interpretation and implementation of international guidelines; an excessively lengthy administrative process in importing countries for recognizing pest- or disease-free areas or areas of low pest or disease prevalence; and the complexities often involved in risk assessment.[7]

In 2003 a number of WTO Members, mainly from Latin America such as Mexico, Peru, Chile and Argentina, proposed to the SPS Committee to develop guidelines to improve the implementation of regionalization.[8] These countries, as well as the EU,[9] complained that many exporting Members which successfully managed to achieve pest- or disease-free status in a certain area experienced difficulties and lengthy delays in the process of getting recognition of PDFAs and ALPDPs by importing Members. Implementation problems were mainly due to very complex and slow administrative procedures in the importing countries.[10] This was regrettable since the possibility to reduce trade barriers through regionalization is an incentive to improve disease control; moreover, creating PDFA and ALPDP and maintaining them entails large investments and efforts that could take many years,[11] in particular for developing countries.

Several WTO Members underlined the need to avoid duplications with the work of international standard-setting bodies (ISSBs). According to some Members, such as the EU,[12] the SPS Committee should have dealt with clear and predictable administrative guidelines while the ISSBs should have focused on the technical and scientific guidelines. According to others (US, Canada, New Zealand, Japan) in

[7]WTO doc. G/SPS/12, Review of the Operation and Implementation of the Agreement on the Application of Sanitary and Phytosanitary Measures, 11 March 1999, para 21.

[8]See WTO doc. G/SPS/R/31, Summary of the Meeting held on 29–30 October 2003, 23 December 2003, para 90 ff. see also in particular WTO doc. G/SPS/W/140, Draft Decision on the Implementation of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures, Proposal by Chile, 23 October 2003.

[9]WTO doc. G/SPS/GEN/461, Review of the SPS Agreement, Update on adaptation to regional conditions, Submission by the European Communities, 12 December 2003, para 24.

[10]WTO doc. G/SPS/GEN/388, Comments on Article 6 of the SPS Agreement – Regionalization, 1 May 2003 para 2; WTO doc. G/SPS/GEN/640/Rev.1, Issues on the Application of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures. Background Document, Note by the Secretariat, 14 September 2006, para 7 ff.

[11]WTO doc. G/SPS/W/148, Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures, Adaptation to Regional Conditions, Including Pest- or Disease-Free Areas and Areas of Low Pest or Disease Prevalence, Proposal by Peru, 7 July 2004, paras 3–4.

[12]WTO doc. G/SPS/R/42, Summary of the Meeting of 27–28 June 2006, 25 September 2006, para 84.

order to avoid duplications, scientific and technical guidelines should have been developed first and the SPS Committee should have only dealt with potential gaps.[13] The first view, supported also by OIE,[14] prevailed. However, it is not possible to neglect the close connection between technical and administrative procedures and the overlaps with administrative steps developed by ISSBs.

Another relevant topic was whether guidelines should have included binding timeframes concerning the administrative procedures. Given the importance that adaptation is done within a reasonable period of time, several Members, such as Brazil and Peru, encouraged the development of clear time schedules in order to avoid undue delays while enhancing transparency.[15] However, this was opposed by many developed countries, especially Japan, a large food importing country, but also US and Korea. These countries seemed to be concerned that setting timeline recommendations would have disregarded peculiarities of single diseases from a scientific and technical perspective and the diverse regulatory environments.[16]

Overall, on the one hand exporting countries suggested that difficulties were protectionist-motivated while importers argued that it was necessary to act with caution to avoid spreading diseases and pests and were reluctant to lose their leeway.[17]

In 2008 the Guidelines to Further the Practical Implementation of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures[18] (hereafter: the Guidelines) were adopted. They are not binding and recall that "Members have the sovereign right to determine their own processes for the evaluation of requests for recognition of pest- or disease-free areas or areas of low pest or disease prevalence" (para 19). At the same time, they set important principles, which are transparency, non-discrimination, predictability, confidence and credibility, and they contribute to clarify and set out procedural steps that exporting and importing countries should follow to adapt their SPS measures. After initial discussion upon request of the exporting Member aimed at clarifying general issues on the evaluation of the request, typical administrative steps include: the exporting Member requests information about procedures for the evaluation of PDFAs and ALPDPs and/or for recognition of those areas, which may be supported by scientific

[13]WTO doc. G/SPS/R/37, Summary of the Meeting held on 29–30 June 2005, Note by the Secretariat, 11 August 2005, para 101.

[14]WTO doc. G/SPS/R/44, Summary of the Meeting of 28 February-1 March 2007, 30 May 2007, para 106.

[15]WTO doc. G/SPS/R/38, Summary of the Special Meeting on Article 6 (Regionalization) held on 30–31 January 2006 27 February 2006, paras 6–8–10.

[16]Ibid., para 7. See also in particular, WTO doc. G/SPS/W/195, The Implementation of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures (Regionalization) Communication from the Republic of Korea, 31 May 2006, para 12.

[17]On the debate within the SPS Committee see, among others, Scott (2007), pp. 186–190; Loppacher et al. (2007), pp. 678–679.

[18]WTO doc. G/SPS/48, Guidelines to Further the Practical Implementation of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures, 16 May 2008.

information; the importing Member then explains its requirements so that the exporting Member may provide relevant documentation. The importing Member evaluates the documentation and gives a feedback to the exporting Member and, if necessary, it may request additional information. After the exchange of relevant information between the countries and, if applicable, after on-site verification by the importing Member in order to verify the information provided, the importing Member makes a determination. Concerning timeframes, the final text leaves broad latitude to Members: there is a general provision according to which "[m]embers should proceed with a recognition process without undue delay" (para 5) but few provisions specify a precise timeframe: initial discussions should be undertaken "within a reasonable period of time, and normally within 90 days of a request or as otherwise mutually decided" (para 15) and in certain circumstances, in particular whether a "relevant international organization" has officially recognized a PDFA or ALPDP, Members may apply an "expedited process" to evaluate the request for their recognition (para 32).

3 The Relevance of International Standards

Another main issue raised by several WTO Members within the SPS Committee was that "importing Members do not, in most cases, give effect to the recognition granted by the international reference organizations"[19] of disease- or pest-free sanitary and phytosanitary status or they give effect to such recognition with delay. During negotiations of the Guidelines, certain Members proposed that among the administrative steps there should be a request of recognition by ISSBs as a prerequisite for bilateral recognition[20] and that when a country obtains ISSB recognition the administrative process "may" be "expedited". While the latter was in the end adopted, as noted above, the former was not included in the final version since several Members, such as US, South Korea and Brazil, underlined that "emphasis should be on the bilateral pursuit of regionalization determination in a transparent and predictable manner"[21] and that decisions on regionalization should be based on relevant facts (therefore determinations by ISSBs would be only one of them).[22] This second approach better fits with the interpretation of art 6.1 according

[19]WTO doc. G/SPS/GEN/388, *supra*, n. 10, para 2.

[20]WTO doc. G/SPS/GEN/640, Issues on the Application of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures. Background Document, Note by the Secretariat, 20 March 2006, para 27.

[21]See US and EC in WTO doc. G/SPS/R/42, *supra*, n. 13, paras 83 and 85 as well as WTO doc. G/SPS/W/189, Comments On Background Document G/SPS/GEN/640 "Issues in the Application of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures", Document Submitted Jointly By Argentina, Brazil, Colombia, Ecuador, Paraguay And Uruguay 24 May 2006, p. 1.

[22]WTO doc. G/SPS/R/42, *supra*, n. 12, para 83.

to which it has to be read as "*lex specialis* to a general obligation of Article 3.1".[23] Indeed art 3.1 obliges Members to "base" their SPS measures on international standards, guidelines or recommendations whereas according to art 6.1 appropriate criteria or guidelines which may be developed by the relevant international organizations are to be "taken into account", something which does not imply that SPS measures should be "based on" international standards so that those measures may contradict relevant standards.[24] Furthermore, it is not clear yet whether ISSBs official recognition of PDFA and ALPDP should be considered as guidelines,[25] and, in any case, exporting Members should also prove that relevant areas are "likely to remain" free (art 6.2).

However, standards adopted by OIE and IPPC[26] have in practice a very significant role. Regionalization had been part of OIE's work since its inception but, in parallel with the discussion on administrative guidelines within the SPS Committee, both OIE and IPPC started to make more efforts in developing international standards on regionalization and on the designation of PDFAs and ALPDPs. In particular, OIE has included in its Terrestrial Animal Health Code (Terrestrial Code) general requirements to obtain and maintain disease-free status (Chapter 4.3.1) and specific requirements for many diseases such as Foot-and-Mouth Disease, Classical Swine Fever, Newcastle Disease, Avian Influenza; moreover, OIE may recognize officially the disease free status of a country or part of it.[27] There is therefore a number of standards which WTO Members often take into account: when the SPS Committee deals with specific trade concerns (which according to some authors are "akin to an informal form of resolution of trade conflicts that operates in parallel to the Dispute Settlement mechanism and covers a broad range of non-tariff barriers of a regulatory nature"[28]) reliance on those standards has been much relevant.[29]

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[23]Gruszczynski (2010), p. 253. On harmonization and autonomy see also Arcuri (2013), pp. 164 ff.

[24]See, among others, WTO Doc. WT/DS245/R Panel Report, *Japan – Measures Affecting the Importation of Apples*, 15 July 2003, para 8.241 "We recall that Article 5.1 requires the 'risk assessment techniques developed by the relevant international organizations' to be 'taken into account'. We note first that this expression does not impose that a risk assessment under Article 5.1 be 'based on' or 'in conformity with' such risk assessment techniques. This suggests that such techniques should be considered relevant, but that a failure to respect each and every aspect of them would not necessarily, per se, signal that the risk assessment on which the measure is based is not in conformity with the requirements of Article 5.1".

[25]Gruszczynski (2010), pp. 256–257.

[26]Art 6.1 refers to "relevant international organizations" without specifying which ones so other organizations' standards may be taken into account but mainly the sister organizations deal with the adoption of those standards: Scott (2007), p. 180.

[27]See, for example, OIE Resolution No. 17 Recognition of the Foot and Mouth Disease Status of Member Countries http://www.oie.int/fileadmin/Home/eng/Animal_Health_in_the_World/docs/pdf/2015_A_RESO_R17_FMD.pdf.

[28]Horn et al. (2013), p. 1.

[29]See, among others, WTO doc. G/SPS/GEN/204/Rev.15, Specific Trade Concerns, 24 February 2015, para 2.79; WTO doc. G/SPS/GEN/204/Rev.13, Specific Trade Concerns, 26 February 2013, paras 2.118 and 2.167.

On the other hand, recently Chile complained again about implementation of art 6 and underutilization of the Guidelines since "specific trade concerns were proof that Members did not always accept international recognition of a country's particular disease status".[30] Indeed regionalization remains a sensitive process involving trust on the counterpart and especially on the veterinary/phytosanitary system in place in the exporting Member, as acknowledged also by the Guidelines,[31] and this is particularly relevant for developing countries having underdeveloped SPS regulatory regimes. That aspect was underlined by the EU with respect to the problem of inconsistencies in the application of regionalization procedures to different Members.[32]

4 The Recent Case-Law on Regionalization

Within this framework, it is interesting to analyse the case-law on regionalization in order to assess to what extent it gives more guidance. In order to proceed, it is relevant to consider that art 6 SPS Agreement sets out very limited procedural requirements and is silent on many relevant issues, such as how to recognize the concepts of PDFA and ALPDP and how the exporting Member has to objectively demonstrate that certain areas are and are likely to remain PDFA and ALPDP.

Article 6 has been interpreted for the first time in 2014 in the panel report *India – Measures Concerning the Importation of Certain Agricultural Products*,[33] which was followed by the Appellate Body's report in 2015.[34] As the case dealt with Avian Influenza (AI), it is necessary to underline that there are two AI groups based on their pathogenicity (i.e. their ability to cause disease in birds): highly pathogenic avian influenza (HPAI) is extremely infectious, and low pathogenic avian influenza (LPAI) has low virulence and is endemic in various species of wild birds.[35] The US notified to OIE occurrences of LPAI in poultry since 2006 but did not notify HPAI

[30]WTO doc. G/SPS/R/76, Summary of the Meeting of 15 and 17 October 2014, 2 December 2014, para 7.4.

[31]"Any determination under Article 6 should consider the strength and credibility of the veterinary or phytosanitary infrastructure of the exporting Member in accordance with the importing Member's appropriate level of sanitary or phytosanitary protection" (WTO Doc. G/SPS/48 *supra*, n. 18, para 8).

[32]See WTO doc. G/SPS/R/42 *supra*, n. 12, para 84: "the ultimate decision to recognize remains with the importing Member and very much depends on the trust in the competent authority of the exporting Member. This trust builds on the veterinary/phytosanitary system in place and previous experience with the exporting Member". See also Canada and US in WTO doc. G/SPS/R/38, *supra*, n. 15, paras 13 and 18.

[33]WTO Doc. WT/DS430/R, Panel Report, *India – Measures Concerning the Importation of Certain Agricultural Products*, 14 October 2014.

[34]WTO Doc. WT/DS430/AB/R, Appellate Body Report, *India – Measures Concerning the Importation of Certain Agricultural Products*, 4 June 2015.

[35]WTO Doc. WT/DS430/R, *supra*, n. 33, paras 2.7–2.12.

outbreaks since 2004,[36] while India notified to OIE 95 outbreaks of HPAI from 2003 to 2013.[37] In 2011 India's Central Government Department of Animal Husbandry, Dairying, and Fisheries (DAHD) issued a statutory order (S.O. 1663 (E)) establishing import restrictions of various agricultural products, such as ducks, turkeys, meat products and eggs, due to concerns related to AI. The DAHD was entitled to adopt this measure thanks to power conferred by the 1898 Livestock Act[38] which empowers the Central Government to regulate the import into India of any livestock which may be liable to be affected by infectious or contagious diseases.[39] With its claim before the WTO, the US asserted that India did not adapt its measures to regional conditions and had not taken into account relevant factors that should be assessed in order to adapt them, such as relevant OIE guidelines (i.e. Chapter 10.4 of the Terrestrial Code), as required by art 6.1. Moreover, India had not recognized the concept of PDFA and ALPDP, as required by art 6.2.[40] India agreed that relevant guidelines were provided by the OIE Terrestrial Code, but argued that according to art 6.1 the guidelines should be "taken into account" so that it is up to importing countries to decide whether to recognize zones according to their ALOP while taking into account also other factors. In addition, art 6.3, concerning the role of the exporting countries, was critical in the interpretation of arts 6.1 and 6.2 since it would have placed the burden upon the exporting country to initiate the proposal to recognize regionalization and to provide relevant evidence so that only when a party complied with art 6.3 requirements of arts 6.1 and 6.2 were triggered.[41]

A month after the Appellate Body report on *India – Agricultural Products*, a second panel dealing with regionalization has been issued. The report *US – Measures Affecting the Importation of Animals*[42] concerned measures taken to avoid spread of Foot-and-Mouth Disease (FMD), a highly contagious viral disease affecting livestock and wildlife which can survive in contaminated materials and in the environment for several months. The US prohibited imports of FMD-susceptible animals and animal products (i.e. fresh beef chilled or frozen) from regions where FMD existed.[43] Argentina claimed that the import ban of FMD-susceptible animals and animal products from Patagonia was inconsistent with arts 6.1 and 6.2 since the US did not take into account OIE region-specific disease status determinations, the level of prevalence of specific diseases or pests of certain regions of Patagonia, and

[36]Ibid., paras 2.45–2.46.

[37]Ibid., paras 2.47.

[38]Live-Stock Importation Act, Act No. 9 of 1898, as amended by the Live-Stock Importation (Amendment) Act (No. 28 of 2001).

[39]WTO Doc. WT/DS430/R *supra*, n. 33, para 2.3.

[40]Ibid., paras 7.618–7.619.

[41]Ibid, paras 7.631–7.645.

[42]WTO Doc. WT/DS447/R, Panel Report, *US – Measures Affecting the Importation of Animals, Meat and Other Animal Products from Argentina*, 24 July 2015.

[43]Code of Federal Regulations, Title 9, Part 94.1.

the eradication and control programme put in place in order to adapt its measures to the SPS characteristics of the areas of origin and destination of the products. Moreover, maintenance of the measure was not based on factors listed in art 6.2.[44] According to the US a claim to evaluate new information concerning disease freedom led the existing measure to be a provisional measure falling within art 5.7,[45] the fact that APHIS was still in the process of adapting its measures was due to justified uncertainty as to whether Argentina objectively demonstrated that Patagonia was and was likely to remain FMD-free, and OIE status determination did not constitute relevant guidelines (something that unfortunately was not clarified).[46]

4.1 Article 6 as a Whole

The Appellate Body (AB) in *India – Agricultural Products* affirmed that "all three paragraphs of Article 6 are interconnected"[47] and that the panel statement that art 6.1 is a free standing obligation did not take into account "important interlinkages"[48] among the paragraphs. Indeed according to the previous panel, art 6.3 "refers to a situation distinct from those of Article 6.1 and 6.2"[49] since it is not addressed to WTO Members generally but only to exporting countries claiming PDFAs and ALPDPs.[50] The AB properly noted, from a substantive perspective, that art 6.1 sets out the main and overarching obligation and that this can be fulfilled "in particular" with respect to PDFAs and ALPDP. Then arts 6.2 and 6.3 elaborate on specific elements and provide for duties of both importing and exporting countries.[51] Along the same line, the panel *US – Measures Affecting the Importation of Animals* stated that the fact that art 6 includes obligation for both the importing and the exporting country "indicates that Article 6 contemplates an interaction in good faith between the two Members, ultimately aimed at adaptation of a measure under Article 6.1".[52]

This interpretation has effects on the relationship between the single paragraphs: concerning the relationship between arts 6.1 and 6.2, the panel in *India – Agricultural Products* was of the view that it was not possible to comply with the general

[44]WTO Doc. WT/DS447/R, *supra*, n. 42, paras 7.626–7.629.

[45]On the link between art 6 and art 5 see WTO Doc. WT/DS447/R, *supra*, n. 42, paras 7.644 and 7.651.

[46]Ibid., paras 7.630–7.635.

[47]WTO Doc. WT/DS430/AB/R, *supra*, n. 34, para 5.141.

[48]Ibid., para 5.152.

[49]WTO Doc. WT/DS430/R, *supra*, n. 33, para 7.674.

[50]Ibid., para 7.674.

[51]WTO Doc. WT/DS430/AB/R, *supra*, n. 34, para 5.152.

[52]WTO Doc. WT/DS447/R, *supra*, n. 42, para 7.655.

obligation to adapt to regional conditions (art 6.1) without having recognized the concepts of PDFA and ALPDP (art 6.2)[53] and came to the conclusion that, being inconsistent with art 6.2, Indian measures were also inconsistent with art 6.1 first sentence,[54] i.e. that India did not adapt its measures to regional conditions. However, the AB stated that the concepts of PDFAs and ALPDPs are "a subset of all the SPS characteristics of an area that may call for the adaptation of an SPS measure"[55] and that PDFA/ALPDP recognition is "one particular way through which a Member can ensure that its SPS measures are 'adapted' as required by Article 6.1"[56]: this means that adapting does not always presuppose recognition.[57]

As to the relationship between arts 6.1 and 6.3, the panel in *India – Agricultural Products* affirmed that it could not be argued, as India did, that "adaptation occurs only *after* a measure is taken pursuant to a specific request for recognition made by an exporting Member"[58] although "a link may be made between information required for the assessment of SPS characteristics envisaged by Article 6.1, second sentence, and the obligation of an exporting Member to provide 'the necessary evidence' under art 6.3, first sentence . . .".[59] However, the AB expressed concern on the panel statement that steps in art 6.3 presuppose compliance of the importing country with arts 6.1 and 6.2.[60] Furthermore, it noted that the obligation to adapt in art 6.1 "does not apply only at one specific point in time (e.g. when an SPS measure is adopted) but is, instead, an ongoing one".[61] Therefore, it concluded that it can happen that a Member objectively demonstrate the existence of a PDFA after the adoption of the relevant SPS measure.[62]

Also, the AB in *India – Agricultural Products* affirmed that

> we understand the relationship of Article 6.3 with the remainder of Article 6 to mean that, . . . an exporting Member claiming . . .that an importing Member has failed to determine a specific area within that exporting Member's territory as "pest- or disease-free" – and ultimately adapt its SPS measures to that area – will have difficulties succeeding in a claim that the importing Member has thereby acted inconsistently with Articles 6.1 or 6.2, unless that exporting Member can demonstrate its own compliance with Article 6.3.[63]

Therefore art 6.3 may amount to a rebuttable presumption.[64] At the same time, even in the absence of objective demonstration according to art 6.3 a Member may

[53]WTO Doc. WT/DS430/R, *supra*, n. 33, para 7.690.
[54]Ibid., para 7.709.
[55]WTO Doc. WT/DS430/AB/R, *supra*, n. 34, para 5.133.
[56]Ibid., para 5.133.
[57]Ibid., para 5.143.
[58]WTO Doc. WT/DS430/R, *supra*, n. 33, para 7.675.
[59]Ibid., para 7.676.
[60]WTO Doc. WT/DS430/AB/R, *supra*, n. 34, para 5.153.
[61]Ibid., para 5.132.
[62]Ibid., para 5.154.
[63]Ibid., para 5.156.
[64]Arcuri (2015), p. 9.

be found in breach of art 6.1[65] and the AB agreed with the panel that "the obligations in Articles 6.1 and 6.2 are not triggered by an invocation of Article 6.3, as argued by India".[66]

In conclusion, as stated by the AB in *India – Agricultural Products*, the three paragraphs of art 6 need to be read together and compliance has to be verified case-by-case depending on the specific circumstances of the case and the nature of the claims.[67]

4.2 The Role of the Importing Countries

As mentioned above, the SPS Agreement requires importing countries to *recognize* the concept of PDFA and ALPDP (art 6.2 first sentence) and, in order to determine them, WTO Members must consider some relevant factors (art 6.2 second sentence). According to the panel in *India – Agricultural Products* art 6.2 imposes an obligation to recognize the idea, the "concept" of PDFA and ALPDP in the abstract, not referring to a specific area,[68] and "recognize" means "acknowledge the existence, legality, or validity of [especially] by formal approval or sanction; accord notice or attention to; treat as worthy of consideration".[69] However, this definition did not clarify whether recognition should be explicit and, in this case, how it should be implemented so that "to comply with Article 6.2, SPS measures adopted by WTO Members must at minimum not deny or contradict the recognition of the concepts of such areas when these concepts are relevant with respect to the disease at issue".[70] By consequence, while the panel acknowledged that the Indian Livestock Act does not include specific procedures on recognition but general provisions that could give the possibility to a recognition, as India argued,[71] it affirmed that the Indian implementation act (S.O. 1663(E)) did not include anything "that allows for the recognition of disease-free areas and/or areas of low disease prevalence within a country that notifies NAI [Notifiable Avian Influenza] to the OIE".[72] It merely imposed a ban on a country-wide basis and therefore *contradicted* the requirements to recognize,[73] bringing to the conclusion that India did not adapt its measures to regional conditions.

[65]WTO Doc. WT/DS430/AB/R, *supra*, n. 34, para 5.157.
[66]Ibid., para 5.157.
[67]Ibid., paras 5.155–5.156.
[68]WTO Doc. WT/DS430/R, *supra*, n. 33, para 7.695.
[69]Ibid., para 7.698.
[70]Ibid.
[71]Ibid., para 7.701.
[72]Ibid., para 7.702.
[73]Ibid.

Before the AB, India mainly argued that the panel should have relied on the Livestock Act but the AB supported the panel scrutiny of the relevant SPS measures as a whole and found correct the conclusion that S.O. 1663(E) contradicts the requirement to recognize the concepts of PDFA and ALPDP.[74] Here again there is no detailed explanation on why there is contradiction but the AB gives (little) more insight on how to fulfil that requirement. Overall art 6 leaves wide latitude on how to ensure adaptation (not prescribing particular steps) and on recognition of PDFA and ALPDP concepts (not clarifying whether recognition must be done in writing through a governmental act, or whether it may be accomplished in some other manner).[75] Moreover, the assessment of compliance depends on the specific circumstances of the case and the nature of the claims, involving scrutiny of specific steps and acts taken or not taken (even though the AB seems to stress as particularly relevant related international standards[76]). However, some concrete guidance on recognition of PDFA and ALPDP concepts is included in a footnote: indeed "compliance with the obligations in Articles 6.1 and 6.2 will be facilitated in circumstances where WTO Members put in place a regulatory scheme or structure that accommodates adaptation of SPS measures on an ongoing basis"[77] and "[t]his would be the case, for example, where a Member has established a mechanism for recognition of specific pest- and disease-free areas and areas of low pest and disease prevalence upon a properly substantiated request being made by an exporting Member seeking such recognition and allowing verification of the same".[78] Finally, the AB also made clear that "recognize" does not mean implementing,[79] therefore upholding the panel conclusion that recognition occurs *in the abstract*.

More insight was given by the following panel in *US – Measures Affecting the Importation of Animals*, according to which art 6.2 implies that Members must

> provide for the possibility that certain areas be determined to be pest- or disease-free areas or areas of low pest and disease prevalence, as well as *specify the requirements* that an area has to meet in order to fall within one of those categories.[80]

In this case the US Animal and Plant Health Inspection Service (APHIS) maintained a list of regions that it declared FMD-free (from which imports were not prohibited) following a detailed procedure involving the country that requested recognition,[81] and even products originating in regions not included in that list may have been eligible for import if they complied with certain sanitary regulations. Therefore, the panel found that US APHIS' general regulatory framework for FMD

[74]WTO Doc. WT/DS430/AB/R, *supra*, n. 34, paras 5.161–5.175.

[75]Ibid., paras 5.136–5.137.

[76]Ibid., para 5.137.

[77]Ibid., para 5.138.

[78]Ibid., ft 503.

[79]Ibid., para 5.174.

[80]WTO Doc. WT/DS447/R, *supra*, n. 42, para 7.656.

[81]Ibid., paras 2.11–2.16.

recognizes the concept of PDFA and ALPDP since the measure at issue (9 CFR 94.1.a)[82] refers to regions that APHIS declared to be free of FMD and 9 CFR 94.0 defines region including a "part of a national entity".[83] In this respect, it is interesting to underline that according to the panel this interpretation is supported by the Guidelines which recommend to "publish the basis for recognition of pest- or disease-free areas and areas of low pest or disease prevalence and a description of the general process used, including the information generally required to evaluate such requests" (para 4). Also, the panel on *India – Agricultural Products* referred to the Guidelines[84] while the AB did not. Indeed, although they may be a useful interpretation tool, it has not to be forgotten that they are not binding and that they "do not provide any legal interpretation or modification to the Agreement".[85]

4.3 The Role of the Exporting Countries

According to art 6.3 exporting countries claiming PDFAs and ALPDPs

> shall provide the necessary evidence thereof in order to objectively demonstrate to the importing Member that such areas are, and are likely to remain, pest- or disease-free areas or areas of low pest or disease prevalence, respectively.

In *India – Agricultural Products*, the panel and the AB mainly dealt with the relationship between arts 6.1 and 6.3, analysed above, while the panel in *US – Measures Affecting the Importation of Animals* went further.

As mentioned, in the latter case the US regulatory framework was compliant with art 6.2 so that art 6.3 became relevant for the recognition of the *specific* area. Although acknowledging that art 6.3 does not specify what constitutes the necessary evidence, the panel clarified that in order for the exporting country to *objectively demonstrate* the disease free status "the information submitted should address the factors listed in Article 6.2 in addition to any other information that would assist the importing Member in making its determination".[86] Then, in assessing specifically whether US did not adapt because of failure to objectively demonstrate by Argentina that Patagonia was and was likely to remain FMD-free, the panel found that Argentina fulfilled its obligation: indeed the previous analysis on art 8 and Annex C(1)(a) SPS Agreement (concerning control, inspection and approval procedures), revealed that APHIS was satisfied with Argentina's information

[82]On the measure at issue see WTO Doc. WT/DS447/R, *supra*, n. 42, para 2.2.

[83]Ibid., para 7.658.

[84]WTO Doc. WT/DS430/R, *supra*, n. 33, para 7.679.

[85]WTO doc. G/SPS/48, *supra*, n. 18, para 2. See, instead, WTO Doc. WT/DS392/R, Panel Report, *US – Certain Measures Affecting Imports of Poultry from China*, 29 September 2010, paras 7.132–7.136 concerning the Decision on the Implementation of Article 4 of the Agreement on the Application of Sanitary and Phytosanitary Measures.

[86]WTO Doc. WT/DS447/R, *supra*, n. 42, para 7.660.

concerning FMD in Patagonia, as proved, inter alia, by the fact that "APHIS sent a letter to SENASA [*Servicio Nacional de Salud Animal* (National Animal Health Service)] stating that no additional information was currently required to proceed with APHIS' rulemaking".[87] Furthermore, under analysis of art 5.6 the panel had found that "information available to APHIS showed that Patagonia was free of FMD and that allowing imports of FMD-susceptible animals . . . from that region . . . would achieve the United States' ALOP".[88] In this regard, it is interesting to underline that the panel took into consideration the OIE FMD-free status recognition but also other factors such as the degree to which Patagonia is separated to adjacent regions or the extent to which movement of animals is controlled from regions of higher risk, therefore confirming that international recognition is relevant but is only one of the elements to be taken into account.[89] Secondly, the panel found that the delay in recognition was unjustified since "in light of our prior findings, the fact that the United States had not yet completed its review of Patagonia, cannot serve to excuse it from its obligations under Article 6.1".[90] In conclusion, since Argentina objectively demonstrate that Patagonia was and was likely to remain FMD-free, the US measure was inconsistent with art 6.1, i.e. the US did not adapt its measure to regional conditions.

5 SPS-Plus Measures in FTAs

Nowadays, due to the Doha Round deadlock, major advancements concerning regulatory issues are occurring at bilateral and regional level through the large number of FTAs that include so-called WTO-plus provisions, i.e., provisions going beyond those of the WTO agreements.[91]

Several FTAs reaffirm respect of SPS obligations or incorporate some SPS provisions. However, it is interesting to underline that EU FTAs of "new generation" (concluded with Korea, Canada, Singapore, Peru, Colombia and others) often include specific measures on regionalization, going beyond the SPS Agreement, and, even before that, the EU included significant provisions in certain agreements such as the 2002 Agreement with Chile. Although these treaties present substantive differences, a common feature is that, when determining PDFAs and ALPDPs, parties

> shall in principle base its own determination of the animal and plant health status of the exporting Party or parts thereof, on the information provided by the exporting Party in

[87] Ibid., para 7.671.

[88] Ibid.

[89] Ibid., paras 7.518 ff.

[90] Ibid., para 7.673.

[91] On regulatory issues see, among others, Wiener and Alemanno (2015), pp. 103 ff.

accordance with the SPS Agreement and OIE and IPPC standards, and take into consideration the determination made by the exporting Party.[92]

In the Agreement with Canada sanitary measures of the importing party concerning certain diseases (including FMD and other significant diseases) should be even based on the zoning decisions made by the counterpart, if the importing Party is satisfied that the exporting party's zoning decisions are in accordance with certain procedural requirement (not agreed yet) and if they are based on relevant international standards, guidelines and recommendations.[93] Of course the importing party is not obliged to conform to the counterpart determination but still these provisions show a very high level of cooperation and also the importance of relevant international standards. Moreover, they are strengthened by other provisions according to which in the event determinations made by a party are not accepted, the counterpart "shall explain the reasons and shall be ready to enter into consultations"[94] or "upon request of the exporting Party, shall provide the information on the basis on which such decision was made, and/or hold consultations, as soon as possible, in order to assess a possible alternative agreed solution".[95]

Overall, cooperation and confidence building, also through the establishment of a SPS Sub-Committee,[96] are much relevant whereas the "new generation" of EU FTAs are less focused on administrative procedures: in the agreement with Canada principles and guidelines for the recognition of regional conditions have not been agreed yet; with Korea a commitment to "establish an appropriate procedure for the recognition of such areas, taking into account any relevant international standard, guideline or recommendation"[97] has been agreed. Instead, the agreement with Chile, concluded in 2002 before the adoption of the Guidelines, included more detailed administrative procedures and even time horizon.[98]

[92]Trade Agreement Between the European Union and its Member States, of the one part, and Colombia and Peru, of the other part, *OJ* 2012 L 354/3, art 94.5; Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part, *OJ* 2011 L 127/6, art 5.8.4; Agreement establishing an Association between the European Union and its Member States, on the one hand, and Central America on the other, *OJ* 2012 L 346/3, art 149.4.

[93]Comprehensive Economic Trade Agreement EU-Canada (CETA), final text, published on 29 February 2016, available at http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf (accessed 29 February 2016), art 5.5.1(c).

[94]EU-Korea *supra*, n. 92, art 5.8.4; EU-Central America *supra*, n. 92, art 149.5.

[95]EU-Peru-Colombia, *supra*, n. 100, art 94.6.

[96]See EU-Korea, *supra*, n. 92, art 5.8.3; Peru-Colombia, *supra*, n. 92, art 94.2; EU-Central America, *supra*, n. 92, art 149.1.

[97]In particular, EU-Korea, *supra*, n. 100, art 5.8.1; Peru-Colombia, *supra*, n. 100, art 94.2. See also EU-Vietnam Free Trade Agreement, Chapter on Sanitary and Phytosanitary Measures, http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154209.%20institutional%20-%20for%20publication.pdf (accessed 29 February 2016), p. 6.

[98]Agreement on sanitary and phytosanitary measures applicable to trade in animals and animal products, plants, plant products and other goods and animal welfare, Annex IV of the Agreement

Finally, several EU FTAs go beyond regionalization since parties recognize the concept of compartmentalization,[99] which addresses animal health and is based on management criteria[100] (while art 6 of the SPS Agreement is based on geographical elements), and the "principle of pest-free production sites" of the IPPC.[101]

The agreements with Ukraine[102] and Georgia[103] also include extensive measures and probably the Transatlantic Trade and Investment Partnership (TTIP)[104] agreement with the US, building on a previous 1999 agreement,[105] would follow the same pattern; instead, Economic Partnership Agreements (EPAs) include less significant provisions[106] and according to some authors they represent a missed opportunity to improve regionalization.[107]

6 Conclusions

Regionalization is a sensitive issue. It is important to foster market access but avoiding outbreaks remains crucial. Notwithstanding attempts to improve implementation at multilateral and bilateral level it is not possible to neglect that, as the AB underlined in *India – Agricultural Products*, every case has to be considered in the light of its specific circumstances so that it is difficult to set detailed procedures covering all cases. At the same time, the adoption of the Guidelines, although not binding, improved to a certain extent the implementation of regionalization concerning administrative procedures; recent case-law gave insight on how

establishing an association between the European Community and its Member States, of the one part, and the Republic of Chile, of the other part, *OJ* 2002 L 352/3, art 6.5.

[99]CETA, *supra*, n. 93, art 5.5.1.e; EU-Peru Colombia, *supra*, n. 92, art 94.8; EU-Central America, *supra*, n. 92, art 149.7; EU-Vietnam, *supra*, n. 97, p. 6.

[100]On this concept see Gruszczynski (2010), pp. 255–256 and OIE, Terrestrial Code, ch. 4.3, art 4.3.1.

[101]EU-Peru Colombia, *supra*, n. 92, art 94.8.

[102]Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part, *OJ* 2014 L 161/3, art 65.

[103]Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Georgia, of the other part, *OJ* 2014 L 261/4, art 56.

[104]See EU-US Transatlantic Trade and Investment Partnership, Sanitary and phytosanitary issues, Initial EU position paper, http://trade.ec.europa.eu/doclib/docs/2013/july/tradoc_151625.pdf (accessed 29 February 2016) and Sanitary and Phytosanitary Measures, Consolidated proposals, https://ttip-leaks.org/andromache/doc11.pdf (accessed 27 May 2016).

[105]Agreement between the United States of America and the European Community on sanitary measures to protect public health and animal health in trade in live animals and animal products (Veterinary Equivalence Agreement), *OJ* 1998 L118/3.

[106]See, among others, Economic Partnership Agreements Between the European Union and its Member States, of the one part, and the SADC EPA States, of the other part, 15 July 2014, art 63.4.

[107]Prévost (2010), p. 40.

importing and exporting Members should fulfil their obligations. The work of ISSBs to elaborate international standards has been relevant so that those are more and more significant, although determinations on regionalization have to be based on other relevant factors such as trust on the sanitary system of the counterpart. Furthermore, significant developments occur at bilateral and regional level within which mutual trust and cooperation make possible to agree on advanced provisions especially on animal health issues, as EU FTAs show.

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The Mutually Agreed Solution Between Indonesia and the United States in *US – Clove Cigarettes*: A Case of Efficient Breach (or Power Politics)?

Johannes Norpoth

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Abstract The Mutually Agreed Solution (MAS) to the *US – Clove Cigarettes* case between the United States and Indonesia evokes the idea of the WTO dispute settlement system allowing for efficient breach. Through the MAS, the case was declared settled based on mutual commitments of the two parties, while the original violation by the US remains in place. The paper first discusses whether MAS are a means through which WTO law allows such flexibility, concluding that such a view is tenable despite valid objections. Then, it inquires whether the MAS found between Indonesia and the US can be considered an efficient breach. In this context, the paper analyses the mutual commitments of the US and Indonesia with specific attention to the potential role of power in the settlement. The paper argues that from a legal perspective the MAS between Indonesia and the US cannot be considered a case of efficient breach, although politically the situation established through the MAS resembles a situation of efficient breach. The paper finds that power imbalances played a role in the settlement and suggests that the case study of this specific MAS highlights systemic risks in the current handling of WTO dispute settlement through MAS.

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1 Introduction

In October 2014 the US and Indonesia notified to the Dispute Settlement Body (DSB) a Mutually Agreed Solution (MAS) to the *US – Clove Cigarettes* case.[1] One of the implications of the Memorandum of Understanding (MoU)[2] reached between the two States[3] could be that the violation by the US remains in force in exchange for specific concessions to Indonesia, mainly under the US General System of Preferences (GSP). Such a solution challenges the idea of the WTO dispute settlement system's (DSS) focus on compliance with WTO rules. Instead, it evokes the idea that the system allows for efficient breach.[4] The paper addresses the question whether MAS are a means through which WTO law allows such flexibility and inquires whether the MAS found between Indonesia and the US is an efficient breach measure.

The MAS is also significant in that the US—the non-compliant respondent in the original dispute—managed not to commit to amend its WTO-incompatible measure, while Indonesia—the successful complainant of the original dispute—committed to addressing US trade concerns about insufficient protection of US intellectual property (IP) rights. At a closer look, even commitments made by the US seem to reflect a rather strong negotiation position of the WTO "culprit". Therefore, the paper analyses the mutual commitments of the US and Indonesia with specific attention to a potential role of power imbalances.

The paper proceeds by first summarising the concept of efficient breach (Sect. 2), before discussing whether WTO law protects entitlements of its Members by a property or liability rule or as inalienable (Sect. 3). Then, it outlines facts of the dispute between the US and Indonesia and analyses details of the settlement (Sect. 4). Subsequently, the paper discusses the MAS between Indonesia and the US in light of the theory of efficient breach (Sect. 5) before offering conclusions that focus on potential systemic risks for the WTO associated with this kind of settlement (Sect. 6).

[1] WTO doc. WT/DS407/17, Notification of a Mutually Agreed Solution, *United States—Measures Affecting the Production and Sale of Clove Cigarettes (US – Clove Cigarettes)*, 9 October 2014.

[2] Through the MoU the two States have fixed a set of mutual commitments which they consider as the basis to declare the dispute settled. In terms of the WTO dispute settlement system an agreement between disputing parties to settle the case is a MAS. After notification of a MAS to the DSB the dispute is considered to be settled under the WTO dispute settlement system.

[3] Memorandum of Understanding between the Government of the United States of America and the Government of the Republic of Indonesia, 3rd Oct 2014, https://ustr.gov/sites/default/files/US%20Indo%20MOU.pdf (accessed 21 January 2016).

[4] Whether WTO law allows States to "buy out of" their obligations or whether it requires States to, eventually, comply with their obligations has been a matter of long-standing academic debate, cf. Hippler Bello (1996); Jackson (1997); Schwartz and Sykes (2002); Trachtman (2007); Pauwelyn (2010), pp. 34–65.

2 The Concept of Efficient Breach

Before addressing the question whether MAS are a mechanism allowing for efficient breach in the WTO DSS, it is expedient to revisit the concept of efficient breach. The concept emanates from the economic theory of contracts. Put simply, the concept of efficient breach is concerned with situations in which deviation from a contractual obligation by one party to a contract leaves both parties to the contract in better overall positions than if the obligation was fulfilled. In the words of Schwartz and Sykes, breach is efficient "whenever the costs of compliance to the promisor exceed the benefits to the promisee".[5] The "breach" in "efficient breach" could refer to a deviation of expected behaviour according to, or against the rules of the contract.[6]

In this context, the distinction between property and liability rules needs to be revisited.[7] An entitlement protected by a property rule is transferable when the entitlement holder consents to the transaction. The assumption is that the entitlement holder will only consent to the transaction once the buyer offers a price that matches the value attached to the entitlement by its holder.[8] A property rule thus requires the obligated party to renegotiate in order to obtain the consent of the entitlement holder. Based on the general assumption of law and economics that all actors are rational utility-maximizers,[9] such renegotiations will only be successful (and deviation efficient), when the benefit to the party wishing to deviate exceeds the value attached to the entitlement by the other party. Only under these conditions, the deviating party will pay the price of the value requested from the entitlement holder in exchange for consent.[10] Provided the respective consent is given, a property rule system would allow for efficient "breach" of the original entitlement to specific performance.[11]

In comparison, an entitlement that is protected by a liability rule may be taken without the holder's consent, provided the original holder of the entitlement receives an objectively determined compensation for it.[12] The shift of the

[5]Schwartz and Sykes (2002), p. 181.

[6]Pauwelyn introduces in so far the distinction between "*intra-contractual behaviour*", which he does not consider to constitute efficient "breach", and "*extra-contractual behaviour*", which he considers to be the actual content of the theory of efficient breach, Pauwelyn (2008), p. 14. In his view the theory of efficient breach thus "*questions the legally binding nature of the law*", ibid.

[7]Calabresi and Melamed introduced these concepts in reference to domestic law settings, distinguishing entitlements as being protected by property, liability or inalienability rules, Calabresi and Melamed (1972).

[8]Ibid., p. 1092.

[9]Cf. Dunoff and Trachtman (1999). The approach rests on the value of individual choice considering each person to be "*in charge of his or her own utility function*" (ibid., p. 11).

[10]Cf. Schwartz and Sykes (2002), p. 182.

[11]A narrower understanding of efficient "breach" would consider only those situations as efficient breach in which a deviation occurred without consent. Cf. Pauwelyn (2008), p. 14.

[12]Calabresi and Melamed (1972), p. 1092.

entitlement is thus dependent on compensating the original holder of the entitlement which should put her in a position as good as if the original entitlement had been fulfilled.[13] If a party, wishing to deviate from its obligations finds the benefits from deviation to exceed the cost of compensation, deviation or "breach" becomes efficient.[14]

Clearly, there is no room for efficient breach when entitlements are protected as inalienable, meaning that the entitlement cannot be transferred, even if the entitlement holder agrees to it.[15]

The introduction to the main tenets of efficient breach highlights the importance of first establishing whether entitlements are protected by a property or a liability rule or as inalienable in the contractual setting in question, before turning to the question of whether breach is efficient.

3 WTO Law: Protection by Property or Liability Rule or as Inalienable?

The pertinent question is whether WTO law, and in particular the legal framework of MAS, permits deviation from its rules. Should it allow for deviation, does it do so based only on consent, indicating a protection by a property rule, or based on compensation, indicating a liability rule?

There is general agreement that the system for modification of individual specific commitments of Members, for instance, under the General Agreement on Tariffs and Trade (GATT) 1994 employs protection by a liability rule,[16] as the respective rules explicitly allow for unilateral adjustments in exchange for compensation of some sort. Less agreement exists with regard to the rules on remedies to non-compliance with a DSB recommendation in the Dispute Settlement Understanding (DSU).

Some argue that the limitation of suspension of concessions or obligations to a level equivalent to the prospective harm in art 22.4 DSU indicates that this remedy has a compensatory rather than an enforcement function. Based on this argument they conclude that WTO law does not require specific performance, but allows for the "take-and-compensate" approach of a liability rule.[17] Others concede that the letter of the law might require specific performance, but maintain that practice

[13]Cf. Pauwelyn (2008), p. 13; Schwartz and Sykes (2002), p. 182.

[14]Schwartz and Sykes (2002), p. 182. Again, a narrow understanding of efficient breach would consider only those situations as efficient breach in which a deviation occurred without full compensation, cf. Pauwelyn (2008), p. 14.

[15]Calabresi and Melamed (1972), pp. 1092 ff.

[16]Cf. Pauwelyn (2008), p. 134; Schwartz and Sykes (2002), pp. 186–188; Zimmermann (2011), p. 397.

[17]Cf. Schwartz and Sykes (2002), pp. 191 f. and 20 ff.

indicates that Members may disregard specific performance of their obligations, provided they "compensate" by accepting the suspension of concessions and other obligations of the successful complainant.[18]

This view, however, is rejected by those who contend that art 22 DSU is rooted in the law of countermeasures of general international law,[19] linking suspension of concessions or other obligations (so-called "retaliation") stronger with the aim of inducing compliance, at least eventually.[20] The latter view finds strong support in the wording of the DSU. The remedies mentioned in art 22 DSU are only temporary measures.[21] This confirms that they are not treated as compensation in exchange for an indefinite shift of an entitlement and from a legal perspective do not terminate the dispute over compliance with the violated WTO rule.[22] This interpretation also finds support in decisions of the Appellate Body (AB).[23] Those viewing WTO law as protected by a liability rule disregard the fact that due to their prospective nature the remedies of art 22 DSU never achieve full compensation.[24] Moreover, they overlook that through these mechanisms the WTO only tolerates a temporary safety valve for non-compliant Members.[25] Therefore, the primary remedies to non-compliance with a DSB recommendation in art 22 DSU do not entail a transfer of an entitlement to compliance, and, hence, do not allow for efficient breach.

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[18]Trachtman (2007), pp. 146 and 149.

[19]Cf. Mavroidis (2000), p. 800.

[20]Jackson (1997); Pauwelyn (2000); Hudec (2000); Charnovitz (2001); van den Broek (2003); Nzelibe (2005); Bronckers and van den Broek (2005); Choi (2007); Eeckhout (2009); Pauwelyn (2010); Shaffer and Ganin (2010); Zimmermann (2011); Bronckers and Baetens (2013); Vidigal (2013); Tijmes (2014). Cf. also arbitrators in these proceedings under art 22.6 DSU, WTO doc. WT/DS27/ARB, *European Communities (EC) – Regime for the Importation, Sale and Distribution of Bananas III (EC – Bananas III)*, 9 April 1999, para 6.3; WTO doc. WT/DS27/ARB/ECU *EC – Bananas III*, 24 March 2000, para 166; WTO doc. WT/DS26/ARB, *EC – Measures Concerning Meat and Meat Products (Hormones) (EC – Hormones)*, 12 July 1999, para 40; WTO doc. WT/DS46/ARB *Brazil – Export Financing Programme for Aircraft*, 28 August 2000, para 3.43 ff.; WTO doc. WT/DS108/ARB, *US – Tax Treatment for Foreign Sales Corporations*, 30 August 2002, para 5.52; WTO doc. WT/DS136/ARB, *US – Anti-Dumping Act of 1916*, 24 February 2004, para 5.5.

[21]Art 22 DSU envisages either mutually agreed compensation or unilateral suspension of concessions or other obligations by the complainant towards the non-compliant respondent as potential remedies. Both measures are explicitly considered temporary, cf. art 22.1 sent. 1 and art 22.8 sent. 1 DSU.

[22]Jackson (1997), p. 116; Zimmermann (2011), p. 394.

[23]WTO doc. WT/DS320/AB/R, Appellate Body Report, *US – Continued Suspension*, 16 October 2008, paras 304–310. "The requirement that the suspension of concessions must be temporary indicates that the suspension of concessions, as the last resort available under the DSU when compliance is not achieved, is an abnormal state of affairs that is not meant to remain indefinitely. Members must act in a cooperative manner so that the normal state of affairs, that is, compliance with the covered agreements and absence of the suspension of concessions, may be restored as quickly as possible" (ibid., para 310).

[24]Zimmermann (2011), p. 398.

[25]Ibid., p. 402.

Still, the question remains whether a MAS between the non-compliant respondent and complainant could be seen as effectuating such a transfer. To be clear, since MAS necessarily involve the *consent* of the original entitlement holder—the complainant entitled to compliance by the respondent –, MAS would only allow for efficient breach under a *property* rule.

This question necessitates closer analysis of the entitlement to be transferred and the legal framework for MAS. The idea of a complainant consenting to non-compliance by the respondent presupposes that the entitlement is of a bilateral, instead of a collective nature. Put simply, in a multilateral treaty, entitlements of a collective nature cannot be transferred by bilateral agreement of two parties to that treaty because these entitlements are held by all parties to the treaty.[26] Thus, entitlements of a collective nature are, at least from the point of view of two disputing parties, closer to a system of inalienability.

On the one hand, it is important to recall in this context that a MAS, as an agreement between the disputing parties only, is explicitly foreseen as a possible, even preferable solution to disputes.[27] Hence, *bilateral agreements* are undoubtedly envisaged by the DSU to settle an otherwise ongoing dispute over compliance. On the other, the substantive and procedural requirements for MAS stipulated in art 3.5 and 3.6 DSU reflect collective aspects, such as protection of third-party rights, non-derogation from essential treaty provisions, and transparency among WTO Members.[28] According to art 3.5 DSU MAS shall be consistent with the covered agreements and "shall not nullify or impair benefits accruing to any Member under these agreements, nor impede the attainment of any objective of those agreements". Moreover, according to art 3.6 DSU MAS "shall be notified to the DSB and the relevant Councils and Committees, where any Member may raise any point relating thereto". In particular, the requirements of consistency with WTO law and non-impairment of benefits of third parties may be read as indications for a *collective relationship* which cannot be distorted through bilateral shifts of entitlements between the disputing parties.

[26]Pauwelyn (2008), p. 115.

[27]Art 3.7 sent. 3 DSU explicitly states: "A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred". Article 22.8 sent. 1 DSU states: "The suspension of concessions and other agreements shall be temporary and shall be only applied until such time as . . . a mutually satisfactory solution is reached".

[28]These requirements reflect customary rules of general international law on *inter se* agreements in multilateral treaty settings as codified in art 41 Vienna Convention on the Law of Treaties (VCLT). If a multilateral treaty does not provide explicitly for the possibility to modify rights and obligations among a sub-set of parties (art 4.1(a) VLCT), *inter se* agreements need to conform to two central substantive requirements: the modification shall "*not affect the enjoyment by the other parties of their rights*" and shall "*not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole*" (art 41.1(b) VCLT).

Previous interpretations from the AB provide limited clarification. The AB has recognized bilateral shifts of entitlements by confirming that rights to demand compliance with the DSB ruling through art 21.5 DSU may be waived in MAS,[29] provided the text of the agreement clearly reveals the intention of the party to relinquish such rights.[30] At the same time, a collective understanding finds support. With regard to art 22.8 DSU, the AB has stressed that an MAS must bring about a "*final and* substantive *resolution to the dispute*"[31] and clarified that "*substantive resolution*" refers to remedying the inconsistencies found by the DSB.[32]

Both statements may be reconciled if a MAS is considered to modify both the procedural situation and the substantive balance of the mutual rights and obligations of the two disputing parties through a subsequent bilateral agreement within the meaning of art 30.4(a) Vienna Convention on the Law of Treaties (VCLT). Pauwelyn suggests that MAS are subsequent *inter se* agreements containing the complainant's dispute-specific, prospective consent to further non-compliance by the respondent and waiver of its dispute settlement rights under art 21.5 DSU.[33] The consent is considered to preclude further findings of inconsistency and, hence, to effectuate also a substantive resolution of the dispute that is considered consistent with the covered agreements. Clearly, the deviation allowed by consent is limited, as the substantive obligation violated in the original case remains valid and applicable in all subject matters arising between complainant and respondent other than the original dispute. Moreover, other WTO Members who shall be notified about the MAS may judge whether they consider action against the non-compliant Member fruitful[34] since their balance of rights and obligations is not touched.

This understanding resonates with a general idea of what a MAS is about, in particular in a situation after a finding of non-compliance. The disputing parties settle an ongoing dispute over compliance with the consequence that the dispute ceases to be surveyed by the DSB. The respondent receives an assurance that its measures will not be challenged in exchange for arranging a state of affairs that the

[29]WTO doc. WT/DS27/AB/RW2/ECU, Appellate Body Report, *EC – Bananas III*, 2nd Recourse by Ecuador to art 21.5 DSU, 26 November 2008, paras 212–222.

[30]Ibid., para 217.

[31]Cf. WTO doc. WT/DS320/AB/R, *supra*, n. 23, para 304 (emphasis added). Article 22.8 DSU specifies the conditions under which the suspension of concessions has to be terminated.

[32]Ibid., paras 304 and 305.

[33]Pauwelyn (2008), p. 109 in fn 6. In light of the 2001 Draft Articles on Responsibility of States for Internationally Wrongful Acts, the MAS would function as a consent precluding wrongfulness pursuant to art 20 and a loss of the right to invoke responsibility according to art 45(a) of the Draft Articles. Since the DSU focuses prospectively on conformity with the covered agreements, art 19.1 DSU, the only prospective nature a consent/waiver under general international law would still mean that the case would be moot under the rules of the DSU.

As arts 30.4 and 30.5 VCLT require conformity with the conditions of art 41 VCLT for *inter se* agreements in multilateral treaty settings, Pauwelyn apparently asserts that the DSU provides for the possibility of *inter se* agreements through MAS in line with art 41.1(a) VCLT. One may reject this argument based on art 3.5 DSU that reflects the more restrictive conditions of art 41(b) VCLT.

[34]Cf. art 3.7 sent. 1 DSU.

complainant considers sufficient to settle the case. In this sense, there is clearly a shift of the complainant's entitlement to demand compliance from the respondent by consent, hence, a situation of intra-contractual efficient breach.

Overall, the reasoning suggested by Pauwelyn describes a legally tenable way how MAS may allow for efficient breach. As this reasoning may also be acceptable to WTO Members and the AB, the MAS between the US and Indonesia will be considered in light of *Pauwelyn*'s reasoning, albeit not without acknowledging valid arguments against or at least qualifying his view. First, viewing a MAS as a subsequent *inter se* agreement diminishes the difference between the explicitly temporary remedies foreseen in art 22.1 DSU and a final substantive resolution of the dispute. In fact, MAS may then validate and extend indefinitely a bilateral legal situation that was envisaged as temporary pending full compliance. Only a stricter reading of the condition of MAS to be consistent with the covered agreements would maintain the focus on remedying the original violation.[35] Second, Pauwelyn's reasoning only remains valid if the obligation modified through the MAS is of a bilateral nature. Even Pauwelyn, who characterizes WTO agreements as bundles of bilateral obligations between the parties,[36] acknowledges that some rules of WTO law, in particular prohibited subsidies pursuant art 3 of the Agreement on Subsidies and Countervailing Measures, could be considered to exist in the collective interest of all Members, thereby transcending the interests of the Members individually and thus to fulfil the criteria for collective obligations.[37]

4 The *US – Clove Cigarettes* Dispute and Its Solution

4.1 The US – Clove Cigarettes *Dispute*

The measure at issue in *US – Clove Cigarettes* was a US ban on flavoured cigarettes. The measure prohibited cigarettes containing "... an artificial or natural flavour (other than tobacco or menthol) ... that is a characterizing flavour of the tobacco product or tobacco smoke".[38] Indonesia, the largest exporter of clove cigarettes to the US market, had successfully complained in WTO dispute

[35]The AB's statement in WTO doc. WT/DS320/AB/R *supra*, n. 23 that all solutions to a dispute mentioned in art 22.8 DSU must be substantive and remedy the inconsistencies found by the DSB can be seen to support this argument.

[36]Pauwelyn (2003), p. 925 ff. Contra to this view Carmody (2006).

[37]Cf. Pauwelyn (2003), pp. 939–940. Therefore, MAS in subsidies-related cases that allow the original inconsistency to remain in place would be more problematic.

[38]Section 907 (a)(1)(A) Federal Food, Drug and Cosmetic Act, added by Section 101(b) of Family Smoking Prevention and Tobacco Control Act, Public Law No. 111-31, 123 Stat. 1776 (22 June 2009).

settlement proceedings[39] that the measure exempted (primarily) domestic menthol cigarettes from the ban and thus discriminated against (imported) clove cigarettes in violation of, *inter alia*, art 2.1 of the Agreement on Technical Barriers to Trade (TBT Agreement).[40]

Whereas the reasonable period of time (RPT) for the US to implement the DSB's recommendation to bring the measure into conformity with WTO law expired on 24 July 2013, the respective provision remained unchanged until now. Given that the AB took particular issue with the fact that the exemption of menthol cigarettes from the ban of flavoured cigarettes could not be explained by a legitimate regulatory objective,[41] the US was essentially faced with two unattractive alternatives to bring the measure into conformity: repealing the whole ban of flavoured cigarettes or extending the ban to menthol cigarettes. Although the latter alternative appeals stronger to the public health rationale of the measure, it would not have resulted in renewed market access for Indonesian clove cigarettes (and presumably met the same national opposition that had prevented the extension of a ban on menthol cigarettes in the first place).

Indonesia reacted promptly after the expiration of the RPT by requesting authorization from the DSB to suspend concessions and other obligations towards the US under Art 22.2 DSU.[42] Interestingly, Indonesia's request to authorize retaliation did not indicate any plans to suspend obligations under the Agreement on Trade-related Aspects of Intellectual Property (TRIPs Agreement) (so-called "cross-retaliation"), which has often been considered to be the main credible enforcement option in disputes between a smaller, developing country and a larger trading power.[43] Instead, Indonesia announced that it would suspend obligations under the GATT 1994, the TBT Agreement and the Agreement on Import Licensing.[44] It seems that the choice of obligations to suspend was mainly influenced by a separate dispute between the US and Indonesia in which the US had complained of violations of these agreements.[45] Presumably, the fact that the USA could remedy the WTO-inconsistency of its measure, simply by including menthol cigarettes into the ban without renewing market access for clove cigarettes, led Indonesia to take a rather defensive stance. The right to suspend obligations was rather employed to defend Indonesia's own potential violations in another dispute instead of inducing

[39]Cf. WTO doc. WT/DS406/R, Panel Report, *US – Clove Cigarettes*, 2 September 2011; WTO doc. WT/DS406/AB/R, Appellate Body Report, *US – Clove Cigarettes*, 4 April 2012.

[40]The obligation at issue in *US – Clove Cigarettes* is of a bilateral, instead of a collective nature since it can be differentiated and individualized as can be seen from the facts of the case.

[41]Cf. WTO doc. WT/DS406/AB/R, *supra*, n. 39, para 225.

[42]Cf. WTO doc. WT/DS406/12, *US – Clove Cigarettes*, Recourse to art 22.2 DSU by Indonesia, 13 August 2013.

[43]Instead of many other commentators see Abbott (2010).

[44]Cf. WTO doc. WT/DS406/12, *supra*, n. 42.

[45]Cf. WTO doc. WT/DS455/1, Request for consultations by the US, *Indonesia – Importation of Horticultural Products, Animals and Animal Products (Indonesia–Horticultural Products)*, 14 January 2013.

compliance by the US with the DSB ruling by inflicting harm on influential US interest groups.[46] Taking into account that a WTO Member can substantially drag on the process until finally bringing a WTO-inconsistent measure into conformity, such a defensive stance would not appear necessary. However, Indonesia lacks the political clout and resources to pursue such a strategy which is sometimes virtuously applied by major trading powers.[47]

The US objected to the proposed suspension of obligation,[48] prompting arbitration proceedings under art 22.6 DSU. A circulation of formal determinations of the arbitrators to the DSB was prevented in June 2014 by a joint communication of the parties that indicated that they were in negotiations to resolve the dispute amicably.[49] The final notification of a MAS followed later on 9 October 2014,[50] which according to art 22.8 DSU terminated any right to retaliate and made arbitration pursuant art 22.6 DSU obsolete.[51]

Quite remarkably, the MoU itself was not annexed to the notification of the MAS to the DSB, thereby disregarding the formalized transparency rules set forth in art 3.6 DSU. The text of the MoU is still not accessible through the WTO, but has been made accessible through the website of the US Trade Representative (USTR) a few months after it was concluded.[52] Interestingly, although transparency in the DSB is considered to safeguard interests of other Members and to provoke community costs for non-compliance,[53] other WTO Members have not commented officially on the MAS, the omission to notify the MoU, or any content of the MoU according to the Minutes of the Meetings of the DSB.[54]

[46]Cf. commentators cited *supra*, n. 21, in particular in favor of the public choice-based logic delineated here Nzelibe (2005).

[47]The following cases can be cited as examples of a tactic to prolong proceedings WTO doc. WT/DS27, *EC–Bananas III*; WTO doc. WT/DS285, *US–Measures Affecting the Cross-Border Supply of Gambling and Betting Services*.

[48]Cf. WTO Doc. WT/DS406/13, *US – Clove Cigarettes*, Recourse to art 22.6 DSU by the US, 23 August 2013.

[49]Cf. WTO Doc. WT/DS406/16, *US – Clove Cigarettes*, Recourse to art 22.6 DSU by Indonesia—Communication from the Arbitrator, 27 June 2014.

[50]Cf. WTO Doc. WT/DS406/17, *US – Clove Cigarettes*, Notification of a Mutually Agreed Solution, 9 October 2014.

[51]Cf. WTO Doc. WT/DS406/18, *US – Clove Cigarettes*, Recourse to art 22.6 DSU by the US—Communication by the Arbitrator, 9 October 2014.

[52]Cf. MoU, *supra*, n. 3.

[53]Trachtman (2008), p. 141; Pauwelyn refers in this regard to the importance of the "kicker" of community costs to back up protection of entitlements by a property rule, Pauwelyn (2008), p. 175. Cf. for the general importance of reputation costs in international law Guzman (2008).

[54]Minutes of the Meetings of the DSB from October 2014 to November 2015 were checked.

4.2 The Content of the Memorandum of Understanding

The MoU specifies that, subject to the notification of the resolution of the dispute,[55] the US and Indonesia commit to specified measures.[56] Hence, fulfilment of the commitments is conditioned by the parties having taken the formal steps to remove the dispute from the DSB's surveillance list. Quite counterintuitively, formal resolution of the dispute precedes the fulfilment of commitments.[57]

Interestingly, the commitments specified in the MoU include neither a commitment by the US to amend its WTO non-compliant measure nor a waiver by Indonesia of its right to initiate compliance proceedings against the US under art 21.5 DSU. The latter point is relevant, as the AB has rejected the idea that any MAS may bar recourse to art 21.5 DSU. Instead, it has taken an objective approach in determining whether an agreement between parties resolves a dispute in such a manner.[58] It has stressed that the text of such an agreement must clearly reveal the intention of the party to relinquish such rights.[59] The MoU fails to mention any waiver by Indonesia,[60] instead clarifying in Section C that the MoU is "otherwise without prejudice to the rights and obligations" of the parties under the WTO agreements. Thus, at least legally, Indonesia may still initiate proceedings against the US for lack of compliance with the DSB ruling.

The commitments in the MoU relate to product eligibility for Indonesian products under the US GSP scheme (4.2.1), IP protection in Indonesia (4.2.2), the treatment of cigars and cigarillos from Indonesia in future US legislation (4.2.3), and an Indonesian export restraint measure for certain minerals (4.2.4).

4.2.1 Product Eligibility Under the US GSP Scheme

The US committed to "give favorable consideration, consistent with U.S. laws and regulations, to ... redesignate insulated ignition wiring sets for vehicles ... as a GSP-eligible product for Indonesia" by presidential determination after

[55]As specified in Section B of the MoU. Section B explicitly mentions the notification of a MAS of the whole dispute to the DSB.

[56]As specified in Section A of the MoU.

[57]At least by its wording the MoU does not constitute an "interim solution" which merely anticipates a final solution of the dispute once the agreed commitments have been fulfilled. For the recent trend on such "interim solutions" in MAS, see Alschner (2014), pp. 84 ff.

[58]WTO doc. WT/DS27/AB/RW2/ECU, *supra*, n. 29, paras 212–222. Moreover, the AB has emphasized the requirement of *substantive resolutions* to a dispute, cf. WTO doc. WT/DS320/AB/R, *supra*, n 23, paras 304–310.

[59]WTO doc. WT/DS27/AB/RW2/ECU, *supra*, n. 29, para 217.

[60]Ibid., para 221, the AB considered a wording of the MoU between Ecuador and the EU that was similar to the wording in Section B of the MoU between the US and Indonesia as neutral and not giving a clear indication of a relinquishment of the right to compliance proceedings under art 21.5 DSU.

reauthorization of the GSP programme by US Congress.[61] Moreover, Indonesia received assurance that for the next 5 years the GSP benefits for the product would not be withdrawn pursuant the competitive need limitation test of the US GSP scheme.[62]

This commitment by the US must be seen against the backdrop of the status of the US GSP scheme at the time of negotiation of the MoU. Parliamentary authorization for the GSP scheme had expired in July 2013 and US administration and Congress were negotiating a re-authorization of the scheme.[63] The language of the commitment reveals that in this domestic political situation, the US only signed a carefully drafted commitment that would not prejudge any legislative procedures or outcomes.[64]

Beyond that, Indonesia had already received a preferential duty-free rate compared to the 5 % most-favoured nation tariff for wiring harnesses under the previous authorization phase of the GSP scheme.[65] Thus, the US commitment only ensured a *status quo* for Indonesian exporters.

4.2.2 IP Protection in Indonesia

Overall, Indonesia's position under the US GSP scheme was threatened. Even before the previous GSP scheme lapsed, the International IP Alliance, an American industry association, had solicited a still on-going review of Indonesia's eligibility under the GSP scheme based on the allegation of insufficient protection of

[61] MoU, *supra*, n. 3, Section A—Generalized System of Preferences Product Eligibility, para 1.

[62] The MoU again uses the rather soft language of giving "favorable consideration, at the appropriate time and consistent with U.S. laws and regulations, to a request from Indonesia for a competitive need limitation waiver"; cf. ibid., Section A—Generalized System of Preferences Product Eligibility, para 2.

[63] Office of the USTR, GSP Expiration: Frequently Asked Questions https://ustr.gov/sites/default/files/FAQs-on-GSP-Expiration-Nov2014_4.pdf (accessed 14 January 2016).

[64] Such commitments of "best endeavor" raise concerns as they are hardly enforceable, even if one were to accept the argument in favour of enforceability of MAS within the WTO DSS (see Alvarez-Jimenez (2011)); rejecting this argument Alschner (2014), p. 89. However, the point about enforcement has become moot in this case since the US has fulfilled its commitment by re-authorizing the GSP scheme (see Sec. 201 of the Trade Preferences Extension Act of 2015) and designating wiring harnesses from Indonesia as an eligible product. However, the reason for designating wiring harnesses as eligible product is apparently explained by the fact that imports from Indonesia were too minimal to apply the competitive need limitation. Thus, a waiver of this test as anticipated in the MoU was not necessary to achieve the result, cf. Office of the USTR, GSP: Results of the GSP Limited Product Review, Including Actions Related to Competitive Needs Limitations, Federal Register, Vol. 80, No. 194, 7 Oct 2015, 60731, http://www.regulations.gov/#!documentDetail;D=USTR-2015-0007-0037 (accessed 14 January 2016).

[65] Cf. Office of the USTR, GSP-eligible Products from All Beneficiary Countries, https://ustr.gov/sites/default/files/GSP%20eligible%20all%20BDCs%20%282012%29%20Revised%20August%202012.pdf (accessed 14 January 2016).

intellectual property.[66] Indonesia's commitments with regard to IP protections in the MoU must be seen against this background.

Indonesia has committed to develop with the US an "action plan for the purpose of achieving improved protection and enforcement of intellectual property rights in Indonesia" which shall "address concerns identified with respect to Indonesia in recent Special 301 Reports".[67] Indonesia has long been on the US Intellectual Property Priority Watch List in Special 301 Reports for its alleged insufficient protection of US intellectual property rights.[68]

This commitment allows the US to maintain its current policy with regard to GSP country eligibility and IP protection, safeguard the interests voiced by the International IP Alliance and further its external IP policy. Thus, it has to be regarded as closely linked with the US commitment regarding its GSP scheme and the wider US foreign policy on IP.

It is likely that the action plan to be agreed with the US will include commitments with regard to IP by Indonesia that are additional to its obligations under the TRIPs Agreement.

4.2.3 Treatment of Cigars and Cigarillos from Indonesia in Future US Legislation

The US, as the non-compliant respondent, does not make any commitment to withdraw or amend its original WTO-inconsistent discriminatory tobacco regulation. The measure at issue in the original dispute remains completely untouched by the MoU. With respect to future tobacco regulation, the US only commits not to "arbitrarily or unjustifiably discriminate against cigars or cigarillos (HS 2402.10) from Indonesia".[69] Cigars and cigarillos, however, are a different product category than cigarettes, which is the product at issue in the original dispute. The

[66]Cf. Office of the USTR, Active GSP Country Practices Reviews, Updated November 2014, https://ustr.gov/issue-areas/trade-development/preference-programs/generalized-system-preference-gsp/current-review-0 (accessed 15 January 2016). According to Sec. 2462 (c) (5) under the GSP-chapter of the US Trade Act of 1974 adequate and effective protection to intellectual property rights is a factor affecting country eligibility under the GSP-scheme. In fact, this threat may have been an additional reason for Indonesia not to retaliate against the US for non-compliance with the WTO ruling by suspending obligations under the TRIPs Agreement.

[67]Cf. MoU, *supra*, n. 3, Section A—Intellectual Property Rights.

[68]Indonesia has been on the IP Priority Watch List at least since 2010. The IP Priority Watch List is compiled by the Office of the USTR as part of an annual Special 301 Report pursuant to Section 182 of the Trade Act of 1974, as amended by the Omnibus Trade and Competitiveness Act of 1988 and the Uruguay Round Agreements Act (19 U.S.C. § 2242). Countries placed on the Priority Watch List are considered to have particular problems with respect to IP rights protection and enforcement and shall be the "focus of increased bilateral attention" on IP issues, including through bilateral agreements. Determinations in this report may also influence country eligibility for GSP-preferences under the US GSP scheme, cf. US Trade Act of 1974, Section 2462(c)(5).

[69]Cf. MoU, *supra*, n. 3, Section A—Cigars or Cigarillos.

commitment is limited to a US pledge to honour its obligations under WTO agreements in future tobacco regulation on cigars and cigarillos and not to repeat a violation of WTO law by favouring menthol flavoured tobacco over clove tobacco. It does not alter the balance of rights and observed obligations between Indonesia and the US. Since Indonesian producers of clove cigarettes reportedly circumvented the ban on clove cigarettes by marketing clove cigars and cigarillos instead,[70] this commitment must be seen as political assurance to Indonesian producers.

4.2.4 Indonesian Export Restraint Measure

The final commitment by the US not to challenge Indonesia's mineral ore export restraint measure through WTO dispute settlement proceedings deserves closer analysis.[71] Indonesia aims to increase national value extraction from its mineral resources through the export restraint measure. The measure requires beneficiation and processing of nationally mined raw mineral ores in Indonesia combined with a gradual phase-in of export restrictions on certain raw materials.[72] Especially the implementation of strict export restrictions in January 2014 led Newmont Mining Corporation, one of the US-headquartered mining company holding large-scale mining licenses in Indonesia, to initiate arbitration proceedings at the International Centre for the Settlement of Investment Disputes (ICSID) against Indonesia through a Dutch-Indonesian Bilateral Investment Treaty (BIT).[73] In what appears to have been a battle of mutual threats, Indonesia came to an agreement with US-based mining companies, partly by conceding to grant export licenses in exchange for commitments by the companies to build smelters for the processing of the mineral ores.[74] Only after this settlement was reached, the US committed in the MoU not to bring the case to the WTO.

The US commitment is drafted carefully. The relinquishment of the right to dispute settlement relates only to the current application of the Indonesian measure, which includes concessions to US investors. Future changes in the application of the Indonesian measure would re-establish a right to WTO dispute settlement for

[70]Cf. International Centre for Trade and Sustainable Development, Bridges (2014).

[71]Cf. MoU, *supra*, n. 3, Section A—Mineral Ores Export Restraint.

[72]The Indonesian Mining Law of 2009 already foresaw the requirement that mining companies in Indonesia process raw materials within Indonesia before exporting them. In January 2014, the provisions (art 103 and 107 Mining Law of 2009) that set forth the export ban took effect and implementing regulations were issued. Cf. for a summary of the respective measures Tivey et al. (2014).

[73]Cf. *Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia*, ICSID Case No. ARB/14/15, 15 July 2014. Cf. for an explanation why the Dutch-Indonesian BIT was used see van der Pas and Damanik (2014).

[74]Cf. for details the following reports New York Times (2014); Indonesia-Investments (2014); van der Pas and Damanik (2014).

the US.[75] At first sight, this seems to be a major commitment. With the current settlements between US mining companies and the Indonesian government in place, however, the US presumably has little interest in initiating a dispute against Indonesia and it strategically retains the right to WTO dispute settlement once the interests of US companies are threatened again. Indonesia, however, was apparently seeking assurance to be able to proceed with its natural resources policy based on the settlements with US companies without any further challenge.

5 The MAS Between Indonesia and the US: A Case of Efficient Breach?

Considering that WTO law may allow for efficient breach by *inter se* modification of entitlements through MAS, the MoU between Indonesia and the US arguably does not meet the legal conditions for efficient breach. A crucial element of efficient breach under a property rule is a transfer of entitlement by consent. The pertinent entitlement of Indonesia was US compliance with its obligations under the TBT Agreement, which would be shifted by a relinquishment of the right to initiate compliance proceedings and related consent to further non-compliance by the US. As outlined above, the MoU does not fulfil the criteria established in previous AB decisions for such a relinquishment[76] since it lacks a clear expression of such an intention of the parties. Moreover, the MoU also lacks any expression of consent to further non-compliance and is instead explicitly without prejudice to any further rights under the WTO agreements. Thus, legally speaking, a transfer of the original entitlement has not occurred and hence, a substantive resolution of the dispute through an *inter se* agreement is still missing.

Nevertheless, it is quite likely that the dispute has come to a final conclusion. The US apparently considers the MoU to represent a *final* resolution of the dispute.[77] From the US perspective, the negotiated result is clearly positive. The US has one controversial case off the DSB's surveillance list. Its menthol cigarette producers still enjoy the benefits of a discriminatory product regulation. It can follow its other dispute against Indonesia without "disturbance" by suspension of obligations from Indonesia. It can make a claim to the International IP Alliance that their concerns about lack of IP protection in Indonesia are addressed. Its mining companies with investments in Indonesia can be assured that their interests can still be pursued at the WTO once their situation worsens. Equally, Indonesia might prefer to consider the dispute settled. While it risks not to gain economically from US compliance, it may instead use the US commitments to communicate "positive

[75]Cf. MoU, *supra*, n. 3, Section A—Mineral Ores Export Restraint.

[76]Cf. WTO doc. WT/DS27/AB/RW2/ECU, *supra*, n. 29, paras 212–222.

[77]Cf. statement by the US in WTO doc. WT/DSB/M/351, Minutes of the Meeting, 20 October 2014, para 8.1.

results" to national stakeholders: it can tell its export-oriented wiring harnesses industry depending on GSP-preferences that a *status quo* of its market access to the US was ensured; its clove cigarillo exporters may learn that the US commits to observe WTO law with respect to clove cigarillos in its future tobacco regulation; it can tell the Indonesian public that its natural resources policy can be maintained. This may distract from the fact that in substantive terms Indonesia has not received much more than securing a *status quo*, while even committing to improved IP protection.

This political result can be described as a *de facto* transfer of the entitlement by consent. Thus, one could consider the MAS as a case of efficient breach, although not in the form envisaged by WTO law. However, it needs to be clarified that the efficiency of this "breach" lies in the promotion of joint political welfare[78] as both governments can more easily communicate positive outcomes to their national constituencies than under a situation of an ongoing dispute.

Overall, the finding deserves critical reflection. Claiming that the MoU simply depicts the values attached by the two governments to all negotiation elements involved, turns a blind eye to the influence of power imbalances on the result. In fact, the case study is illustrative of the problems that arise when larger trading powers hold more negotiating chips in their hands than developing countries. Dependency on conditioned GSP-preferences, latent threats of insufficient IP protection through Section 301 reports and WTO law as a potential second order protection for national investors harmed by developing country legislation were all factors that apparently weighed into the deal finally struck between Indonesia and the US—a deal which appears overall more favourable to the US than to Indonesia. Against this backdrop it seems problematic that the theory of efficient breach with its basic assumption that all players act as rational utility-maximizers turns a blind eye to potential power-based distortions of the individual choices of actors which may become relevant in a negotiation context between large trading powers and developing countries.

In light of these findings, it is particularly remarkable that the MAS and the lack of notification of the MoU were not commented in the meetings of the DSB. Surveillance by the DSB is generally considered important to ensure that non-compliance entails community cost.[79] However, a bilateral solution between strikingly different trading partners in matters of power that did not lead to substantive compliance has not sparked any opposition of the central collective organ in the WTO DSS.

[78]This is exactly what Schwartz and Sykes argue is the metric of welfare for decision-makers in the trade context. Schwartz and Sykes (2002), pp. 183 ff.

[79]Hudec (2000), p. 34; Trachtman (2008), p. 141; Pauwelyn (2008), p. 172 ff.

6 Conclusions

With regard to the operation of the DSS at the compliance stage, some troubling findings can be drawn from the foregoing. Firstly, the case study highlights how power imbalances weigh into MAS, entailing results that seem more favourable to the original wrongdoer than the complainant. Secondly, a MAS may apparently serve as an instrument to prevent both further surveillance of compliance by the DSB and further challenge by the original complainant, although substantive compliance has not been achieved. This is possible as a MAS allows for politically efficient exchanges between the two disputing parties which do not seem to raise objections by the other WTO Members represented in the DSB. The uncritical treatment of the MAS by the DSB suggests that most WTO Members follow the idea of a bilateral relationship between complainant and respondent.[80] Moreover, it calls into question that the DSB is indeed the forum to ensure that non-compliance with WTO law entails community costs. One needs to bear in mind, however, that an important explanatory factor for the MoU between the US and Indonesia was that the US could remedy non-compliance with the non-discrimination obligation without any economic gain for Indonesia. Hence, the systemic problems described here seem to be most prominent in such constellations.

Whether stricter mandatory review of the content of MAS with a view to ensure substantive compliance or devising a specialized category of entitlements that follow a separate logic of dispute resolution or protection would be valuable solutions to the problem at the WTO is, however, beyond the scope of this paper. Its main proposition is that the WTO as an institution has reason to worry about settlements of disputes such as the one analysed here.

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[80]Remarkably, even the lack of notification of the MoU as required by art 3.6 DSU did not raise any objections by WTO Members.

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Part III
Energy Issues in International Trade and Investment Law

Energy Regulation in International Trade: Legal Challenges in EU–Russia Energy Relations from an Investment Protection Perspective

Natasha A. Georgiou

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Abstract The EU–Russia energy partnership is a highly strategic relationship that has profound implications for the international arena as far as energy security and stability are concerned. The Ukraine crisis and subsequent sanctions brought this realization to the fore, with the future of this partnership hanging in the balance. Bilateral relations have come under increasing pressure in recent years, following a series of trade disputes and supply disruptions, bringing Russia's reliability as a trade partner into question. Tensions have been further exacerbated by Russia's withdrawal from the ECT which has effectively rendered energy cooperation based on political dialogues and commitments that lack legally binding norms. With the unlikelihood of a revised Partnership and Cooperation Agreement following the EU's suspension of all talks in response to Russia's annexation of Crimea, the basis of legal ties between these two powers has been brought into question. However, with Europe heavily dependent on Russian energy resources, the EU has a vested interest in keeping Russia firmly entrenched in the global trading system. This Chapter will assess the role of international law in EU–Russia relations; in particular, whether the ECT and WTO provide an appropriate legal framework in the context of energy trade from an investment protection perspective.

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1 Introduction

The EU–Russia energy partnership is potentially one of the most important international relationships to have evolved in the twenty-first century. Despite the partnership being relatively young, it is a highly strategic relationship, the development of which will have profound implications for the international arena, as far energy security and stability are concerned. However, EU–Russia energy relations do not exist in a vacuum—they have evolved against a wider geopolitical backdrop of strained relations between Russia and the West and an ever-growing concern about energy security.[1] Energy security is therefore an issue of bilateral tension and remains to be the ultimate test of the EU–Russia relationship. The matter was brought to the fore following the January 2009 gas crisis when gas supplies to Europe were brought to a halt following a transit dispute between Russia and Ukraine.[2] The gas crisis revealed the EU's vulnerability in its energy dependence on Russia, which subsequently pushed energy security to the top of the EU foreign policy agenda. As a result, energy security emerged as a contentious issue in EU–Russia relations which has contributed to the steady deterioration of mutual relations in recent years.[3] Nevertheless, the EU and Russia are condemned to be partners.[4] This is exacerbated by the fact there is simply no justifiable alternative to Russia as a supplier in the short term (as holder of the world's largest gas reserves) and in turn the EU as a buyer (with the most lucrative market for a heavily oil-and-gas dependent Russia). This strong interdependence and mutual interest mean that energy remains a strategic sector within which relations can be further developed for an EU–Russia energy partnership.[5] True partnership coupled with a common legal framework appear to be the fundamental components necessary to ensure energy security and prosperity in the twenty-first century.[6]

This Chapter will look at current EU–Russia relations in the energy field through the prism of international law. As a broad topic too extensive to cover in its entirety, this Chapter will limit its scope by focusing on energy relations in the gas sector and will scrutinise the legal aspects of this strategic relationship specifically from a trade and investment protection perspective. By identifying the major legal challenges which have inhibited any constructive engagement between these two powers, the Chapter will assess to what extent these recurring issues can be addressed moving forward. The Chapter will argue that one of the predominant problems and ever-prevailing issues in EU–Russia energy relations is the fact that there is no solid over-arching international legal framework regulating energy in international trade and investment between these two powers. This has resulted in a

[1] Cameron (2009), p. 20.
[2] Pirani et al. (2009), p. 4.
[3] Petrovic et al. (2009), p. 91.
[4] Cameron (2009), p. 26.
[5] Leal-Arcas (2009a), p. 409.
[6] Mandelson (2008).

void in the legal infrastructure. As a result, there is a deficiency in the legal framework in terms of an effective legal solution for potential trade disputes and supply disruptions which are a threat to security of European energy supply.[7] Other simmering issues include the absence of reciprocity in energy market access and the lack of coherence amongst Member States in their external energy relations with Russia. These issues are interrelated and closely affiliated to the need for a revised bilateral and international legal framework, as diverse positions and a lack of cooperation amongst Member States undermine collective EU actions and legislative initiatives[8] Inevitably what this Chapter is trying to advocate is that a solid legal framework between the EU and Russia can help stabilise relations between both parties by preventing any trade disputes and supply disruptions, which would ultimately diffuse any potential threats and an imminent gas crises. Nevertheless, it needs to be stated from the outset that, whilst this Chapter proposes that a revised legal framework will facilitate security of energy supply through legal certainty and stability, it does not purport to suggest that this will provide a blanket solution to all issues in EU–Russia relations which are in essence, geopolitical at heart.

2 Gaps in the Legal Framework

Bilateral relations between the EU and Russia have predominantly been based on the Partnership and Cooperation Agreement (PCA), which was signed in 1994 and entered into force on 1st December 1997 for an initial duration of 10 years. The agreement, which has been renewed annually since 2007, has provided a legal framework for bilateral trade and has regulated political, economic and cultural relations between the EU and Russia. The PCA remains the basis for EU–Russia relations until replaced by a new agreement.[9] Nonetheless, there is an urgent need for a revision of this framework, as the legal basis of this agreement has increasingly been brought into question given that several provisions of this agreement are outdated and no longer reflect the current state of affairs.[10] From an international perspective, the Energy Charter Treaty (ECT)[11] and its Transit Protocol (TP) constitute the only intergovernmental agreement in the energy field that has

[7] Marhold (2011).

[8] De Jong and Wouters (2011), p. 47.

[9] http://eeas.europa.eu/delegations/russia/eu_russia/political_relations/legal_framework/index_en.htm (accessed 8 March 2015).

[10] The EU and Russia have both changed substantially since the signing of the PCA as a result of internal developments—the EU has undergone enlargement and institutional reform whilst Russia has developed into a market economy and has acceded to the WTO.

[11] The Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in December 1994 and entered into legal force in April 1998. The ECT aims at strengthening the rule of law on energy issues, by creating a level playing field and in so doing, mitigating risks associated with energy-related investment and trade.

legally binding rules backed by a dispute settlement mechanism.[12] The ECT is therefore significant in that it is the first binding multilateral instrument aimed at the promotion and protection of foreign investment in the energy sphere; and in addition thereto, it is the first multilateral agreement with detailed provisions on energy transit.[13] Nonetheless, Russia never ratified the treaty and instead opted for provisional application under art 45 ECT,[14] having finally announced on the 20 August 2009 that it would be terminating its provisional application.[15]

The issues concerning an obsolete PCA and Russia's withdrawal from the ECT are interrelated given that from an EU perspective, the new bilateral Partnership Agreement (PA) which is supposed to replace the PCA, is expected to be strongly based on the principles of the Energy Charter and other principles fundamental to EU values, such as reciprocity, transparency and non-discrimination.[16] From a Russian perspective however, the ECT, which proposes free access to Russia's strategic gas sector as well as its production and transit infrastructure, is to its detriment, offering it no reciprocal gain.[17] The inability to reconcile these matters is a fundamental problem that has hindered further development on a bilateral and international legal framework.

Moscow's biggest gripe with the ECT (with the exception of the Yukos case which has prevented ratification), is the concern that Russia's "State champions" such as Gazprom would be obliged to open their network to Central Asian countries with cheaper gas. However, the ECT does not impose mandatory "third party access"[18] to energy infrastructure and as such these alleged concerns appear to be unjustified. Russia's subsequent withdrawal from the ECT has therefore somewhat tarnished Russia's reputation within the international community as Moscow's termination of its provisional application was construed as a disregard of standards of international law.[19] Furthermore, it ironically deprived Russian investments of additional protection abroad[20] which should have been a source of concern, given Russia's issues with the EU's Third Energy Package (TEP). Nevertheless, Russia's withdrawal did not have immediate consequences for European investments on Russian soil given that the

[12]Selivanova (2010b), p. 61.

[13]Ibid.

[14]Art 45 of the ECT states that despite non-ratification, the ECT is provisionally applicable provided that it is not inconsistent with existing domestic legislation.

[15]Carlson et al. (2009).

[16]European Commission, External Energy Relations—From principles to Action, COM (2006) 590, 12 October 2006; European Commission, Review of EU–Russia Relations, COM (2008) 740, 5 November 2008.

[17]Lukyanov (2008), p. 1110.

[18]The ECT includes provisions confirming the principle of national sovereignty over energy resources in art 18. The contracting parties are therefore free to decide the extent to which they wish to open their energy sector to foreign investment. See also Selivanova (2010a).

[19]Konoplyanik (2009), p. 23.

[20]Ibid.

arbitral Tribunal in the Yukos[21] case held that Russia was bound by the ECT for investments pre-dating its withdrawal on the 19 October 2009[22] despite not having ratified the treaty.[23] This meant that all investments prior to the withdrawal date would be protected for an additional 20 years.[24] The ECT's deeply enshrined investment protection rules and the ECT's extensive membership therefore make any proposal to replace the ECT, as the legal architecture in the energy sector, highly unlikely.[25]

3 The WTO as an Effective Legal Framework?

Given the fragmented legal framework in EU–Russia relations, the question that ultimately follows is whether the WTO can address the gaps in the legal infrastructure regulating energy in international trade. Although EU–Russia legal relations have benefitted from Russia's WTO accession, to the extent that Russia is bound by enforceable international trade rules, many areas of energy trade are perceived to fall outside the scope of the WTO agreements which are not specifically addressed in this broad trade framework.[26] There is a clear distinction within the WTO discipline between trade in goods and trade in services, with specific rules applicable to trade in goods by way of the General Agreement on Tariffs and Trade (GATT) and trade in services through the General Agreement on Trade in Services (GATS).[27] This distinction has raised concerns as it is neither prevalent nor clear in the energy sector.[28] The extent to which energy matters can effectively be

[21]The Yukos case, which was believed to be politically motivated, is arguably the most controversial investment arbitration case of all time. As CEO of Russia's largest oil firm, Mikhail Khodorkovsky was arrested for alleged tax fraud and Yukos was subsequently dismantled and auctioned off. See also Youngs (2009), p. 61.

[22]ECT provisions on arbitration and investment protection remain valid for 20 years from the date of Russia's withdrawal, until 2029. This follows from art 45.3(b) ECT. See also *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case no. AA 227, Interim Award on Jurisdiction and Admissibility, 30 November 2009, para 339.

[23]Konoplyanik (2009), p. 23.

[24]Ibid.

[25]In April 2009, President Medvedev launched an alternative to the ECT, inviting Europe to join a new charter. See President of Russia, Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles), 21 April 2009, http://archive.kremlin.ru/eng/text/docs/2009/04/215305.shtml (accessed 8 March 2015). Medvedev's proposal was too broad and incompletely structured to be seen as a credible alternative to the ECT. See Nappert (2010), p. 11. Having dismissed Medvedev's proposal, the Commission upheld that any new proposal should be considered within the ECT framework and any deviation benchmarked against the Charter. See De Jong and Wouters (2011), p. 32.

[26]This is arguably due to the fact that the major energy exporting countries at the time were not founding Members of the GATT. See Selivanova (2010a).

[27]Leal-Arcas and Abu Gosh (2014), p. 18.

[28]Cossy (2009).

addressed by the WTO agreements, in particular the GATT, is therefore a matter that is highly debated,[29] which has been further complicated by the emerging debate regarding the dichotomy of goods and services.[30]

Some of the prevailing legal challenges, which have revealed limitations in the WTO system, include the nature of energy materials and products that are fundamentally different to manufactured goods, which the WTO predominantly deals with.[31] In addition thereto, the traditional focus of GATT has been on market access of foreign products rather than access to foreign supplies. This means that trade rules are designed to address import barriers rather than export barriers, which is problematic, as trade restrictive practices in global energy trade stem from export taxes and restrictions.[32] Furthermore, legal challenges have been brought to the fore with doubts raised as to whether GATT art V which establishes a general rule on freedom of transit of goods, is applicable to transportation of energy through fixed infrastructure.[33] Given energy trade is conducted through pipelines and transmission grids, this is cause for concern and ultimately raises the question whether the WTO is able to address issues pertinent to the energy field.[34] Additional concerns relate to whether GATT art V addresses issues crucial to energy trade such as disruption to transit and new infrastructure for insufficient capacity.[35] In contrast, the trade provisions of the ECT which draw largely on GATT/WTO, are better tailored to address the requirements of energy trade given the extensive definition of energy products and services and the fact that gas pipelines are included as a means of transport in art 7 ECT.[36] Nevertheless, the ECT has its limitations given Russia's termination of provisional application, which makes its effectiveness as a legal instrument in EU–Russia energy relations a moot point.

The new PA which was under negotiation, following Russia's WTO membership, was expected to provide a comprehensive framework for bilateral trade and investment relations, with a view to improving the regulatory environment by building upon the WTO rules and going beyond the PCA provisions.[37] However, in response to Russia's illegal annexation of Crimea, the EU has suspended all talks on the new PA and sanctions have been imposed.[38] The challenges surrounding modernisation of EU–Russia bilateral relations therefore need to be addressed as Russia's withdrawal from the ECT has essentially reduced EU–Russia energy

[29]Marhold (2013), p. 1.

[30]Leal-Arcas and Abu Gosh (2014), p. 18.

[31]Selivanova (2010a).

[32]Selivanova (2010b), p. 53.

[33]Cossy (2009).

[34]Selivanova (2010a).

[35]Ibid.

[36]Marhold (2013), p. 1.

[37]http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/russia (accessed 8 March 2015).

[38]http://eeas.europa.eu/russia/index_en.htm (accessed 8 March 2015).

cooperation to non-legally binding dialogues and commitments, such as that of the EU–Russia Energy Dialogue. Such instruments are at best described as "soft law" mechanisms, which lack legal force in matters of investment protection, transit and dispute resolution.[39] This is significant given that Russia is the EU's third biggest trading partner with supplies of oil and gas making up a large proportion of the country's exports to Europe.[40] EU–Russia relations are therefore in desperate need of legislative and institutional reform which increasingly necessitates calls for international governance, at a bilateral and multilateral level.[41]

4 Prevailing Legal Challenges in EU–Russia Energy Relations

The current political climate has taken its toll on the EU–Russia energy partnership. Bilateral ties have been somewhat tarnished by the Crimea crisis and the subsequent sanctions imposed which have been detrimental to bilateral relations between these two powers. Nevertheless, a solid legal framework is required to foster cooperation and in turn facilitate trade and investment in the energy sphere. As one of the EU's largest trading partners and a major supplier of energy exports, there is no justifiable alternative to Russian energy sources in the short to medium term.[42] It is therefore imperative that the current basis for cooperation is revised as a matter of urgency and that negotiations regarding the new PA are resumed so that a more comprehensive framework can be put in place. However, both partners have different strategic interests and manifestly inconsistent views of the legal framework required. For Russia, *security of demand* is a priority, and as such the Gazprom model of vertically integrated national gas champions, delivering gas through pipelines with no freedom of access, is in Russian interest and consequently, fundamental to Russian energy policy.[43] For the EU, on the other hand, *security of supply* is a key concern and for this reason, diversification of energy sources is mandatory and has been facilitated by the unbundling requirements of the EU's TEP.[44] Inevitably, the legal requirements under the TEP[45] are difficult to reconcile with the Gazprom strategy, which further complicates the energy dynamic between

[39]Van Elsuwege (2012), p. 6.

[40]http://eeas.europa.eu/russia/index_en.htm (accessed 8 March 2015).

[41]Westphal (2006), p. 45.

[42]Boncourt (2014).

[43]Van Elsuwege (2012), p. 23.

[44]Ibid., p. 24.

[45]The TEP included rules on energy unbundling which entailed the separation of networks from production and supply activities. See European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/55/EC concerning common rules for the internal market in natural gas, COM (2007) 529, 19 September 2007.

the EU and Russia.[46] Moscow wants access to EU markets but is not prepared to reciprocate with similar arrangements for EU companies. The European Commission has therefore warned Gazprom that it will fall privy to competition law within the EU, pursuant to principles of market liberalization.[47] The Commission's unbundling requirements would in effect be loosening Russia's energy grip within Europe by preventing any downstream movement into energy activities.[48] These diametrically opposed policy objectives and agendas have inevitably hindered any constructive engagement and reduced negotiations on a revised legal framework to a piecemeal manner.[49] This stalemate validates the view that the EU and Russia appear to be talking in different languages,[50] given their inability to reach a compromise on their fundamentally different approaches in the energy domain. This stand-off has been further exacerbated by a number of simmering issues in the energy sphere including amongst others: reciprocity; investment protection; and solidarity, which will be discussed in further detail below.

4.1 Lack of Reciprocal Energy Market Access

In the absence of a new PA, the concept of reciprocity emerged as the principle of access to energy resource and infrastructure. In this context, restrictions on energy investments to gain political leverage became the new order of the day in EU–-Russia energy relations.[51] The Kremlin's strategy of collecting key energy assets and pipelines in Central and Eastern Europe to control domestic markets as leverage in negotiations with the EU are seen as obstacles for foreign investments in the energy sector.[52] Reciprocity in energy market access is thus a contentious issue in EU–Russia relations that has come to mean different things from each player's perspective.[53]

The TEP and the reciprocity clause were intended to address concerns in Brussels regarding restrictions imposed on EU companies trying to invest in Russia's energy market.[54] The Yukos case of 2003 served as a blunt reminder of the lengths to which the Russian State would go to retain control over its oil and gas

[46]Van Elsuwege (2012), p. 24.

[47]EU Observer, Putin and Barroso in Public Scrap on EU Energy Law, 24 February 2011, https://euobserver.com/foreign/31869 (accessed 10 March 2014).

[48]Cameron (2009), p. 23.

[49]Leal-Arcas (2009b), p. 348.

[50]Romanova (2008), p. 226.

[51]Belyi (2009), p. 123.

[52]Woehrel (2009), p. 9.

[53]Belyi (2009), p. 128.

[54]Ibid., p. 124.

sector. However the cases of Sakhalin II[55] and Shtokman[56] in 2006 raised most concerns within the Union. Further alarm bells began reverberating in Brussels with Russia's adoption of the Law on Foreign Investments in Strategic Companies (Law No. 57-FZ) in April 2008.[57] The subsequent amendment of a number of laws, in particular the 2008 revision of the Russian Law on the Subsurface (Law No. 58-FZ), constituted a further cause for concern for the EU.[58] Law No. 57-FZ and Law No. 58-FZ drew widespread criticism given that they were fundamentally inconsistent with the ECT's investment provisions of non-discrimination and international business practice.[59] The different views held by Moscow and Brussels with regard to their respective foreign investment legislation continue to be a source of contention in EU–Russia relations.[60]

[55]Sakhalkin II, an oil and gas development project on Sakhalin Island in Russia, was governed by a Partnership Sharing Agreement (PSA) which meant that the Russian State could not receive any profit until all costs incurred by the foreign company had been recovered. Shell was criticised for cost overruns which brought about massive losses to the State, including serious environmental damages to the region. All environmental concerns regarding the project were later resolved when Shell agreed to sell a majority stake in the project to Gazprom. See New York Times, Shell Cedes Control of Sakhalin-2 to Gazprom, December 2006, http://www.nytimes.com/2006/12/21/business/worldbusiness/21iht-shell.3981718.html (accessed 8 March 2015).

[56]Shtokman is one of the world's largest gas fields, for which Gazprom was in need of a partner as it lacked the necessary advanced technology to extract gas from this field. A short list of candidates was announced in September 2005 for which lengthy negotiations ensued until a decision was finally made in 2007 when Total, Statoil and Norsk Hydro agreed to become partners with Gazprom. See Romanova (2008), p. 224.

[57]The Law on Foreign Investments in Strategic Companies (Law No. 57–FZ) adopted in April 2008, set out the oil and gas sector as a strategic sector for which investment now required government approval. As a result, foreign investors were required to obtain consent for any acquisition in excess of 50 % in companies deemed to be strategic, which enabled the designated authority to monitor the activities of foreign investors in the energy sector. See Law No. 57–FZ 'On the Procedure for Contributing Foreign Investments in Legal Entities which are of Strategic Importance for the Defence of the Country and Security of the State' (Law on Foreign Investments in Strategic Companies), http://www.russland.no/filestore/57FZ.27.html (accessed 8 December 2010).

[58]Law No. 58–FZ amended and repealed certain legislative provisions including the Law on the Subsurface, which was the fundamental legislative act and general framework for licensing, exploration and development of activities relating to natural resources in Russia. The amendment enabled the Russian government to grant approval to terminate the right to mineral exploration and production whether the foreign entity had a license or not. See Hóber (2009), p. 438. Significantly, the license to use subsoil parcels of federal significance on the Russian continental shelf could only be granted to Russian entities controlled by the State, with at least a 5-years' experience in this sort of exploration. As a result of these limitations, only Gazprom and Rosneft qualified for the licenses. See Seliverstov (2009), p. 17.

[59]Nappert (2010), p. 12.

[60]Russia views its laws on foreign investment as a necessity for the purpose of protecting its strategic industry, which is a lifeline of the Russian economy. However, Moscow views the EU's TEP as detrimental to the investment climate between the EU and Russia, vital to the internal energy market and the EU's energy policy. See EU Observer, EU and Russia to Sign Trade Memo Amid US Mockery, 7 December 2010, http://euobserver.com/9/31442 (accessed 8 March 2015).

4.2 Investment Protection in EU–Russia Bilateral Relations

International trade and investment requires solid legal foundations—multilateral trade regimes and bilateral rules are necessary to provide an efficient regulatory framework for cross-border trade and investment. This is particularly important for the EU as Russia's most important investor.[61] According to the European Commission, it is estimated that up to 75 % of foreign direct investment (FDI) stocks in Russia come from EU Member States.[62] The EU therefore has a contingent interest in ensuring its investment protection rights are not fettered and any potential risks mitigated in its dealings with Russia.

European investors have generally erred on the side of caution with Russia following incidents such as the Sakhalin dispute and the Yukos case. This has made investment protection a thorny issue that needs to be addressed as the investment provisions of the ECT (Part III) will eventually lapse in 2029. Despite there being no immediate urgency, this is significant given that the regulation of investment is largely absent in the WTO. The WTO does not deal with investment policy except to a limited extent through the GATS,[63] whereas the ECT has deeply enshrined investment protection provisions in place, which are bolstered by the dispute settlement mechanism that includes both State-to-State and Investor-to-State arbitration.[64] The GATT/WTO focus on traditional issues of market access has meant that prevailing issues such as investment protection have largely been left unaddressed. The WTO regime therefore seems to entail deficiencies in its ability to effectively regulate energy in international trade and investment, when compared to the ECT.[65]

As a result of the lacuna in the legal architecture, bilateral investment treaties (BITs) have emerged as the default international law instrument in EU–Russia energy relations. Although BITs are not specifically drafted for energy, their provisions apply to a broad range of investments which inevitably include investments in the energy sector.[66] BITs therefore provide a legal framework for EU–Russia energy relations from an investment perspective given that Russia has concluded BITs with approximately 24 EU Member States.[67] However, by virtue of the Lisbon

[61] European Commission, Trade–Russia (EUROPA, 9 September 2014), http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/russia (accessed 8 March 2015).

[62] Ibid.

[63] WTO agreements prohibit investment measures that are inconsistent with obligations of national treatment and the prohibition of quantitative restrictions. These prohibitions concern trade in goods, not services, whereas the GATS covers investments linked to trade through mode 3 (commercial presence). See Selivanova (2010b); Selivanova (2009), p. 7.

[64] Under art 26 ECT an investor can litigate directly against a government. See Konoplyanik and Wälde (2006), p. 523.

[65] Selivanova (2009), p. 7.

[66] Lehavi and Licht (2011), p. 115.

[67] See http://unctad.org/sections/dite_pcbb/docs/bits_russia.pdf (accessed March 2014).

Treaty[68] and arts 207.1 and 206 of the TFEU, the scope of the common commercial policy has been extended to FDI bringing this within the realm of the EU's exclusive competence.[69] Although the change in the EU's competence will not have an immediate effect on existing BITs pursuant to Regulation 1219/2012[70] which establishes a transitional regime, it is anticipated that all exiting BITs (including those signed with Russia) will eventually be replaced by new agreements with the EU pursuant to art 207 TFEU.[71] Therefore, despite BITs playing a significant role in EU–Russia energy investments in the absence of a comprehensive and reliable legal framework, the fact that the entire BIT regime between Russia and the EU Member States is expected to be replaced following the extended competence of the EU, means that the current BITs do not provide an adequate investment framework for EU–Russia relations in the future.

4.3 Call for Solidarity and Coherence in External Energy Relations

The EU Council made repeated references to solidarity during the 2009 gas crisis which made energy security a top priority on the EU agenda. Sustainable and reliable energy supplies has subsequently become a source of bilateral tension as Brussels endeavours to overcome EU dependence on Russia by seeking to diversify its energy supplies.[72] The Treaty of Lisbon introduced solidarity in matters of energy supply within the EU. Significantly art 194 stipulates that the aims of the Union's energy policy shall be pursued "in a spirit of solidarity" between Member States. In this respect, the signing of bilateral deals with Russia's State-run gas monopoly Gazprom could be seen as undermining solidarity and the development of a coherent external energy policy within the EU.[73] Given that sustainable and reliable energy supplies are source of tension between the EU and Russia,[74] bilateral gas deals with Moscow may not be completely consistent with the EU's policy of diversification in its quest for energy security, as it potentially risks entrenching the EU further in its energy dependence on Russia.

[68]The Treaty of Lisbon entered into force on 1 December 2009 as the latest landmark in the Union's evolved constitutional architecture. It amended the EU treaties and renamed them into the current Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU).

[69]Strik (2014), p. 2.

[70]Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries, *OJ* L 351/40.

[71]Bungenberg (2010), p. 143.

[72]Leal-Arcas (2009b), p. 346.

[73]Barysch (2010), p. 4.

[74]Petrovic et al. (2009), p. 91.

More recently, these bilateral gas deals have included Nord Stream[75] and Turkish Stream.[76] Both proposed pipelines are deemed to be controversial by the EU due to concerns that the construction of Turkish Stream and the extension of Nord Stream would lead to overcapacity. Turkish Stream (replacing the cancelled South Stream) in particular is considered to be in direct competition with EU-backed pipelines.[77] Furthermore, both pipelines would need to comply with EU unbundling rules[78] which is significant given that South Stream, the failed pipeline to which Turkish Stream is a successor, was aborted in December 2014 due to inconsistencies with EU legislation, in particular the EU's network ownership unbundling.[79] Such deals are predominantly viewed by many countries within the EU—mostly Central and Eastern European States—as a flagrant example of quick bilateral politics with negotiations at EU level largely absent and thus perceived as lacking any form of solidarity.[80] Fragmentation within the energy market is therefore rife and remains an obstacle yet to be overcome.

The EU has much to gain from a united stance towards Russia, given the recurring energy cuts, lack of equal market access and the protracted negotiations on a revised bilateral agreement, all of which are detrimental to energy cooperation.[81] However, different priorities, historical ties, national loyalty, energy mix and market positions have resulted in a discord within the EU in its approach towards Russia.[82] This impasse within the Union has made it easier for national governments to justify bilateral ties with Moscow which has in turn facilitated the Putin regime to pursue its own agenda through barter deals with individual Member States pursuing national interests on matters that ought to have been negotiated at a

[75]Nord Stream is an existing 55 bcm/y pipeline that connects Russia to Germany via the Baltic Sea. It is to be extended to double its capacity following an agreement between Gazprom, Royal Dutch Shell, E.ON and OMV.

[76]Turkish Stream is a 63 bcm/y pipeline connecting Russia to Turkey via the Black Sea, intended to carry Russian gas to South East Europe.

[77]Turkish Stream is considered a rival to the Western-backed Trans Adriatic Pipeline (TAP) pipeline project which will carry Azeri gas to European markets. TAP is part of the Southern Gas Corridor and is seen as Europe's alternative to its reliance on Russia. See Raszewski (2015), p. 4.

[78]EurActiv, Barroso Warns Bulgaria on South Stream, 28 May 2014, http://www.euractiv.com/sections/energy/barroso-warns-bulgaria-south-stream-302467 (accessed 10 July 2014).

[79]The Commission confirmed that the breach of EU law related to three major issues which included: firstly, the EU's network ownership unbundling which prohibits Gazprom as both producer and supplier of gas to simultaneously own production capacity and its transmission networks; secondly, non-discriminatory third party access to the pipelines which means that Gazprom does not have exclusivity as the only shipper; thirdly, the tariff structure which needs to be addressed. See EurActiv, South Stream Bilateral Deals Breach EU Law, Commission Says, 4 December 2013, http://www.euractiv.com/energy/commission-south-stream-agreemen-news-532120 (accessed 1 December 2014).

[80]De Jong and Wouters (2011), p. 38.

[81]Rosner (2009), p. 166.

[82]Alcaro and Alessandri (2010), p. 191.

multilateral level.[83] With bilateralism emerging as the default approach of engagement with Russia, the EU's endeavours to bolster its energy policy towards Russia has been hindered by the lack of coherence amongst Member States in their stance towards Russia. It is posited that a call for EU solidarity in Brussels' diversification efforts will prove more beneficial in the long run than individually negotiated bilateral deals amongst select Member States dependent on Russian gas.[84] This was recently reaffirmed in the Commission's gas stress test results, which concluded that greater solidarity was required between all Member States and greater diversification amongst their suppliers.[85]

In this respect, the solidarity mechanism of art 122.1 TFEU warrants special attention as it anticipates that the EU institutions act "in a spirit of solidarity between Member States" should there be any shortage of supply of energy or similar products.[86] The specific mention of "energy" in relation to "supply" creates a legal basis whereby the Union can intervene to the extent that there are any supply disruptions.[87] As such, the solidarity principle sets a platform for the measures to be taken during a time of crisis to ensure energy security.[88] However, there appear to be some inconsistencies between art 122.1 TFEU and the Union's policy on energy under art 194 TFEU.[89] Significantly art 194.2 TFEU imposes limitations on the measures to be undertaken to achieve the objectives of art 194.1 TFEU, as they "shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply". The extent to which art 194.2 impacts the solidarity measures under art 122.1 and the EU's ability to act in the event of a supply disruption is therefore unclear but inevitably allude to a potential conflict between these two provisions.[90]

Therefore, whilst the Commission's calls for supranational coordination and integration in energy policy have been bolstered by the formation of an Energy Union,[91] the aims of the Union's energy policy cannot be implemented in a manner

[83]Gawlikowska-Fyk et al. (2015), p. 14.

[84]EurActiv, Cameron: EU–Russia Relations Should Be More Positive, 9 April 2008, http://www.euractiv.com/en/foreign-affairs/Cameron-eu-russia-relations-positive/art-171457 (accessed 1 April 2014).

[85]European Commission, Communication from the Commission to the European Parliament and the Council on the Short Term Resilience of the European Gas System. Preparedness for a Possible Disruption of Supplies from the East during the Fall and winter of 2014/2015, COM (2014) 654, 16 October 2014.

[86]Lorca (2009), p. 108.

[87]De Jong and Wouters (2011), p. 41.

[88]Ibid.

[89]Article 194 TFEU states that the aims of the Union's energy policy shall be pursued "in a spirit of solidarity" between Member States.

[90]De Jong and Wouters (2010), p. 533.

[91]On 25 February 2015 the European Commission put forward a proposal for an Energy Union with the aim of achieving a "sustainable, low-carbon and climate-friendly economy that is

which impinges on the sovereign rights of States to exploit their energy resources as they deem appropriate. Although the 2006 and 2009 gas crises prompted Member States heavily dependent on Russian gas to call for greater integration in the form of an Energy Union, Member States which are less reliant on Russian natural resources have been reluctant to agree to this integration in energy policy. In this respect, while art 122.1 TFEU can be seen as a test of Member States' dedication to the Lisbon Treaty's solidarity provision, based on the level of implementation amongst Member States,[92] solidarity is not a definitive or quantifiable concept.[93] It is nebulous and therefore subject to Member States' interpretation and the amount of backing it is afforded in a time of crisis.

Nevertheless, if there is any lesson to be learnt from the South Stream project, it is that failure to comply with EU legislation is likely to lead to political controversy and a defunct pipeline. EU leaders therefore have a vested interest to ensure that any intergovernmental agreement signed with third party States and non-EU energy suppliers are consistent with EU law. It is only by upholding the rule of law and in 'a spirit of solidarity' that concrete diversification efforts can be achieved to the ultimate benefit of all EU Member States, rather than through individual pipeline deals for cheaper gas that may have damaging consequences for Europe's energy security as a whole. It follows that the EU's inability to speak with one voice is partly the reason why the EU has thus far failed to develop a coherent strategic approach towards Russia.[94] A lack of solidarity and coherence in external energy relations therefore remains one of the pivotal challenges that lie ahead for the EU in its energy dependence on Russia and in turn security of its energy supply.

5 Conclusions

The EU–Russia energy relationship is a complex partnership driven by strong interdependence and mutual reliance. The future of this strategic relationship very much depends on whether an agreement can be reached on the issues addressed above which have complicated this relationship and are making cooperation increasingly more difficult. Reciprocal market access remains to be a contentious issue in EU–Russia relations. Russia is unlikely to move on reciprocity and change its perception of the TEP as unfair and riddled with double standards.

designed to last". The Commission's Energy Union initiative calls on Member States to move away from a fragmented system of uncoordinated national policies, market barriers and energy-isolated areas having identified an inherent need for a common European approach in the energy sector. See below, n. 101.

[92]Ibid., p. 525.

[93]De Jong and Wouters (2011), p. 41.

[94]Leal-Arcas (2009a), p. 351.

A more pressing issue is the need for a revised legal framework by way of a new bilateral agreement and a solution to the future role of the ECT. On a close analysis of the legal instruments in place, it is evident that there are gaps in the legal infrastructure. The PCA is outdated and the effectiveness of the ECT in EU–Russia energy relations, despite its potential as a legal instrument to regulate energy, is limited given Russia's termination of provisional application. However, the ECT still has an important role to play in the investment protection architecture, given its provisions are still applicable for 20 years from the date of Russia's withdrawal as a result of the legacy provision.[95] The Energy Dialogue as a forum for discussion does not result in any legally binding norms and at best can be described as an institutional mechanism of political cooperation. Despite Russia's accession to the WTO, which was hailed as a breakthrough for EU–Russia relations, there are doubts as to whether this general trade framework can specifically address cooperation in the energy sphere as many areas of energy trade appear to fall outside the scope of the WTO agreements.[96]

The fragmented legal framework and patchwork of legal instruments[97] address only some problematic aspects of EU–Russia energy relations such as trade in goods and services under the WTO and investment protection under the ECT. As a result, several issues remain unresolved which continue to jeopardise cooperation between these two powers. Amongst the substantive issues, such as the nature of a new PA which has been suspended and the WTO's effectiveness in regulating energy, Russia believes its concerns as a major energy producer have not been adequately addressed.[98] It would appear, however, that the EU is unlikely to abandon the legal nature of such an agreement and the rules of the ECT, in its entirety; and that ultimately a less controversial way forward will need to be agreed to address thorny issues such as a new PA and the role of the ECT.[99]

Finally, as mentioned above, coherence in external energy relations is a matter closely related to the above mentioned issues of reciprocity and the need for a bilateral and international framework, as a lack of cooperation between EU Member States can undermine solidarity and collective EU legislative actions. Inconsistent manoeuvres between old and new Member States on how to deal with Russia have ultimately created a rift within the EU, with old Member States preferring to cut bilateral deals.[100] Given the fragmented EU energy market, the Commission has undertaken a more active role in the bilateral negotiations of EU Member States and external suppliers. Whilst the EU's energy policy is far from ideal, the EU's commitment to its plight for a coherent approach in its energy policy has been

[95]Riley (2010), p. 37.

[96]Selivanova (2010a).

[97]Selivanova (2010b), p. 61.

[98]De Jong and Wouters (2011), p. 46.

[99]Ibid.

[100]The signing of bilateral deals with suppliers such as Gazprom, are repeatedly seen as undermining the development of a coherent external energy policy. See Barysch (2010), p. 4.

reinforced with the unveiling of the Energy Union initiative.[101] Due to the inconsistency between Member States internally, the external dimension of the EU's energy policy has not been accurately developed.[102] The EU's inability to speak with one voice therefore gives credence to the mantra "too little Europe, too little union" which is arguably one of the reasons why the EU has thus far failed to develop a coherent strategic approach towards Russia.[103]

Challenges surrounding a revised legal framework need to be addressed and negotiations regarding a new PA resumed for the purpose of deepening EU–Russia trade relations. Although this has been partially resolved with Russia's accession of the WTO, an updated bilateral framework is still imperative for reasons of legal certainty and to ensure EU–Russia energy relations are based on a solid institutional structure.[104] Whilst energy trade has always been covered by the GATT/WTO, energy trade has *de facto*, not *de iure*, been perceived as excluded from its scope.[105] This Chapter is therefore of the view that a more specialised legal framework is required to deal with energy specific matters. Despite the ECT being a more specialized international instrument tailored to regulate trade and investment in the energy sector, its effectiveness as a legal framework in EU–Russia relations, with the exception of the investment protection provisions, is superfluous. The deeply enshrined investment protection provisions of the ECT have served to illustrate why the EU has been adamant to negotiate a new PA incorporating an energy chapter heavily based on the ECT. Ultimately, whether negotiations regarding the new PA resume, with Russia conceding on provisions strongly based on principles of the Energy Charter, would be a welcomed eventuality that yet remains to be seen.

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[102] Barysch (2008), p. 7.

[103] Leal-Arcas (2009a), p. 351.

[104] Van Elsuwege (2014), p. 459.

[105] Marhold (2013), p. 1; Leal-Arcas and Abu Gosh (2014), p. 24.

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Renewable Energy and WTO Subsidy Rules: The Feed-In Tariff Scheme of Switzerland

Jean-François Mayoraz

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Abstract In recent years, States around the world have been starting to facilitate the production of renewable electricity by providing subsidies to producers in order to address climate change. As a consequence, policy makers have been developing various forms of instruments to support renewable electricity production. Amongst them, a popular tool is the feed-in tariff (FIT), which is currently used by around 73 countries.

Switzerland is one of the 73 countries, which has been using a FIT-scheme as an instrument to support the production of renewable electricity since 2009. According to art 7a.1 of the Swiss Energy Act network operators are obliged to take all electricity from producers of renewable electricity and to compensate them with a fixed tariff. With the new energy strategy 2050 the State support of renewable energy has become even more important. Interestingly, renewable energy composes

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already a majority of the total electricity production in Switzerland, namely from hydropower.

This research aims to contribute to the current discussion of the compatibility of FIT-schemes with WTO subsidy rules. By analysing Switzerland's FIT-program, the research question is asked whether the current WTO subsidy regime allows Switzerland enough policy space to pursue its objective to raise its production of green electricity by using a FIT-program.

1 Introduction

The desire and aim to shift electricity production from conventional energy sources to renewable energy sources has been developing around the world in recent years. Reasons for this desire are various but concentrate mainly around securing energy supply, mitigating climate change, more independency in energy matters or concerns towards nuclear energy. As the production of electricity from renewable energy sources cannot compete (yet) with conventional electricity production, States aiming at changing their energy supply mix have been starting to promote renewable energy sources.

Thereby, feed-in-tariffs (FIT) are the most common tool that policy makers introduced for supporting the production of green electricity. Currently, around 73 countries are using FIT-schemes in order to promote renewable energy sources.[1] A FIT guarantees a fixed and above the market price tariff for purchases of green electricity from eligible producers paid over a defined term. In addition, power companies are usually required to purchase all electricity from these producers at this premium rate.[2] On the one hand, FIT-schemes offer investment security. On the other hand, however, producers feel no competition pressure and may miss opportunities to optimize their cost structure.[3] As a consequence, FIT-schemes may distort competition and it is thus legitimate to ask, whether these schemes should be disciplined under international subsidy rules.

The use of FIT-schemes for the promotion of renewable energy has been recently called into question by a WTO dispute. Japan and the European Union (EU) challenged the compatibility of a FIT-program introduced by the Canadian Province Ontario with WTO subsidy law.[4] In this case, the WTO judiciary has been confronted with the question whether a FIT should be qualified as a subsidy in the

[1] REN21 (2015), p. 88.

[2] Mendonça et al. (2010), p. xxi.

[3] Waldner and Rechsteiner (2012), para 7.

[4] WTO doc. WT/DS412AB/R, WT/DS426/AB/R, Appellate Body Report, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector, Canada – Measures Relating to the Feed-In Tariff Program*, 6 May 2013; WTO doc. WT/DS412/R, WT/DS426/R, Panel Report, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector, Canada – Measures Relating to the Feed-In Tariff Program*, 12 December 2012.

sense of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). The Appellate Body (AB) avoided answering this question. Nevertheless, it gave some interesting insights into how it might examine a FIT-scheme under the SCM Agreement.

Switzerland introduced its FIT-program in 2009.[5] Although the majority of electricity produced in Switzerland is already from renewable energy sources, namely hydropower, Switzerland intends to continue an environmental friendly energy policy and to phase out electricity production from nuclear energy. Therefore, the promotion of green electricity plays an important role in Switzerland. Against this background, Switzerland may serve as a blueprint to demonstrate the need to reform the SCM Agreement for future situations, in which green electricity is established in the market but governments still intend to further promote green electricity due to legitimate policy objectives.

This paper analyses Switzerland's FIT-scheme under WTO law and takes into account the recent development in WTO case law. It focuses mainly on the notion of subsidy as this marks the first step in disciplining subsidies. In doing so, the research question is asked, whether the current WTO subsidy regime allows Switzerland enough policy space to pursue its objective to raise its production of green electricity by using a FIT-program. In order to answer the research question, this contribution starts with a brief introduction to the WTO subsidy rules as well as to the recent WTO case law on Ontario's FIT-program (Sect. 2). Next, an introduction to Switzerland's FIT-scheme is provided including a closer look at the support of hydropower (Sect. 3). Finally, the Swiss FIT-scheme will be analysed in the light of the WTO subsidy regime (Sect. 4).

Despite the new decision of the Appellate Body in *Canada – Feed-In Tariff Program*, which tended to favour support of green electricity, this paper concludes that certain aspects of Switzerland's promotion of renewable energy may still fall within the notion of subsidy in the sense of the SCM Agreement. This raises the risk for this State support being challenged before the WTO judiciary, which creates legal uncertainty. Therefore, this paper argues in favour to "green" the SCM Agreement so as to account for the rational of subsidies.[6]

2 Subsidies to Renewable Energy in WTO Law

2.1 Defining a Subsidy Under WTO Law

WTO law disciplines the use of subsidies in the SCM Agreement, which also regulates countervailing measures taken by WTO Members in order to offset negative effects of other Members' subsidies. A subsidy exists if (1) a financial

[5]Federal Administration (2008).

[6]See for options Shadikhodjaev (2015), pp. 493 ff.

contribution, or price support, by a government or any public body (2) confers a benefit (3) to a specific recipient.[7] The latter requirement opens the door for the subsidy disciplines under the SCM Agreement whereas the first and second requirements are decisive in determining whether a State measure falls within the notion of subsidy of the SCM Agreement.

Originally, the SCM Agreement included an exemption for certain subsidies in art 8. However, this article expired in 1999 and has not been prolonged yet. Therefore, all State measures considered as a subsidy under the SCM Agreement are subject to possible legal challenges today.

2.1.1 Financial Contribution

A *financial contribution* by a government can be made either directly, i.e. providing funds, goods, services or forgoing income due; or indirectly, i.e. channelling payments through a private body (art 1.1(a)(1) SCM Agreement). Alternatively, any form of income or price support may also be considered as a subsidy (art 1.1(a)(2) SCM Agreement).

The four possible forms of a financial contribution are enumerated exhaustively in art 1.1(a)(1)(i)–(iv) SCM Agreement, with paragraphs (i)–(iii) being direct in nature. As a pre-condition, art 1.1(a) SCM Agreement encompasses only financial contributions made by a government or any public body. Therefore, the first step is to identify a government or a public body as the subsidizing entity. Thereby the critical question lies on the interpretation of the term "public body". As former case law suggested,[8] a public body in the sense of the SCM Agreement was considered to be "any entity controlled by a government".[9] In recent case law, however, the Appellate Body overturned this view and interpreted the term "public body" as "an entity that possess, exercises or is vested with governmental authority".[10] It should be noted that a *de jure* evidence for delegation of governmental authority is not readily available in each case. Therefore, whether an entity's operation can be considered as part of governmental authority has to be examined on a case-by-case basis.

With respect to indirect financial contributions, paragraph (iv) aims primarily at preventing circumventions of paragraphs (i)–(iii).[11] It recognizes that a government may also grant indirectly a financial contribution by making payments to a funding

[7] Arts 1 and 2 SCM Agreement.

[8] WTO doc. WT/DS273/R, Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, 11 April 2005, para 7.50.

[9] WTO doc. WT/DS379/AB/R, Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, 25 March 2011, para 320, referring to the Panel Report.

[10] Ibid., para 317.

[11] WTO doc. WT/DS296/AB/R, Appellate Body Report, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, 20 July 2005, para 113; WTO doc. WT/DS257/AB/R, Appellate Body Report, *United States – Final*

mechanism or through entrusting or directing a private body. However, the difficulty lies in identifying the types of government actions that constitute entrustment or direction. The terms "entrust" and "directs" encompass not only acts of "delegation" and "command". In some circumstances, "guidance" by a government may also be seen as direction. Nevertheless, in general it can be expected that entrustment and direction of a private body involve, "some form of threat or inducement".[12] Therefore, it seems unavoidable to assess on a case-by-case basis whether a government's action constitutes an entrustment or direction of a private body.

As an alternative to financial contribution, any form of income or price support may also constitute a subsidy if it confers a benefit to a specific recipient. At first sight, the phrase in art 1.1(a)(2) SCM Agreement seems as broad as to capture any government measure that leads to raising prices within a market. However, the panel in *China – GOES* rightfully narrowed its meaning as to capture only government measures that set or target a given price and consequently excluded every government measure that has an incidental and random effect on price.[13]

2.1.2 Benefit

A subsidy in the sense of the SCM Agreement requires secondly a *benefit* conferred to a recipient. For a benefit to be demonstrated, the recipient has to obtain an advantage that it could not obtain in the market place. Therefore, it has to be examined whether the recipient is "better off" than it would have been absent the contribution.[14] The appropriate basis for this examination is to be found in the marketplace by using a so-called private-investor test. According to this private-investor test, a benefit can be identified "by determining whether the recipient has received a financial contribution in terms more favourable than those available to the recipient in the market".[15] This approach is inspired by art 14 SCM Agreement, where for the purpose of countervailing measures prevailing market conditions serve as basis for the calculation of the amount of a subsidy in terms of the benefit.

Note however that a comparison with the private market place is only meaningful if the market itself is not distorted.[16] In cases, where a market is distorted, recourse to an alternative benchmark outside the country or a constructed

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Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada, 17 February 2004, para 52.

[12]WTO doc. WT/DS296/AB/R, *supra*, n. 11, para 116.

[13]WTO doc. WT/DS414/R, Panel Report, *China – Countervailing and Anti-Dumping Duties on Grain Oriented Flat-Rolled Electrical Steel from the United States*, 16 November 2012, para 7.84.

[14]WTO doc. WT/DS299/R, Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, 3 August 2005, para 7.176.

[15]WTO doc. WT/DS70/AB/R, Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, 20 August 1999, para 157.

[16]WTO doc. WT/DS316/AB/R, Appellate Body Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, 1 June 2011, para 900.

benchmark is possible provided that calibration accounting for the prevailing conditions in the given market is made.[17] The Appellate Body recently distinguished between government intervention that creates new market and intervention in an existing market when recourse to an alternative benchmark is made.[18] If the government establishes a new market, the appropriate alternative benchmark for determining a benefit has to be found within the contours of this newly established market, i.e. finding a competitive market with the same characteristics.

2.2 *Feed-In Tariff Schemes and the Notion of Subsidy*

In *Canada – Feed-In Tariff Program* the WTO judiciary was confronted for the first time with the question whether a feed-in tariff program by the Canadian Province of Ontario was a prohibited subsidy. In the Ontario feed-in tariff program a premium price per kilowatt-hour of electricity was paid to producer using wind-power or solar photovoltaic (PV) for their electricity production. Ontario was aiming at diversifying its electricity supply mix and replacing its coal-fired facilities, which consequently should also reduce greenhouse gas emissions. While the objectives of this measure seem legitimate, the case was brought to the WTO because Japan and the EU complained about the requirement of using Canadian equipment for the production of renewable electricity in order to be eligible for the program.[19] The panel and Appellate Body found this local content requirement indeed to be inconsistent with the national treatment provision under art III.4 GATT and art 2.1 Agreement on Trade-Related Investment Measures (TRIMs Agreement). Canada argued that its measure falls within the government procurement under art III.8 GATT. This argument was rejected because the Appellate Body noted that the government was purchasing electricity, whereas foreign electricity-generation equipment was allegedly being discriminated.[20] However, neither the panel nor the Appellate Body could confirm the existence of a subsidy, although they examined this claim under the SCM Agreement extensively.[21]

[17]WTO doc. WT/DS257/AB/R, *supra*, n. 11, para 103.

[18]WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, para 5.188.

[19]Local content requirement concerns seem to be the most common issue why complainants challenge State measure promoting renewable energy. See Asmelash (2015), p. 284, Leal-Arcas and Filis (2014) and Meyer (2013).

[20]WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, para 5.75 ff.

[21]WTO doc. WT/DS412/R, WT/DS426/R, *supra*, n. 4, paras 8.6-7; WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, paras 5.79, 5.84 and 6.1.

2.2.1 Involved Agencies Are Public Bodies

Under Ontario's FIT-program, three government agencies were responsible for making payments to suppliers for delivered electricity, transmission of electricity and administration of the electricity market. The panel found all of them to be public bodies within the meaning of art 1.1(a)(1) SCM Agreement, which was not disputed by the parties.[22] A *de jure* evidence consisting of an explicit statutory provision under Ontario's domestic law, which assigns and delegates governmental authority to these agencies, was pivotal to the panel for its conclusion to qualify these agencies as public bodies.[23]

2.2.2 The Government of Ontario Purchased Goods in Form of Electricity

The panel qualified the financial contribution in this case as a purchase of goods by the government of Ontario in the sense of art 1.1(a)(1)(iii) SCM Agreement. It viewed that Ontario has obtained possession of electricity through certain payments.[24] The Appellate Body upheld this conclusion but refined that a financial contribution under art 1.1(a)(1) SCM Agreement may take several forms listed in sup-paragraphs (i)–(iii) simultaneously. Two notable elements can be drawn from the Appellate Bodies findings. First, the Appellate Body recognized electricity as a *good* since it accepted that the FIT scheme constitutes a government's purchase of goods. Therefore, this case approves that electricity falls within the WTO regulatory domain on goods. Second, the Appellate Body's refinement concerning the possibility of a measure to fulfil several forms of financial contribution offers complainants in their complaint the option to favour the form of financial contribution, which allows imposing the severest countermeasure under the SCM Agreement.[25]

2.2.3 Higher Hurdle for the Benefit Analysis in a New Market

As mentioned before, in *Canada – Feed-In Tariff Program* the Appellate Body introduced a new possibility for recourse to an alternative benchmark within the benefit analysis. It followed a two-step approach in order to analyse whether a benefit has been conferred to producer of green energy in Ontario. First, it held that

[22]WTO doc. WT/DS412/R, WT/DS426/R, *supra*, n. 4, paras 7.231–7.239.

[23]Ibid., para 7.234.

[24]Ibid., paras 7.169–7.185, 7.223–7.241.

[25]See WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, para 5.130. The Appellate Body acknowledged that art 14 SCM Agreement offers different methods for calculating the amount of a subsidy depending on the type of financial contribution.

the determination of the relevant market is a necessary pre-condition for the benefit analysis. Unlike the panel, which concluded that renewable and conventional sources of energy are in the same wholesale electricity market,[26] the Appellate Body identified two separate markets: a market for conventional, and a market for renewable energy, in particular a market for each wind- and solar PV-generated electricity. It based its findings on the importance to take into account the supply-side substitutability of a product when identifying the relevant market, namely cost structure, operating costs and characteristics among generating technologies.[27] In its view, not only the demand-side substitutability matters but also the supply-side substitutability. As a consequence, the benefit analysis should be conducted within competitive markets for wind- and solar PV generated electricity instead of the entire wholesale electricity market.[28]

After having defined the relevant market, the Appellate Body examined whether a benefit had been bestowed to the producers. In this context, the Appellate Body introduced a new conceptual interpretation. It distinguished between government action that aims at creating a new market and government intervention in an established market.[29] In its view, the former does not "in and of itself"[30] amount to a subsidy. As a result, the Appellate Body set the hurdle for demonstrating a subsidy being bestowed in a newly created market higher than in an already established market.[31] However, it could not complete the benefit analysis due to lack of information. Nevertheless, it established some determining factors for the benefit analysis.[32]

2.3 A Comment

Before the Appellate Body Report on *Canada – Feed-In Tariff Program* was issued, the prevailing doctrine considered that FIT-schemes may fit into the subsidy notion of the SCM Agreement.[33] The Appellate Body introduced more flexibility within

[26]WTO doc. WT/DS412/R, WT/DS426/R, *supra*, n. 4, para 7.322.

[27]WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, para 5.178.

[28]Ibid., para 5.178.

[29]Ibid., para 5.188.

[30]Ibid.

[31]Ibid., para 5.190. The Appellate Body held that a benchmark price could be found by finding some market with the same characteristics as in Ontario. This might seem to be an unlikely event but it shows that the Appellate Body has not completely closed the door for demonstrating that a governmental creation of a new market amounts to a subsidy.

[32]WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, para 5.246.

[33]Rubini (2011), p. 23; Jerijian (2012), p. 10; Cottier et al. (2011), p. 226; Bigdeli (2009), p. 169.

the notion of subsidy, in particular by taking a new approach towards the benefit analysis. First, it found the absent supply-side substitutability to be decisive in this case to argue for a distinct renewable energy market. Second, it distinguished between government intervention establishing a new market and government intervention in an established market. In doing so, the AB allowed more leeway for Member States when designing their industrial policy. The newness of a market can preserve their measures from WTO subsidies disciplines. Although the Appellate Body did not decide on whether Ontario's FIT-scheme is a subsidy, its findings allow to anticipate that in its view an FIT-program should not fall within the subsidy notion of the SCM Agreement.

The added flexibility to the subsidy notion is seen critically in the literature. The Appellate Body's emphasis on the importance of supply-side factors inherits certain risks because it gives States the opportunity to support their infant industry by simply stating that their product is not competitive with existing products due to different supply-side factors such as cost structures.[34] Moreover, this situation should be already regulated in art XVIII(c) GATT, which offers an explicit and restrictive provision for this kind of promotion.[35] As a result, the increasing relevancy of supply-side substitutability may open the door for unwanted production subsidies[36] and may even challenge the WTO judiciary approach on the concept of like products as well.[37] In addition, it is argued that the distinction between established and new market lacks a legal basis in the SCM Agreement.[38] There are no indications in the SCM Agreement, which could suggest such a distinction. Lastly, the Appellate Body gave no guidance on what it considers as a new market and thus created a new loophole.

In sum, with the Appellate Body's finding and the doctrine's criticism on the case it still remains open whether FIT-programs are considered as subsidies within the meaning of the SCM Agreement. Nevertheless, future complainants now dispose guidance from the Appellate Body on how a FIT-scheme may be qualified as a subsidy. Against this background, it will be more likely that future panels will dispose all information needed in order to decide whether a subsidy exist. Therefore, this case offers no sustainable safe haven for green measures since under the current WTO subsidy rules it is conceivable that a FIT-program might be considered as a subsidy, independently of its objective.[39] This puts a State promotion at risk to be challenged.

[34]Cosbey and Mavroidis (2014), p. 26.

[35]Article XVIII(c) states an exception for infant industries, which is limited for use by developing countries only.

[36]Pal (2014), p. 136.

[37]Shadikhodjaev (2013), p. 875.

[38]Cosbey and Mavroidis (2014), p. 27; Pal (2014), p 134.

[39]Cosbey and Mavroidis (2014), p. 29.

3 The Feed-In Tariff Scheme of Switzerland

3.1 Electricity Market in Switzerland

A local, decentralized and federalist market structure characterizes Switzerland's electricity market, in which hundreds of power companies supply electricity to consumers.[40] With respect to electricity production, Switzerland is in a different situation than most other countries. In 2014, Swiss electricity producers produced 69.6 billion kWh in total. 37.9 % was from nuclear energy sources and 5.7 % from conventional thermal power plans. The prevailing energy source in Switzerland is hydropower, which accounts for 56.4 % of the electricity production.[41] Thus, Switzerland's electricity production has already a low carbon emission and a high share of renewable sources. However, *new* renewable energy sources, such as solar or wind, account for only 3.9 % of the total electricity production.[42]

3.2 Legal Framework for Feed-In Tariffs

The Swiss energy policy is outlined in art 89 of the Swiss Constitution. The Confederation and Cantons shall, within the scope of their powers, ensure a sufficient, diverse, safe, economic and environmentally sustainable energy supply as well as an economic and efficient use of energy.[43]

With regard to the promotion of renewable energy, the Constitution states that the Confederation "shall encourage the development of energy technologies, in particular in the fields of saving energy and the renewable energy sources".[44] Article 74 (regarding protection of the environment) and art 64 (regarding research in general) complement the constitutional basis for the promotion of renewable energy sources.

Based on these constitutional assignments, the 1998 Energy Act[45] and its corresponding 1998 Energy Ordinance[46] have been enacted on the federal level

[40]The exact number of existing power companies is vague: the Association of Swiss Electricity Companies has over 400 Members, which produce, distribute and trade 90 % of the electricity in Switzerland. See http://www.strom.ch/de/verband/mitglieder.html (German) (accessed 31 January 2016).

[41]Besides Switzerland, only few countries such as Norway and Austria dispose a high share of hydropower too. In Norway 96 % and in Austria 66 % of electricity is produced from hydropower. Both countries dispose no nuclear energy sources. See Swiss Federal Office for Energy (2015a), pp. 2–3, 7.

[42]Swiss Federal Office for Energy (2015b), p. 6.

[43]Swiss Constitution, art 89.1.

[44]Swiss Constitution, art 89.3.

[45]Classified Compilation (SR) 730.0.

[46]Classified Compilation (SR) 730.01.

in order to implement the federal energy policy strategy. Similar to the constitutional provision, the Energy Act aims at ensuring a sufficient, diversified, secure, economic and environmental friendly energy supply.[47] It provides for, amongst others, an increased use of renewable energy sources.[48] In addition, the Energy Act lays down concrete targets regarding electricity production from renewable energy sources, which raises the share of green electricity up to 77 % of the total electricity production in the upcoming decades.[49] The term "renewable energy" encompasses hydropower, solar energy, geothermal energy, ambient heat, wind energy and energy from biomass and biological waste.[50]

In order to fulfil these statutory objectives, the federal legislator introduced a "Feed-In Remuneration at Cost" as the main instrument for the promotion of renewable energy sources in 2009.[51] Art 7(a) Energy Act serves as the legal basis for this FIT-program and obliges network operators to take all electricity from producers of renewable electricity and to compensate them with a fixed tariff. In addition, the Energy Supply Act 2007[52] guarantees a non-discriminatory and privileged access for electricity from renewable energy sources to the grid.[53]

The Energy Act has been subject to various upcoming reforms.[54] After the nuclear incident in Fukushima (Japan) the Federal Council decided to change the energy supply mix in Switzerland and to phase out nuclear energy.[55] The government intends not to replace the existing nuclear power plants at the end of their lifespan. In order to maintain security of supply, it is planned to increase energy efficiency and to expand electricity production from hydropower as well as from new renewable energy sources.[56] This plan is labelled as the "Energy Strategy 2050" and activated a series of measures. Amongst them, the above-mentioned feed-in tariff program plays, again, an important role for increasing the share of renewable energy sources in the Swiss electricity production.[57]

In conclusion, the importance of the FIT-program for Switzerland's energy policy cannot be denied. Whether it is to fulfil the aims set in the Constitution or to push the State's energy supply mix towards a nuclear free future, the Swiss government uses the FIT-program as its main instrument to promote the production

[47]Energy Act, art 1.

[48]See Energy Act, arts 1.2(c), 3.1(b) and 5.3.

[49]Federal Gazette (BBl) 2004 1661, p. 1667.

[50]Energy Ordinance, art 1(f); the same wording is used in art 4.1(c) of the Energy Supply Act.

[51]Federal Gazette (BBl) 2013 7561, p. 7623.

[52]Classified Compilation (SR) 734.7.

[53]Energy Supply Act, art 13.3(c).

[54]Federal Gazette (BBl) 2013 7561, p. 7657.

[55]Swiss Federal Office for Energy (2011).

[56]See for the objectives of the new Energy Strategy 2050: Federal Gazette (BBl) 2013 7561, pp. 7593–7594.

[57]Federal Gazette (BBl) 2013 7561, p. 7624.

of electricity from renewable energy sources. Thereby, the Constitution, the Energy Act and as a completion the Energy Supply Act serve as the legal bases.

3.3 Mechanism of the FIT-Program in Switzerland

3.3.1 Current Mechanism

The Swiss FIT-program requires network operators to feed-in and to remunerate all electricity produced from renewable energy sources at cost.[58] This guaranteed feed-in and cost-covering remuneration is available for new power facilities. A power facility is regarded as "new" if it is put into operation or is substantially renewed or expanded after 1 January 2006.[59] Moreover, the FIT-program promotes only selected renewable energy sources, which are solar energy, geothermal energy, wind energy, hydropower (up to 10 MW), biomass energy and energy from biological waste.[60] Lastly, for each technology a maximum share from the total fund is defined.[61] This is to prevent that certain technologies receive an excessive share from the fund.

The cost-covering remuneration is calculated on the basis of the production costs of a reference facility[62] and consists of a fixed tariff per kWh paid to the eligible producers. This fixed tariff is defined in the Energy Ordinance and exceeds the market price.[63] It is guaranteed over a fixed term[64] and is financed through revenues from sales on the market and a central fund. The central fund fills the difference between the market price and the fixed tariff and is fed by a surcharge on the electricity transmission price. This surcharge is limited to 1.5 cents per kWh and thus caps the total available financial resources.[65] Currently, the Federal Council set the surcharge at 1.3 cents per kWh adding up a total annual amount of around 800mio Swiss Francs available for the FIT-program.[66]

Two key entities are responsible for the proper execution of the FIT-program, which are supervised by the Swiss Federal Office of Energy (SFOE). First, the national grid operator "Swissgrid" is in charge of collecting the above-mentioned surcharge. For this purpose, it set up a foundation called "KEV-Stiftung". This

[58]Energy Act, art 7a.

[59]Energy Act, art 7a, last sentence.

[60]Energy Act, art 7a.

[61]Energy Act, art 7a.4.

[62]Energy Act, art 7a.2.

[63]See for the current tariffs Annex 1.1–1.5 of the Energy Ordinance.

[64]The guaranteed length of the support depends on the technology. See Annex 1.1–1.5 of the Energy Ordonnance for more details.

[65]Energy Act, art 15b paras 4 and 5.

[66]Swiss Federal Office for Energy (2015c).

foundation is also responsible for managing the central fund, from which the remuneration at cost is financed. Moreover, Swissgrid also handles the application procedures for the FIT-program.[67] Second, the "Balance Group for Renewable Energy" (BGRE) passes the electricity from the promoted producers on to other balance groups,[68] which further transfer the electricity to end-consumers, and pays the fixed-tariff to the promoted producers.[69] The SFOE has appointed the company "Energie Pool Schweiz" (EPS) to be the responsible BGRE.[70] Since the other balance groups pay only the market price,[71] EPS regularly clears the difference between the market price and the fixed tariff remuneration with Swissgrid using the central fund.

3.3.2 Reforms Within the Framework of the Energy Strategy 2050

With the new Energy Strategy 2050 the Federal Council introduced new objectives for the electricity production from renewable energy sources. These aims constitute a significant increase of the current objectives, in particular with respect to other renewable energy sources than hydropower.[72]

As a consequence, the promotion of renewable energy sources becomes more important. This impacts the future design of the Swiss FIT-program: first, the cost covering FIT shall shift to a feed-in system with an incentive for participating in the market. This means that producers shall sell their electricity by themselves on the market. In addition, producers receive a premium for the ecological surplus, which constitutes the difference between a defined remuneration and the market price or reference market price. This surplus is financed by the central fund as before. As a result, promoted producers do not gain less, but receive an incentive to participate in the market and to produce electricity when it is needed most.[73] Second, the surcharge shall increase to 2.3 cents per kWh in order to raise more financial resources. Lastly, only "new" facilities shall be supported, i.e. facilities which are put into operation after 1 January 2013. Substantially renewed or expanded facilities are not supported anymore. Instead, they receive a one-time investment aid. These proposals by the Federal Council are currently debated in the Parliament.

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[67] Energy Ordinance, art 3 g.

[68] A balance group is an energy account. See Swissgrid (2015).

[69] Energy Supply Ordinance, art 24.

[70] Swiss Federal Office for Energy (2008).

[71] The market price is defined by the Swiss Federal Office for Energy. See: Energy Ordinance, art 3b^{bis}.

[72] The total production of electricity from renewable energy (excluding hydropower) sources shall be at 4400 GWh by 2020 and by 2035 at 14'500 GWh. With regard to hydropower, the production shall reach at least 37'400 GWh by 2035. See: Federal Gazette (BBl) 2013 7561, p. 7594.

[73] Federal Gazette (BBl) 2013 7561, p. 7625. This system is somewhat a combination of the tariff system with incentives for participation in the conventional market and demand-oriented tariff-differentiation as described in Mendonça et al. (2010), pp. 42–43.

3.4 Support of Hydropower in Particular

Hydropower is the predominant renewable energy source and continues to play its important role in the electricity supply for Switzerland.[74] However, in recent years the profitability of hydropower has been decreasing due to over-capacities, low prices for coal and increasing feed-in of subsidised renewable energy electricity in Europe.[75] This forced the Swiss government to decide whether it should expand the support for the hydropower industry .

Today, only small-scaled hydropower plants with a capacity of up to 10 MW are eligible for the cost covering FIT-program, which applies to around 1'000 facilities.[76] The reform of the FIT-program within the Energy Strategy 2050 proposes several changes with regard to the promotion of hydropower. First the support for hydropower plants with a capacity of less than 300 kW shall be excluded due to their disproportional environmental impact.[77] Second, the support of hydropower facilities between 300 kW to 10 MW production capacity shall remain under the new regime provided that it is a "new" facility. Third, hydropower plants that are substantially renewed or expanded shall receive an investment contribution instead of a feed-in remuneration as before.[78] The Federal Council hesitates to expand the State-support to larger hydropower plants. Also for the SFOE a State intervention in favour of large hydropower plants would create further market distortion and is thus unnecessary in its view.[79] However, there is much support for the promotion of large hydropower in the Parliament.[80]

4 Analysing Switzerland's FIT-Scheme in the Light of WTO Law

4.1 The Role of Swissgrid and EPS

The narrow interpretation of the term public body given by the Appellate Body may allow for some more policy space for State measures because one has to establish whether an entity possesses governmental authority, which is not a straightforward exercise.[81] However, in the Swiss FIT-scheme it seems irrelevant what role

[74]Federal Gazette (BBl) 2013 7561, p. 7594.

[75]Swiss Federal Office for Energy (2014), p. 2.

[76]Swiss Federal Office for Energy (2013).

[77]Federal Gazette (BBl) 2013 7561, p. 7625; Swiss Federal Office for Energy (2014), p. 6.

[78]Federal Gazette (BBl) 2013 7561, p. 7625.

[79]Swiss Federal Office for Energy *supra*, n. 75, p. 8.

[80]Neue Zürcher Zeitung (2014).

[81]Shadikhodjaev (2013), pp. 869–870.

Swissgrid and EPS play since either they act as public bodies or are directed or entrusted by the government to provide a financial contribution. Both entities are organized as limited companies under Swiss private law. In principle, they are independent but are assigned with key tasks regarding the execution of the FIT-program. If these tasks are considered as exercising governmental authority, the form of financial contribution constitutes a purchase of goods, similar to the situation in the case *Canada – Feed-In Tariff Program*.[82] As private bodies, it can be argued that the government directs or entrusts these two entities to carry out the purchase of electricity.[83] The direction or entrustment lies in the statutory obligation to purchase and remunerate electricity from renewable energy sources, which leaves no flexibility for both entities.[84] Alternatively, by setting a fixed tariff, the Swiss FIT-scheme can be seen as a form of price support.[85]

In sum, it is conceivable to regard the Swiss FIT-program as a financial contribution or price support fulfilling the first prong of the subsidy notion under the SCM Agreement.

4.2 Relevance of the New Benefit Analysis

The Swiss FIT-program remunerates producers with a premium tariff, which is normally set above the market price. Prior to the Appellate Body Report in the *Canada – Feed-In Tariff Program* case it was generally assumed that conventional and renewable energy sources compete in the same wholesale electricity market and thus a fixed premium tariff paid to renewable energy producers confers a benefit.[86] Under these assumptions, the Swiss FIT-program is likely to be considered as a subsidy as well because it ensures a profit that might not exist in a normal market place fulfilling the second prong of the subsidy notion.

In its findings in the *Canada – Feed-In Tariff Program* case the AB seemed to introduce more policy space for State measures pursuing legitimate policy objectives such as climate mitigation. Its new approach to the benefit analysis impacts the subsidy determination with regard to FIT-schemes. Therefore, the question here is, whether Switzerland's FIT-scheme is a subsidy in the sense of the SCM Agreement.

Following the Appellate Body's new approach regarding the importance of supply-side substitutability when determining the relevant market, one can conclude that each renewable energy source used in Switzerland to produce electricity constitutes a separate market. As a consequence, the market benchmark in the Swiss

[82]WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, paras 5.118–5.139.

[83]Art 1.1(a)(1)(iv) SCM Agreement.

[84]Hettich and Walther (2011), p. 164; Zlatanov (2009), p. 65; Pinelli (2014), p. 160.

[85]Art 1.1(a)(2) SCM Agreement. See Bigdeli (2009), pp. 171–172; dissenting opinion in Howse (2005), p. 22.

[86]WTO doc. WT/DS412AB/R, WT/DS426/AB/R, *supra*, n. 4, para 5.169; Bigdeli (2009), p. 170.

electricity market has to be found within the competitive markets for hydropower, wind-power, solar-power, etc. separately. In the next step, one has to identify whether the Swiss FIT-program constitutes an intervention to a new market or in an established market. However, the Appellate Body gave no guidance on what it sees as a *new* market nor did it define a threshold for an established market. The renewable energy sources excluding hydropower produce 3.4 % of the electricity in Switzerland. Considering that within this total share each source holds a smaller share, it might be conceivable that the FIT-program for these renewable energy sources constitute an intervention for creating a new market. Thus, a higher threshold for identifying a benefit would be applied as outlined above, which impedes the determination of a subsidy and leaves Switzerland more policy space for supporting these new renewable energy sources. Conversely, the FIT-program seems more problematic with regard to the support of hydropower since Switzerland's electricity production already disposes a high share of hydropower. Therefore, it is likely to assume that the FIT-program for hydropower constitutes an intervention in an established market, which facilitates the determination of a subsidy compared to the *new* market situation.[87] Nevertheless, the Swiss government supports hydropower for the same reasons as it supports the other renewable energy sources. This leads to the conclusion that for pursuing the same legitimate policy objective more policy space is available with regard to State measures creating a new market than for State measures intervening in an established market.[88]

In sum, considering the entire wholesale electricity market in the benefit analysis, the Swiss FIT-program is likely to be a subsidy. Under the new case law regime, the FIT-program to new renewable energy sources might not be considered as a subsidy whereas the support for hydropower is more likely to be a subsidy in the sense of the SCM Agreement. However, the policy objective remains the same in both instances, namely to expand a sustainable and environmental friendly electricity supply.

5 Concluding Remarks

By using the Swiss FIT-program as an example, this paper has carved out the policy spaces for State measures promoting renewable energy sources taking into account recent developments in WTO case law, namely in the case *Canada – Feed-In Tariff Program*. First, policy spaces may exist in the definition of the term public body, which has been narrowed by the Appellate Body. However, the Swiss FIT-program shows that using private entities for the execution of the FIT-program may be

[87] As shown, Switzerland limits the FIT-program to hydropower facilities with a capacity up to 10 MW. Therefore, this conclusion underlies the assumption that electricity produced from these facilities compete in the same market as hydropower electricity from larger hydropower stations.

[88] See also Coppens (2014), p. 461.

regarded as a direction or entrustment by the government due to strict statutory instructions. Therefore, whether these private entities are public or private bodies seems irrelevant for identifying a financial contribution. Second, the importance of determining the relevant market and the use of supply-side substitutability introduced more policy space as well allowing governments to carve out their supported industry from subsidy disciplines by simply stating that their industry is not competitive due to absent supply-side substitutability. Whether such a development is desired is questionable and criticized in the literature. Lastly, the distinction between new and old markets seems also in favour of more policy space for State measures supporting green energy. However, the example of Switzerland shows that this distinction could also lead to an odd result. Switzerland's energy policy aims to expand its electricity production from renewable energy sources. For that, it introduced a FIT-program. Using the Appellate Body's distinction, this instrument is now seen in two different ways. With regard to hydropower it is more likely to be a subsidy than with regard to other renewable energy sources, although it is used for the same policy objective.

To conclude, the subsidy interpretation by the Appellate Body in *Canada – Feed-In Tariff Program* was necessary so as not to discourage governments from pursuing a climate-friendly policy agenda. Nonetheless, the Swiss example shows the need for a true exemption for green subsidies in the SCM Agreement. Switzerland might serve as a blueprint for future situations, in which electricity from renewable energy sources are well established in the market but governments wish to continue their support in order to carry on their environmental friendly policy agenda. Under these circumstances, the WTO judicial interpretation of the SCM Agreement reaches its limits and it is on the Member States to include the rationale of a subsidy in the SCM Agreement.

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The Nexus Between the WTO and the ECT in Global Energy Governance

Anna Marhold

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Abstract This article discusses the nexus between the ECT and the WTO in global energy governance. The two treaty-based regimes each cover an area of the global energy governance patchwork. Moreover, they are connected in substance. While the former is concerned with providing a framework for the regulation of trade in virtually all goods and services, the latter offers a specialized regime for energy trade and investment regulation. Apart from discussing the origins of the ECT and

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its relationship to the WTO, the article examines where the treaties overlap and where they are at tension with each other. It does so in view of the changes that have taken place over the past two decades of their existence.

1 Introduction

This article discusses the nexus between the Energy Charter Treaty (ECT) and the World Trade Organization (WTO) in global energy governance.[1] These two treaty-based regimes each cover an area of the global energy governance patchwork. Moreover, they are connected to each other in substance. While the latter is concerned with providing a framework for the regulation of trade in virtually all goods and services, the former offers a specialized regime for energy trade and investment regulation. Apart from discussing the origins of the ECT and its relationship with the WTO, the article examines where the treaties overlap and where they are at tension with each other. It does so in view of the changes that have taken place over the past two decades of their existence.

2 The WTO and the Origins of the ECT

2.1 The WTO and Energy in Context

The GATT 1947 was originally set up to regulate trade in goods.[2] The WTO took on a broader set of responsibilities in 1995, adding trade in services, trade-related investment measures and intellectual property to its portfolio. The Organization's objective is to promote free trade by reducing tariffs and other trade barriers and eliminating discriminatory treatment in international trade relations.[3] Simply put, it is an organization that administers trade rules and a specialized dispute settlement system. It additionally provides for an institutional forum for trade negotiations, addressing various trade-related issues. Energy products have been *de jure* covered by the GATT/WTO system from 1947, and energy services were added through GATS after the establishment of the WTO. However, the regulation of energy has been anything but a problem-free topic in the multilateral trading system and continues to pose a plethora challenges to the WTO legal framework today.[4]

[1]The Energy Charter Treaty (entered into force 18 April 1998) 2080 UNTS 100; the World Trade Organization (WTO) was established on 1 January 1995. For the texts of the WTO agreements, see https://www.wto.org/english/docs_e/legal_e/legal_e.htm.

[2]General Agreement on Tariffs and Trade (GATT), Geneva, 21 November 1947, entered into force 29 July 1948, 55 UNTS 194.

[3]Preamble, Marrakesh Agreement Establishing the World Trade Organization.

[4]Marhold (2013).

2.2 ECT

The ECT seems to have sprouted as a separate branch of the GATT/WTO regime in the early nineties and continues to operate as a (semi-)distinct treaty-based system today.[5] The ECT is partly an elaboration on the GATT, but specially geared towards energy. Both the WTO and ECT frameworks contain partially overlapping elements, objectives and membership. Conversely, both treaties have diverging functions and mechanisms, which are not necessarily in accordance with one another.

The ECT was signed in Lisbon in 1994, just before the establishment of the WTO. It entered into force in 1998. The ECT is a similar treaty regime to the WTO, but in addition to regulating energy trade, it incorporates a significant investment part and an environmental protocol.[6] In essence, it was born as an alternative to concluding an energy specific agreement within the GATT/WTO framework after the Cold War. The trade provisions of the ECT draw largely upon the GATT, but are better adapted to the needs of energy trade, for instance by providing extensive definitions of energy products (Energy Materials and Products) and services (in the form of "Economic Activity in the Energy Sector"). It also clearly incorporates gas pipelines as a means of transport in art 7 on transit.[7] The objective of the Treaty is to provide a stable and predictable framework for trade in energy materials, products and energy-related equipment, based on GATT/WTO rules.[8]

To assume that the ECT is a completely separate treaty regime from the WTO would be a mistake. With regard to the trade provisions of the ECT, the purpose of its establishment seems to have been to introduce GATT-type standards in the energy sector to former communist countries.[9] It was intended to promote reform towards GATT compatibility and help with GATT/WTO accession.[10] This is visible in the way ECT trade rules are set up: the ECT incorporates WTO rules "by reference" in art 4.[11]

The Energy Charter Secretariat (ECS), the administrative body overseeing the ECT, has taken tension and overlap between the WTO and the ECT into account by providing extensive guidelines on incorporation of WTO rules into the Treaty.[12]

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[5]The inauguration of the ECT was in 1994—right before establishment of the WTO in 1995. The term "semi-distinct" is used here because the treaties are partly connected in substance through arts 4 and 29 ECT.

[6]Investment and its dispute settlement are regulated in ECT Parts III and V, and the ECT additionally houses a Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA).

[7]See Annex EM ECT. Art 1.5 ECT incorporates "Economic Activity in the Energy Sector" and art 7.10(b) ECT explicitly groups gas pipelines as "Energy Transport Facilities".

[8]Energy Charter Secretariat (2001) and Energy Charter Secretariat (2003).

[9]Frasl (1996), pp. 460–461.

[10]Ibid.

[11]Arts 4 and 29 ECT.

[12]The GATT and several WTO agreements are incorporated into the ECT "by reference" through art 4 ECT, but important exceptions exist.

This so-called "coordination *ex ante*" was aimed at functioning as a conflict prevention tool.[13] However, gaps, conflicts and uncertainties remain.

2.3 WTO/ECT Overlap

In the substantive sense, the WTO and ECT deal with partially overlapping issue-areas: the WTO regulates the trade of goods and services, of which energy goods and services are a subcategory.[14] The ECT, on the other hand, aims to regulate trade and investment in energy materials and products and related services.[15] With respect to geographical delimitations, neither of the treaties is bound to a specific topographical area, but the treaties have largely overlapping membership, which has changed significantly since the establishment of both treaty-regimes.

Procedurally, overlap occurs with respect to dispute settlement in the WTO and the ECT. The WTO has its own built-in dispute settlement mechanism, the Dispute Settlement Body (DSB), to solve trade disputes between WTO Members in this exclusive forum. The ECT provides a rather "informal" mechanism to resolve trade disputes through diplomatic means, and additionally has an Investor-State and State-State dispute settlement mechanism.[16]

3 WTO and ECT: Overlap and Changes in Membership

Neither the WTO nor the ECT is tied to a particular region *per se*. However, substantial overlap in membership between the treaties does occur, because they are connected in substance through arts 4 and 29 ECT, providing for incorporation of GATT trade rules in the ECT. Rather than looking at geographical overlap, it is more fruitful to scrutinize the overlap and change in membership to the WTO and ECT. This helps us to assess what developments have taken place in the past two decades.

[13]Pauwelyn (2003), pp. 327 ff.

[14]Energy products are taken up in WTO Members' Schedules of Concessions, services are taken up in Members' Schedules of Specific Commitments.

[15]ECT, Annex EM.

[16]ECT, Annex D, and arts 26 and 27.

3.1 WTO

From its establishment in 1995, the WTO started out with 113 Members, and 61 observers. Fourteen countries were neither Members, nor observers, and continue to function outside of the multilateral trading system today. By 2016, WTO membership has expanded drastically: with Kazakhstan's accession to the Organization in 2015, the WTO now has 162 Members.[17] Amongst them are major fossil fuel producing, exporting and transporting countries, a large part of which has joined the WTO only after its establishment in 1995.[18] Other major players in the energy sector are in the process of negotiating accession. Nine Members out of 13 of the Organization of Oil Exporting Countries (OPEC) are already in the WTO.[19] It is thus evident that major stakeholders in the global energy landscape are full-fledged participants in the multilateral trade system.

3.2 ECT

The WTO's wide-ranging membership is in stark contrast with the membership of the ECT. It entered into force in 1998 with 40 Parties to the Treaty. At the same time, 8 ECT signatories chose to apply the Treaty provisionally pending ratification, while 29 countries were observers to the ECT. By 2016 the numbers have changed, but the amount of countries that has acceded to the ECT is still far less comprehensive than that of the WTO: merely 46 countries have ratified the ECT. 5 ECT signatories continue to apply the Treaty provisionally, and 26 countries have observer status with the ECT. In a notorious move, Russia stepped back from the agreement altogether in 2009, after applying it provisionally since its signature in 1994.[20] Italy also withdrawn from the treaty as of 2016. The number of countries who are neither parties nor observers is 122. Major energy producing and exporting countries like Canada, Indonesia, the United States, Algeria, Bahrain, China, Kuwait, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates and Venezuela have observer status to the ECT only.

[17] See https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (accessed 4 March 2016).

[18] Major energy producing, exporting and/or transporting States who joined the WTO after 1995 are Angola (1996), China (2001), Ecuador (1996), Oman (2000), Qatar (1996), Russia (2012), Saudi Arabia (2005), Ukraine (2008) and the United Arab Emirates (1996).

[19] See http://www.opec.org/opec_web/en/about_us/25.htm (accessed 4 March 2016).

[20] Investments made during the period of provisional application (1998–2009) are protected until 29 October 2029.

3.3 WTO and ECT Membership: Changes and Overlap 1998–2016

Substantial changes have taken place in membership to the WTO and ECT alike, from the early days of the WTO and the entry into force of the ECT, to roughly two decades later. The biggest development admittedly is the vast number of accessions to the WTO of a considerable amount of former WTO observers. These were reduced from 50 in 1998 to only 22 in 2016. Prominent non-ECT countries in this category are Russia, China, Saudi Arabia and Oman.

Overlapping membership between the two treaty-regimes became an instant reality with the entry into force of the ECT in 1998. This *de facto* resulted into two "tiers" of ECT membership: (1) simultaneous WTO Members and ECT parties, and (2) ECT parties that have not acceded to the WTO (yet). Therefore, there are three possible modes of "membership interaction" within the legal framework of the ECT, namely: (a) among ECT/WTO Members, (b) between ECT/WTO Members and non-WTO ECT Parties, and (c) among non-WTO ECT Parties.

In 1998, 25 Members to the WTO were simultaneously parties to the ECT. By 2016, the number of simultaneous ECT/WTO Members has risen to 42. This increase indicates that a substantial number of countries that were ECT parties *only* in 1998 did indeed accede to the WTO over time. Hence, the ECT's partial objective to function as a stepping-stone to WTO accession seems to have been successful, though arguably ECT membership was not the only reason that triggered WTO accession. Russia, as *the* major Eurasian energy producing and exporting country, proves to be a special case and the only country to effectively "swap" (provisional) ECT membership for WTO accession, while minimising unwanted commitments on energy along the way. It acceded to the WTO in August 2012, after protracted negotiations of almost two decades.[21]

4 Issue-Area Overlap Between the WTO and the ECT

4.1 Trade in Energy

The WTO and the ECT partially overlap in issue-area as both instruments are relevant for trade in energy products and related services. The Organizations share a partial common objective, namely the promotion of free(er) trade.[22]

[21] WTO doc. WT/ACC/RUS/70, WT/MIN(11)/2, Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization—Restricted, 17 November 2011.

[22] Desta (2003), p. 539.

The WTO regulates trade in goods (GATT), services (GATS), intellectual property (TRIPs) and trade-related investment measures (TRIMs), accompanied by an "exclusive forum" dispute settlement mechanism, administered by the DSB.[23] Energy falls within the WTO's remit, because energy products are taken up in Members' GATT art II schedules. Additionally, energy services are covered in Members' service schedules and disputes relevant for energy are being settled in the WTO dispute settlement system. The WTO estimates that at least 18 % of intra WTO-trade involves energy goods such as fossil fuels.[24] Energy is either classified as a good, regulated by the GATT (energy products such as crude petroleum or natural gas) or a service, regulated by the GATS (such as the transportation of an energy product). Sometimes, it possesses the elements of both.[25]

The ECT in arts 4–6 and 29 deals with trade in energy goods and related economic activity (read: services) *only*, with the exception that the ECT deals with investment in addition to trade.[26] The definition of "energy" under the ECT is very wide: it relates to trade in energy, energy products and energy related equipment, all of which are specified under Annex EM of the ECT. The ECT generally focuses on five broad areas:

- Protection and promotion of foreign energy investments, based on most-favoured nations (MFN) treatment or national treatment (NT), set out in art 10.3;
- Free trade in energy materials, products and energy-related equipment, based on WTO rules, in arts 4, 56 and 29[27];
- Freedom of energy transit through pipelines and grids in art 7, based on GATT art V on transit, but more specific[28];
- Reducing the negative environmental impact of the energy cycle, set out in art 19 and the PEEREA[29]; and
- Dispute resolution, e.g. trade related disputes, State-to-State and/or Investor-to-State disputes, in Part V, arts 26 to 32, and transit disputes, in art 7.

[23]Governed by the rules of the WTO Dispute Settlement Understanding (DSU).

[24]WTO (2010a), p. 54.

[25]A case in point here is electricity: there is still no conclusive categorization of electricity in the WTO, although "electrical energy" is registered under code 2716 of the Harmonized System Convention (adopted 14 June 1983, entered into force 1 January 1988, 1503 UNTS 167); in EU law, however, electricity is explicitly considered a "good" and not a "service". In ECJ, Case C-393/92 *Almelo v Energiebedrijf IJsselmij* [1994] *ECR* I-1477 [28] and Case C-158/94 *Commission v Italy* [1997] ECR I-5789 [17], the European Court of Justice has ruled that electricity, despite its intangible character, should be treated as a "good".

[26]Konoplaynik and Waelde (2006), p. 529; Waelde (1996).

[27]Art 29 ECT sets out temporary trade rules for ECT parties in the process of WTO accession.

[28]See art 7.10(b) ECT, at 1: "'Energy Transport Facilities' consist of high-pressure gas transmission pipelines, high-voltage electricity transmission grids and lines, crude oil transmission pipelines, coal slurry pipelines, oil product pipelines, and other fixed facilities specifically for handling Energy Materials and Products".

[29]ECT PEEREA.

The ECS intentionally based ECT trade rules on the GATT/WTO. The ECT has, for instance, incorporated the trade rules of the GATT in its trade part by means of art 4 ECT.[30] Overlap with respect to the trade provisions of both treaty-regimes therefore occurs there where the trade provisions of the WTO (GATT) meet the energy trade provisions of the ECT (arts 4, 5, 6, 7 and 29). To foster transparency concerning this overlap between the GATT and the ECT, the ECS issued two extensive guides with a referencing mechanism, in 2001 and 2003.[31] There are several basic rules at the heart of this incorporation of GATT rules "by reference" in the ECT[32]:

- The trade provisions of the ECT apply with and between parties to the ECT that are not Members to the WTO *only*.[33]
- Conversely, trade in energy materials and products between ECT parties, who are also WTO Members, are regulated by the trade provisions of the WTO.[34]
- Trade between ECT Members, of which at least one is not a WTO Member, is generally governed by WTO rules incorporated to the ECT through art 29.2 (a) ECT.[35]
- The ECT uses a "negative" reference listing technique, incorporating all WTO provisions, unless they are listed in Annex W(A) to the ECT.[36]

There are some exceptions with regard to WTO rules integrated in the ECT: bindings on customs duties as set out in art II of the GATT are not automatically taken over. Instead, they are replaced by a softer, "best-endeavours" commitment discouraging parties to the ECT to increase custom duties or importation and exportation charges of any kind.[37]

Art 7 ECT on transit goes further than art V GATT and explicitly incorporates gas pipelines as a means of transport.[38] It thereby creates additional obligations for ECT Parties who are also WTO Members. This can be seen as a so-called "WTO-

[30] Art 4 ECT reads "Nothing in this Treaty shall derogate, as between particular Contracting Parties which are parties to the GATT, from the provisions of the GATT and Related Instruments as they are applied between those Contracting Parties".

[31] *Supra*, n. 9.

[32] ECS (2003) viii.

[33] Art 29.1 ECT.

[34] Art 4 ECT.

[35] Art 29.2(a) ECT. The exceptions are listed partly in Annex W of the ECT Trade Amendment, partly in art 29.2.b of the ECT and most importantly relate to the dispute settlement system of the WTO, which cannot be used for non-WTO Members. In their case, it is replaced in Annex D by a panel-based dispute resolution mechanism inspired by the DSU, less "heavy".

[36] Annex W(A) ECT.

[37] Arts 29.3–29.5 ECT. However, *export* tariffs, which are highly relevant for the energy sector and utilized for "dual energy pricing", also remain largely unregulated in the WTO, with the exceptions of some recent bindings on them in selected accession protocols (e.g. Russia and China).

[38] In WTO law, it is still debated whether art V GATT covers fixed infrastructures such as gas pipelines. See on this issue Azaria (2009).

plus effect of the ECT".[39] It is also worth mentioning that negotiations on an ECT Protocol on Transit are on-going (but stalled) since 1999.[40]

GATS,[41] TRIPs[42] and TRIMs[43] are not taken over into the ECT, but have an equivalent article in the ECT: services are covered under the overarching term of "Economic Activity in the Energy Sector",[44] a commitment to protect intellectual property rights is taken up in the Final Act of the International Conference[45] and art 5 ECT incorporates trade related investment measures.[46] It should be mentioned that here, the conflict between the two treaties caused by simultaneously applicable provisions is not solved. Additionally, the WTO special and differential treatment provisions do not apply in the ECT, except for paras 1–4 of the Enabling Clause.[47]

Plurilaterals that are not binding on all WTO Members have not been taken over in the ECT. In the same vein, WTO multilateral agreements, which are substantially irrelevant for the subject matter of the ECT, such as the agreements on agriculture or on sanitary and phytosanitary measures, do not apply either. Last but not least, protocols of accession of new Members to the WTO are not incorporated into the ECT.[48]

One can conclude that with regard to *trade in goods* provisions, the ECS has taken into account the risks stemming from overlap and tension in substance between the ECT and the WTO and has pre-emptively set out conflict rules to reconcile both treaties. Conflicts not (directly) solved in the ECT concern TRIMs, TRIPs and GATS.

4.2 Investments in Energy

Another important issue-area where conflict of rules between the WTO and the ECT remain unsolved is where investment protection in the WTO (through GATS Mode 3)[49] meets protection of energy services investments in the ECT (Part III ECT). Trade in services is covered in the ECT by means of art 1.5, but the GATS is not incorporated in

[39]Frasl (1996), p. 484.

[40]See the most recent informal text of the "Transit Protocol" dated 22 October 2010, TT87 22/01/2010.

[41]Annex W (A)(b) ECT.

[42]Annex W (A)(c) ECT.

[43]Annex W (A)(iv) ECT. See also Defilla (2003).

[44]Art 1.5 ECT.

[45]ECT Parties made a commitment to provide protection of intellectual property rights, laid down in the Final Act of the International Conference and Decision by the Energy Charter Conference in Respect of the Amendment to the Trade-Related Provisions of the Energy Charter Treaty, Joint Declaration on Trade-Related Intellectual Property Rights.

[46]Art 5 ECT "Trade-Related Investment Measures", linked to Annex D and art 26 ECT.

[47]Through Annex W (A) para 2.a ECT.

[48]Agreement Establishing the World Trade Organization, art XII.1 and Annex W(A)(1) ECT.

[49]GATS art 1.2(c).

the ECT as such.[50] This leads to a parallel applicability of WTO rules and ECT rules concerning the protection of energy investments in the following manner.

The ECT protects investments in the energy sector in a direct way by granting them NT and MFN in art 10.3 in Part III.[51] "Investment in the energy sector" in the sense of the ECT refers to any investment associated with an "Economic Activity in the Energy Sector", i.e. concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of energy materials and products covered in the ECT.[52] Conversely, investment in the WTO becomes relevant when we look at the modes of supply of services in the GATS. As with GATT Schedules, WTO Members make sector-specific commitments in their GATS Schedules of Specific Commitments, where they agree on particular market access commitments with regard to trade in services.[53] There are horizontal commitments, which apply to all commitments in the schedules, and sector specific commitments affecting only to the sector in question, which may additionally only apply to one or more of the four modes of supply of the GATS. These are (a) Mode 1, when neither the service supplier nor the service consumer has to move; (b) Mode 2, when the consumer moves to the country where the service is supplied; (c) Mode 3, when the service supplier establishes commercial presence in the country where he/she supplies; (d) Mode 4, when the service supplier is established in a different country.[54]

WTO Members have to grant MFN to all foreign services, and NT to GATS commitments made in their schedules.[55] It figures that investments in services, including investments in energy services, are covered in the GATS through art I.2 under c, Mode 3, when the service supplier establishes commercial presence in the country where he/she supplies (i.e. a foreign company setting up subsidiaries or branches to provide services in another country).[56]

In principle, GATS rules apply to all energy related services.[57] There are some sectors, which are particularly relevant to energy and to which Members committed in the services schedules, e.g. construction and related engineering services, distribution services, environmental services, financial services, transport services and other Services not included elsewhere.[58] Moreover, since the start of the Doha

[50]Annex W (A)(b) ECT.

[51]Art 10.3 ECT "Promotion, Protection and Treatment of Investments".

[52]See definitions of respectively "Economic Activity in the Energy Sector" and "Investment" in arts 1.5 and 1.6 ECT.

[53]Mavroidis et al. (2010), pp. 802–819.

[54]GATS art I.2.

[55]GATS art II "General Obligations and Disciplines" and art XVII "National Treatment".

[56]Mavroidis (2013) and Molinuevo (2011).

[57]Marceau (2011), p. 26.

[58]Energy services identified by Members in WTO doc. TN/S/23, Report by the Chairman to the Trade Negotiations Committee, 28 November 2005. See WTO doc. MTN.GNS/W/120, Services Sectoral Classifications List, 10 July 1991.

Round (2001-present), 45 Members have undertaken commitments in "services incidental to mining",[59] 27 in "on-site preparation work for mining",[60] 18 in "services incidental to energy distribution",[61] and 12 "on pipeline transportation of fuels".[62]

It thus follows that investment in energy services may fall within the scope of GATS protection on the basis of art I.2(c) Mode 3. This is the case for those WTO Members that have made sector-specific commitments in services relevant to the energy sector, or in energy services directly, and to which Mode 3 of supply of services (commercial presence) applies.

The rules of conflict of the ECT have not taken this into account adequately, presumably since the complete exclusion of the GATS from the ECT left this scenario unforeseen. One thing should be noted in this respect, though: the ECT does not provide for pre-establishment or market access obligations, in contrast to GATS arts II and XVI.[63] The conflict between the ECT and the GATS is therefore likely to arise in the post-establishment phase only.[64] The result is, however, that both treaties can apply with respect to protection of investments in the energy sector. Overlap in issue-area in this instance can continue to have an impact when it comes to procedural provisions of the treaties: with respect to dispute resolution in energy investments, both the procedures provided for the ECT and the WTO could apply.

5 Procedural Overlap: Dispute Settlement in the WTO *v.* the ECT

Parallel competence concerning the WTO and the ECT occurs in the area of settling trade as well as investment disputes as well. The first has been accounted for by ECT rules of conflict, the latter has not.[65]

[59] See WTO doc. S/C/W/311 Energy Services—Background Note by the Secretariat, Doc, 12 January 2010, CPC [883].

[60] Ibid., CPC [5115].

[61] Ibid., CPC [887].

[62] Ibid., p. 14.

[63] See GATS arts II and XVI.

[64] Dolzer and Schreuer (2008), p. 80.

[65] See Table 1 below.

5.1 Settlement of Trade Disputes

Article 3.2 of the DSU designates the dispute settlement mechanism as a central element in the WTO providing security and predictability to the multilateral trading system.[66] Members to the WTO must settle any trade dispute among themselves, including the disputes on energy trade, in this *exclusive* forum.[67] Members are in effect precluded from settling their trade disputes elsewhere. The function of this is twofold: it provides Members with a multilateral forum for dispute settlement to the exclusion of any other and at the same time it prevents them from having recourse to unilateral determinations of a breach of WTO law. The functioning of the WTO dispute settlement system is not free of criticism, but with around 475 cases settled in the nearly 20 years of the WTO's existence, it is clearly one of its success stories.[68] The WTO has witnessed several energy-related disputes recently, e.g. the *Canada—Renewable Energy* case.[69] In that case, the panel and the Appellate Body had to resort to what some call "legal acrobatics" in order to avoid finding that a scheme aimed at promoting a public good—the underlying feed-in tariff for renewable energy—was in fact a subsidy.[70]

The ECT, on the other hand, provides mechanisms for the settlement of both energy trade and investment disputes. It offers State-to-State,[71] Investor-to-State,[72] Transit,[73] Energy Trade[74] and Environment and Competition[75] dispute settlement. Concerning energy trade dispute settlement and overlap in competence between the WTO and the ECT, the latter has taken into account several conflict resolution measures.[76] Following art 4 ECT, the WTO DSU applies to the resolution of energy trade disputes between ECT parties who are simultaneously WTO Members.[77] Since the DSU is not available to non-WTO Members, it is replaced by a dispute resolution mechanism in Annex D for trade disputes between an ECT/WTO

[66] Art 3.2 DSU.

[67] See connection with art 4 ECT.

[68] McRae (2004), p. 3.

[69] WTO doc. WT/DS412AB/R, WT/DS426/AB/R, Appellate Body Report, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector, Canada—Measures Relating to the Feed-in Tariff Program*, 6 May 2013; WTO doc. WT/DS412/R, WT/DS426/R, Panel Report, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector, Canada—Measures Relating to the Feed-in Tariff Program*, 19 December 2012.

[70] Cosbey and Mavroidis (2014), p. 9.

[71] Art 27 ECT; this article does explicitly not apply to energy trade disputes, see art 28 ECT.

[72] Art 26 ECT.

[73] Art 7.7 ECT.

[74] ECT art 29 and Annex D.

[75] ECT arts 6 and 19.

[76] Frasl (1996), p. 478.

[77] Art 4 ECT and Energy Charter Secretariat (2003), p. viii.

Member and a non-WTO ECT party or a dispute amongst non-WTO ECT Parties.[78] This mechanism follows the WTO dispute settlement model closely, but it is more informal in nature, less detailed and legalistic.[79]

Transit disputes are treated differently from the rules of conflict for "regular" trade disputes between the ECT and WTO. Resolution of transit disputes under the ECT is accounted for in art 7.7. It prescribes that in case of an energy transit dispute, ECT parties will have recourse to the mechanism under art 7.7, after exhausting any other relevant contractual remedies between them.[80] The procedure for dispute resolution itself is conciliatory in nature and largely takes place along diplomatic channels, with the appointment of a conciliator by the Secretary General of the ECT, who "shall seek the agreement of the parties to the dispute".[81]

There is no apparent conflict between art V GATT and the procedure set out in art 7.7 ECT, since the commitment in this article goes back to what is called the "WTO-plus nature of the ECT": it offers settlement of transit disputes in a way that is not provided for by GATT art V. As a result, the rights and obligations provided for in art 7.7 ECT go beyond WTO commitments for simultaneous WTO/ECT Members. Article 7.8 ECT further emphasises that nothing in art 7 shall derogate from a Party's rights and obligations under international law including customary international law, existing bilateral or multilateral agreements, *ergo* including art V of the GATT.[82] Article 7 ECT, including its dispute resolution mechanism, therefore seems to be an elaboration on the obligations set out in art V GATT, with the latter setting the minimum standard.[83] For energy transit disputes between all shades of ECT membership interaction (among ECT/WTO Members, between a ECT/WTO Member and a non-WTO ECT party and among non-WTO ECT parties), the obligations in this article thus seem to go further than those in art V GATT for energy transit disputes.

5.2 Settlement of Investment Disputes

With regard to the resolution of energy investment disputes in the ECT and WTO, the parallelism stemming from issue-area overlap in this field continues to hold in the area of dispute settlement. Article 26 ECT provides for Investor-to-State dispute settlement, while art 27 covers State to State disputes (non-trade issues only).

[78] In conjuncture with art 29.7 ECT.

[79] As set out in arts 17 and 20 DSU. See also Frasl (1996), p. 479.

[80] Ibid.; Frasl (1996), p. 495; Energy Charter Secretariat (2001), p. 37, and Azaria (2009).

[81] Art 7.7(b) and (c) ECT.

[82] See Azaria (2009), p. 589.

[83] Ibid., p. 591, referring to the *traveaux preparatoires* of the ECT: European Energy Charter Conference Secretariat 22.4.94/2647.

The overlap between the energy investment dispute resolution procedures of the WTO (GATS Mode 3) and the ECT (energy investment protection) manifests itself in the State to State dispute resolution as set out in art 27 ECT. In other words, there may be overlaps and conflicts between the dispute settlement mechanisms if they are available to the *same* parties, i.e. States that are simultaneous ECT and WTO Members. Where art 27 of Part V of the ECT offers a route for resolution of such disputes for ECT Members, the DSU arguably simultaneously applies to disputes of energy investment protection stemming from violation of GATS Mode 3 for WTO Members. This observation theoretically opens up a route for forum shopping for WTO/ECT Members in case of an energy investment dispute.

One provision worth mentioning with regard to ECT investment protection in relation to other agreements, though, is art 16 ECT. The article comes closest to being a conflict prevention/coordination tool and is aimed at the instances when one or more contracting parties enter or have entered into other international agreements, concerning the subject matter of ECT Part III or Part V. In essence, the provision—in a somewhat cumbersome manner—prescribes that those provisions, which are more favourable to the investor or the investment of either the ECT or the other agreement, should prevail.

The potential overlap and/or conflict in the narrow sense of private law in this area between the WTO and the ECT does not hold true where it concerns GATS Mode 3 dispute resolution in the WTO (State to State) versus Investor-to-State dispute settlement according to art 26 ECT. Here, we see the two dispute settlement mechanisms working in parallel rather than in conflict with one another, since they do not involve the same parties or the same applicable law, even though the disputes may stem from the same events. In this case there is a fruitful complementarity between the ECT and the WTO dispute resolution mechanisms, where both the WTO (for States) and the ECT (for investors) provide a potential forum for redress in the field of energy investment protection.

5.3 Recap: The Nexus Between the ECT and the WTO

By way of overview of this Section, Table 1 attempts to compare both treaties and identify issue-area and procedural overlap between them. It also identifies resolution of conflict between the WTO and the ECT, where available.

Table 1 Resolution of conflict, issue-area and procedural overlap—a comparison between the WTO and the ECT

	WTO	ECT	WTO rules in ECT: resolution of conflict
Trade in energy goods	– GATT – TBT – TRIMs – TRIPs – Trade Remedy Agreements: Anti-Dumping, Subsidies and Safeguards – Market Access Agreements: Import Licensing, Rules of Origin, Customs Valuation and Preshipment Inspection **Not directly relevant for trade in energy goods:** – SPS – Other WTO Agreements: Agreement on Agriculture, Textiles – Plurilaterals, not binding on all WTO Members (GSP, Government Procurement, Civil Aircraft)	– Trade Provisions ECT (arts 4, 5, 6 and 29 ECT[a]) – Art 5 ECT "Trade Related Investment Measures" – Art 7 ECT "Transit" (ECT Transit Protocol to be elaboration on ECT and this Article) – Transit Protocol (under negotiation—Most recent informal text available: TT87 22/01/2010) **NB** The aim of the Transit Protocol is to complement the ECT while being in accordance with art 7 ECT (Draft art 3 Transit Protocol)	**GATT 1994 incorporation into ECT by reference (art 4 ECT):** – GATT 1994 Applies: (a) Among ECT/WTO Members (art 4 ECT) (b) Between ECT/WTO Members and non-WTO ECT Parties (art 29.2(a) ECT)[a] – Trade Provisions ECT (art 4 s, 5, 6 and 29 ECT) apply among non-WTO ECT Parties only (art 29.1 ECT)[a] – Art 7 ECT creates additional obligations for ECT/WTO Members (i.e. art 7 prevails over art V GATT—the so-called "WTO-plus effect of the ECT"—The same would account for an ECT Transit Protocol (Draft art 3 Transit Protocol) **Main exception to GATT incorporation by reference (Art 4 ECT):** – Schedules of Concessions art II GATT are not incorporated into the ECT, but ECT has "Best-endeavours" clause (arts 29.3–29.5) ECT[a]) **WTO Agreements excluded from incorporation into ECT:** (a) Plurilaterals, not binding on all Members (Annex W ECT), e.g. Government Procurement, Civil Aircraft) (b) WTO Agreements, not directly relevant for ECT (Annex W ECT), e.g. Agreement on Agriculture, SPS, Textiles) (c) The WTO Special and Differential Treatment provisions do not apply in the ECT, except for paras 1–4 of the Enabling Clause (through Annex W, section A, para 2(a) ECT) **Conflict not solved:** – TRIMS not incorporated in ECT (Annex W(A)(iv) ECT), but similar article in art 5 ECT "Trade Related Investment Measures" – TRIPS not incorporated in ECT (Annex W(A)(c) ECT), but commitment to provide protection of intellectual property rights (Final Act of the International Conference and Decision by the Energy Charter Conference in Respect of the Amendment to the Trade-Related Provisions of the Energy Charter Treaty, Joint Declaration on Trade-Related Intellectual Property Rights)
Trade in energy services	– GATS	– "Economic Activity in the Energy Sector" (art	– Art 11 ECT "Key Personnel" takes up issues treated as specific commitments under the GATS (the so-called "WTO-plus effect of the ECT"

(continued)

Table 1 (continued)

	WTO	ECT	WTO rules in ECT: resolution of conflict
		1.5 ECT) – Transit Protocol (under negotiation—Most recent informal text available: TT87 22/01/2010)	**Conflict not solved:** GATS not incorporated in ECT (Annex W(A)(b), but energy services nevertheless covered in ECT as "Economic Activity in the Energy Sector"
Resolution energy trade disputes	– DSU	– Annex D "Interim Provisions for Trade Dispute Settlement" – Art 7.7 ECT for Transit disputes	– DSU Applies: (a) Among ECT/WTO Members (Art 4 ECT) – Annex D Applies: (a) Between ECT/WTO Members and non-WTO ECT Parties (art 29.7 ECT[a]) (b) Among non-WTO ECT Parties (art 29.7 ECT[a]) – Art 7.7 ECT creates additional obligations for ECT/WTO Members (the so-called "WTO-plus effect of the ECT")
Energy investment protection	– GATS Mode 3 "Commercial Presence"	– Part III ECT "Investment Promotion and Protection"	**Conflict not solved:** Overlap/tension where GATS Mode 3 investment protection coincides with ECT Part III (because GATS not incorporated in ECT)
Resolution energy investment disputes	– DSU for GATS Mode 3 disputes	– Part V ECT "Dispute Settlement": (a) Investor-State (art 26 ECT) (b) State-State (art 27 ECT, non-trade matters only)	**Conflict not solved:** (Stems from issue-area conflict) Overlap/tension where GATS Mode 3 investment protection disputes coincide with ECT Part III, State-State disputes (art 27 ECT) (post-establishment). However, see art 16 ECT "Relation to Other Agreements" regarding Part III and V of the ECT. WTO/ECT complementarity regarding Investor-State disputes (Art 26 ECT)
Environmental protection	– Possible through Art XX GATT **NB** Also see WTO Decision on Trade and Environment	– Art 19 ECT "Environmental Aspects" – Environmental Protocol (PEEREA)	– Art 19 ECT and the Environmental Protocol (PEEREA) create additional obligations for ECT/WTO Members (the so-called "WTO-plus effect" of the ECT)

[a]Article 29 ECT sets out transitional arrangements and ceases to exist for an ECT Party when it joins the WTO. The application of art 29 ECT will end only upon universal WTO membership of all ECT Parties

6 The WTO-ECT Relationship 20 Years Later: Unresolved Issues

While the WTO was set-up from the standpoint of creating an optimal long-term governance model for international trade regulation, the ECT seems to have been brought into life to deal with problems as they arose after the fall of the Iron Curtain. It was these unpredicted circumstances that led to the establishment of the ECT and which simultaneously caused tension and overlap between the two treaties.[84]

One element that stands out is the fading relevance of the ECT provisions on energy trade. Above we discussed how the trade provisions of the ECT are only applicable between non-WTO Members who are Party to the ECT. Because of the large number of accessions to the WTO, this means that these trade rules are only applicable between a handful of ECT parties by 2016 (as opposed to 1998): Afghanistan, Azerbaijan, Bosnia and Herzegovina, Uzbekistan and Turkmenistan.[85] With the exception of Turkmenistan, all these countries are WTO observers and currently in the process of acceding to the WTO. Between all other ECT parties who already are WTO Members, and even between these ECT/WTO Members and non-WTO ECT parties, GATT rules apply, with the abovementioned exceptions. The fundamental question that arises from this is what will happen to the trade provisions of the ECT once all WTO observers who are ECT Parties have acceded to the Organization? Will they become obsolete, with the exception of the "WTO-plus" style provisions such as art 7 on transit (especially relevant for natural gas)? Will the other trade provisions of the ECT still have a legitimate purpose? This remains to be seen.

6.1 The Risks of ECT/WTO Tension and Overlap

The main risk of overlap between the WTO and the ECT is evidently one of parallel applicability in issue-area and procedure with no clear hierarchy. While introducing ECT rules of conflict from the start has averted tension between the main trade provisions between WTO and the ECT, certain conflicts remain unresolved even two decades later. This is a problem, because it results in an inefficient system of energy governance. This is particularly harmful when considering the need for a well-functioning framework that reflects modern energy and sustainable development needs.

A case in point here is the applicability of TRIMs, TRIPs and GATS agreements of the WTO with respect to trade in energy in parallel with their corresponding

[84]Meyer (2012), p. 390.

[85]Left out are the ECT countries who apply the ECT provisionally, or have applied it provisionally in the past: Russia, Belarus, Australia, Iceland and Norway.

provisions in the ECT, but the tension here has not been solved.[86] There is no "real" normative conflict between these norms in that they are not contradictory in nature and both the WTO and the ECT aim to transmit a similar message: to provide rules on trade-related investment measures, intellectual property and trade in services. But the rules on TRIMs, TRIPs and GATS of the WTO and the rules of the same notion in the ECT are not in the least identical and might result in significantly diverging results if applied in practice.[87] Instead of an inherent normative conflict, the problem here is that both the WTO and ECT are applicable in parallel. Which of the norms prevails? It appears there is no straightforward answer in this case. The rules of the ECT have not provided for any explicit conflict clauses regarding TRIMs, TRIPs and the GATS and both norms are deemed to be "equal".

Another WTO/ECT overlap, concerning both issue-area and procedure, stems from the unresolved parallel applicability of the WTO and the ECT with regard to the protection and dispute settlement of energy investments. This overlap is not an exclusive problem of the WTO and the ECT, but part of a greater discourse on the gaps and overlaps between trade and investment law in general. While the issue-area overlap with respect to GATS Mode 3 investment protection and Part III ECT is subject to the same questions as those with regard to TRIMs, TRIPs and the GATS above, the procedural overlap in this particular instance faces a practical issue for countries who are simultaneous WTO/ECT Members. Arguably, investments of one WTO Member in the energy sector are protected by GATS rules under GATS Mode 3 in the area of another WTO Member. But, investments of an ECT party or an investor of an ECT party in the energy sector are additionally protected through the rules set out in Part III of the ECT.[88] Dispute settlement for States (not investors) who are WTO/ECT Members would therefore appear to be possible under the DSU as well as under art 27 of Part V of the ECT.[89] If both the WTO and the ECT have competence in resolving disputes concerning energy investment disputes, which dispute settlement forum has precedence? Here, there are two possible lines of argument, one making the case for prevalence of dispute settlement in the WTO over the ECT, and the other vice versa. Nonetheless, neither of these scenarios provides conclusive legal answers to the question which treaty-regime should have priority.

With respect to the WTO, one could claim that a dispute in the energy sector, stemming from a violation of the GATS in connection with Mode 3 (commercial presence) should be litigated first and foremost between WTO Members before a WTO panel. A strong argument in favour is that the WTO offers an exclusive forum for dispute resolution for its Members and they are precluded from going elsewhere.

[86]See Table 1.

[87]It goes without saying that rules on TRIMs, TRIPs and GATS within the WTO are much more elaborate than the rules provided on these topics in the ECT.

[88]Part III ECT.

[89]Note, however, that in the case of art 26 of the ECT, the investor would be the litigating party, while under the DSU it would be a State, namely a WTO Member.

Furthermore, GATS Mode 3 is evidently a part of the agreements of the WTO (namely the GATS), and consequently falls within the jurisdiction of WTO panels.[90] That being said, GATS Mode 3 has only been one the table in one WTO dispute so far, namely in *China—Certain Measures Affecting Electronic Payment Services*, a dispute which moreover did not concern energy investment protection.[91]

Conversely, there is a case to be made that settling State-to-State energy investment disputes through art 27 ECT has precedence over the WTO. The ECT offers a specialised regime for the settlement of energy investment disputes. The view that a specialised regime should prevail in this case could coincide with the rules of conflict resolution. What is more, the ECT has been used very frequently for such disputes, as opposed to the WTO.[92] It must however be said that contrary to the WTO, there is nothing in the wording of the ECT that prescribes exclusive settlement of energy investment disputes under the ECT.[93]

Another possible solution in such circumstances is to resort to the text of art 16 ECT, and decide which provision of what agreement (WTO or ECT) is more favourable to the case at hand. If nothing else, this fact certainly puts the perceived "exclusivity" of the WTO dispute settlement system into question, as a parallel route of settlement for energy investment disputes is available through the ECT.

6.2 Cooperation and Coordination to Overcome Tension?

From the above it is obvious that parallel applicability causes some tension between the WTO and ECT. But how can these institutions best manage the unsolved conflicts stemming from overlap in substance and procedure? This seems difficult to predict and largely depends on the course both treaty-regimes aim to take in the future.

In absence of clear rules prescribing how to manage the risks of fragmentation concerning the WTO and ECT, one can look at the fairly straightforward suggestions made in analogy in the somewhat related field of international environmental law.[94] Wolfrum and Matz propose an approach where closer *cooperation* and

[90]Pauwelyn (2003), p. 443 and art 1.1 DSU.

[91]WTO doc. WT/DS413/R, Panel Report, *China—Certain Measures Affecting Electronic Payment Services*, 16 July 2012.

[92]In contrast, see the extensive list of dispute settlement cases litigated under the ECT, "Investor-State Dispute Settlement Cases" on http://www.energycharter.org.

[93]In fact, in case parties to a dispute failed to settle it amicable pursuant to art 26.1 ECT, art 26.2 ECT gives the investor three options for submitting the dispute for resolution: "(a) to the courts or administrative tribunals of the Contracting Party to the dispute; (b) in accordance with any applicable, previously agreed dispute settlement procedure; or (c) in accordance with the following paragraphs of this Article" (the latter referring to the ad hoc dispute settlement procedure provided for in the ECT).

[94]Pauwelyn (2006), [25], citing Wolfrum and Matz (2003), pp. 159–163.

coordination between overlapping regimes and institutions can contribute to overcoming tension.[95] What is meant here is a broad concept of both terms, and it implies voluntary and coordinated action between stakeholders of both institutions.[96] To make coordination and cooperation successful, it seems that both institutions have to have a common objective in mind. With regard to the WTO and the ECT this could be a (more) optimal regime to regulate economic activity in the energy sector. But fruitful cooperation does not only concern active involvement of institutions, for there are two crucial aspects: (1) interaction of States in the work of international institutions, and, (2) cooperation between different institutions.[97] This should not be in the form of a one-time event, but has to be part of a continuing process.[98] In part, this has been attempted in the early 2000s, with the ECS providing rules of coordination for WTO and the ECT. But this alone is not enough, because gaps and overlaps continue to exist. To add to this, conflict resolution between the WTO and the ECT based on the ECS guides as it stands now seems quite complex and perhaps unnecessarily so.[99] Perhaps it is not unthinkable that coordination between the two treaty-regimes could happen in a simpler manner in the future.

The WTO and ECT have made a renewed careful step in the direction of increased cooperation and coordination by organising a common conference at the WTO Headquarter in Geneva in 2013, focusing on legal problems concerning energy in the WTO, the ECT and the interaction of these legal instruments.[100] This is just the beginning of what predictably will be a long journey if both institutions aspire to take trade and regulation of the energy sector seriously.

A more interesting development in this respect is the political declaration on global cooperation in the field of energy, the 2015 International Energy Charter, negotiated under the auspices of the ECS in The Hague.[101] While this declaration is a political declaration and a soft law instrument, it is a positive sign that ECT Members, signatories as well as non-signatories gathered around the table to discuss global energy challenges ahead. Its purpose was to produce an updated document to the founding document of the ECT, the European Energy Charter, concluded in 1991.[102] The concept of the International Energy Charter "aims at

[95]Wolfrum and Matz (2003), pp. 159–163.

[96]Ibid., p. 161.

[97]Ibid.

[98]Ibid., p. 159.

[99]Energy Charter Secretariat (2001, 2003).

[100]WTO, WTO News, Lamy Calls for Dialogue on Trade in Energy in WTO, 29 April 2013, http://wto.org/english/news_e/sppl_e/sppl279_e.htm (accessed 4 March 2016).

[101]International Energy Charter, Agreed Text for Adoption in The Hague at the Ministerial Conference on the IEC on 20 May 2015, http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/IEC_EN.pdf (accessed 31 May 2016).

[102]The 1991 Energy Charter, also known as the European Energy Charter, was the founding document for the Energy Charter Treaty and provides the political foundation for the Charter process.

enhancing international cooperation in order to meet common challenges related to energy at national, regional and international levels, including the evolution of global energy architecture".[103] The document hints to more cooperation and coordination between multilateral agreements in the field of energy. Its signatories have agreed to foster synergies among energy-related multilateral fora and stated the wish to take full advantage of the expertise of existing international organisations in the energy field.[104] More importantly, for cooperation between the ECT and WTO, the signatories to the 2015 Charter aim to ensure the development of trade in energy is consistent "... with major multilateral agreements such as the WTO Agreement and its related instruments ...".[105] These goals should be achieved by means of, for instance, guaranteeing an open and competitive market for energy products, materials, equipment and services, access to energy resources and access to national, regional and international markets.[106]

7 Conclusions

This contribution examined the nexus between two major treaty-based systems relevant for governance in the energy sector, the WTO and the ECT. While the WTO, established in 1995 governs global trade in general, the ECT which came into force in 1998, offers a specialized regime for the regulation of the energy sector. Both treaties intersect and overlap in several places. The goal of this article was to scrutinize the origins of the resulting overlap between them and to examine where tension and parallel applicability occurs. Parts that are prone to the risks of fragmentation are the parallel applicability of the WTO and the ECT in the field of TRIMs, TRIPs and GATS. The tension between energy investment protection and State-to-State dispute resolution in the ECT *vis-à-vis* the protection offered to such investments in Mode 3 of the GATS present an additional challenge. One straightforward way to prevent and overcome conflict in these areas of the WTO and the ECT is to foster increased cooperation and coordination between institutions, as proposed by Wolfrum and Matz.[107] With an eye on future energy governance, both treaty regimes would arguably highly benefit from increased cooperation, coordination, and perhaps even integration. This would be particularly useful considering the ambitions of the ECT—in view of the 2015 International Energy Charter—to function as a hub in international energy regulation, whether with or without involvement of the WTO. Or, alternatively, it would be a helpful exercise for the WTO in tackling energy issues more proactively.

[103] See Preamble to the text of the 2015 Charter.

[104] Ibid.

[105] International Energy Charter (2015) Title I—Objectives [1].

[106] Ibid.

[107] Wolfrum and Matz (2003).

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"Ain't No Sunshine": Photovoltaic Energy Policy in Europe at the Crossroads Between EU Law and Energy Charter Treaty Obligations

Francesco Montanaro

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Abstract After the EU-driven liberalisation of the electricity market in Europe, EU Member States put in place a variety of measures to develop photovoltaic (PV) energy sources. These policies, however, soon proved to be unsustainably expensive, particularly in a moment in which the condition of EU Member States' public finances is generally problematic. In order to fulfil the tight EU fiscal requirements, many EU Member States withdrew or substantially curtailed support for renewable energies. In response to these policy changes, a group of solar power investors initiated several arbitral proceedings against Spain, Italy, and Czech Republic under the Energy Charter Treaty (ECT). This wave of claims has once

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again brought to the fore the vexed question of compatibility between ECT and EU obligations in intra-EU cases. Given the variety of possible interpretative approaches and the lack of binding precedent doctrine in international investment arbitration, this paper maintains that solving this conflict through hermeneutic means is not entirely satisfactory. Therefore, it suggests a two-step strategy to accommodate it and neutralise its detrimental effects.

1 Introduction

Over the past few years, EU Member States have withdrawn or substantially reduced the support to photovoltaic (PV) energy production. While these policy changes seem to be required or, at least, encouraged by EU law, they could also trigger Member States international responsibility under the Energy Charter Treaty (ECT). By invoking the violation of the latter, several European solar power investors have sued Spain, Italy, and the Czech Republic before international arbitral tribunals. This new strip of cases revives the vexed question concerning the compatibility of EU with ECT obligations in intra-EU cases. Caught between the hammer and the anvil, EU Member States find themselves in an extremely uncomfortable "lose-lose situation". Two approaches may be envisaged to deal with this conflict between international obligations. On the one hand, arbitral tribunals may accommodate it on a case-by-case basis through interpretative means. On the other hand, the States subject to these diverging obligations may seek a conclusive solution through political means. To identify the most suitable solution, this article proceeds as follows.

First, it outlines the legal and economic context in which EU Member States enacted policies promoting photovoltaic and renewable energies. Notably, this section briefly illustrates how the EU seeks to reconcile a variety of objectives, such as electricity market liberalisation, environment protection, and sustainability of public finances. With this in mind, it enquires how EU law may come into conflict with the ECT. Second, it shows that solving such a conflict case-by-case through hermeneutic means is largely unsatisfactory owing to the lack of binding precedent and the variety of possible interpretative solutions. In conclusion, it puts forward a two-step strategy that could not only resolve the conflict in the long-term, but also immediately neutralise the unfair and undesirable consequences thereof. On the one hand, it argues that only an amendment of the ECT would avoid future conflicts with EU law. On the other hand, it suggests that the rules governing the EU excessive deficit procedure should be interpreted in a way that can attenuate the financial effects of the violation of the ECT.

2 The Legal and Economic Background of the Disputes: The Liberalisation of the Energy Market

At the end of the nineties, Member States set in motion a process leading to a gradual liberalisation of the energy market which was marked until then by high concentration and large State involvement. This process occurred under the impulse of the three EU "energy packages".

The first package comprised two "framework" directives on electricity and gas.[1] These directives followed a twin-track approach that not only required Member States to separate the natural monopolistic functions of the Transmission System Operator (TSO) from generation and distribution, but also entrusted the incumbents in the electricity market with public service obligations.[2]

The second package introduced the concept of functional unbundling, according to which TSOs should set up a separate and independent organisation and decision-making process to carry out the transmission functions.[3] Furthermore, Member States had to create independent national regulatory authorities (NRAs) to regulate a wide range of issues, such as tariffs and conditions for access to transmission networks, allocation of transmission capacity and congestion management.

The third package took further steps towards the creation of an European electricity market by providing (1) the structural unbundling of the TSOs, (2) procedural and substantial rules geared to the solution of cross-border issues, and (3) new and more far-reaching powers for the NRAs.[4]

[1]Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, *OJ* 1997 L027/20; Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, *OJ* 1997 L204/1.

[2]Hancher and Larouche (2011), p. 753.

[3]Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, *OJ* 2003 L176/37; Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, *OJ* 2003 L176/57.

[4]Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, *OJ* L211/55; Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, *OJ* L211/94.

3 PV Energy Support Schemes and EU Law Constraints

While pursuing stronger market integration and competitiveness of the energy market, the EU also sought to encourage the exploitation of renewable energies. In the framework of the "Climate and Energy Package", the Renewable Energy Directive sets ambitious objectives in terms of electricity production from renewable resources.[5] Since market and regulatory failures would generally impede a sufficient production of electricity from renewable resources, this directive also allowed for the introduction of support schemes.[6]

EU Member States adopted a variety of measures to shore up renewables, namely (1) price support schemes, such as feed-in-tariffs (FITs) and (2) green certificates, (3) tax incentives and (4) subsidies for PV plants projects.[7] Since all these measures imply a deployment of public resources or a transfer of resources to private undertakings, they can come into conflict with EU State aid rules and with EU fiscal discipline.

In terms of the former, Article 107.3 of the TFEU stipulates the conditions under which State aids may be compatible with the internal market. In particular, Article 107.3(c) provides that State aid can be granted

> to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.

In the framework of the State aid modernisation, the Commission recently issued the "Guidelines on State aid for environmental protection and energy", which amend the rules governing the Commission assessment of State aid granted to renewable energy producers under Article 107.3.[8] For reasons of space, this paper cannot embark on a comprehensive analysis of the new guidelines. However, it is worth noting that they seek to better integrate three seemingly diverging interests such as environmental protection, energy security, and safeguard of effective

[5]Directive 2009/28/EC of the European Parliament and of the council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, *OJ* 2009 L140/16.

[6]Article 3.3(a), Directive (EC) 2009/28. European Commission, Guidance for the design of renewables support schemes, SWD (2013) 439 final, 5 November 2013, p. 3. See also European Commission, Renewable energy progress report, COM (2013) 175, 27 March 2013, p. 7; European Commission, Renewable Energy: Progressing towards the 2020 target, COM (2011) 31, 31 January 2011. Subsidies to fossil fuels certainly represent a major regulatory failure. See generally IMF (2013), pp. 19–20.

[7]See Couture and Gagnon (2010), pp. 955–961; Sarasa-Maestro et al. (2013), pp. 317–318.

[8]European Commission, Guidelines on State aid for environmental protection and energy 2014–2020, 2014/C 200/01. See also European Commission, Communication on EU State Aid Modernisation, COM (2012) 209 final, 8 May 2012. The previous version of the guidelines was issued in 2008. See European Commission, Community Guidelines on State Aid for Environmental Protection, 2008/C 82/01.

competition. To this end, they introduce new rules concerning State aid for renewable energy that urge Member States to transit to more market friendly measures in support of renewable energy.[9] More specifically, they provide, amongst others, that the (1) price of green certificates systems should be established by demand and supply in the market, (2) all aids should be granted through a competitive bidding process from 2017, and (3) operating aid should take the form of a premium in addition to the market price.[10]

Similarly, EU fiscal discipline may collide with national PV energy policies, because the Member States directly or indirectly bear the costs of production of PV energy. Direct support generally takes the form of tax breaks or tax incentives. Indirect support, instead, occurs in case of accumulation of large tariff deficits, which can arise when regulated tariffs do not cover the cost borne by energy companies to produce PV energy.[11] Although consumers normally bear this deficit, the accumulation of large tariff deficits may ultimately require State intervention. For instance, States may earmark their revenues to repay such tariff deficits or guarantee the securities representing consumers' debt.[12] The sovereign debt crisis and the strict EU fiscal discipline substantially reduced the room for such interventions.[13] In fact, it is no coincidence that all the Member States sued by PV investors experienced a parallel rise in government debt and in the costs associated with the support for renewable energies.[14] Spain's public debt/GDP ratio increased from 60.1 to 92 % between 2010 and 2014 and is expected to reach 102.1 % by 2016.[15] Likewise, Italy's government debt/GDP ratio over the same period equalled 127.9 % and will further increase in the next 4 years.[16] The government debt/GDP ratio of the Czech Republic, the only non-Euro country involved in these arbitral proceedings, rocketed by 17 % in the period 2008–2013.[17]

EU fiscal discipline is a complex combination of obligations stemming from (primary and secondary) EU law as well as from the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). The TFEU sets out the framework for the coordination of Member States' economic policies

[9]Szyszczak (2014), p. 618. See also Almunia (2014).

[10]European Commission, Guidelines *supra*, n. 8, pp. 124–135.

[11]Johannesson et al. (2014), p. 19.

[12]Ibid., pp. 48–49. See also Creutzig et al. (2014), p. 1022. See also Robinson (2013), p. 3.

[13]European Commission, Renewable Energy *supra*, n. 6, p. 8.

[14]See Johannesson et al. (2014), pp. 23–24 and 39.

[15]European Commission, Country Report Spain 2015, SWD (2015) 28 final, 26 February 2015, p. 8.

[16]European Commission, Country Report Italy 2015, SWD (2015) 31 final, 26 February 2015, p. 10.

[17]European Commission, Country Report Czech Republic 2015, SWD (2015) 23 final, 26 February 2015, p. 8.

(preventive arm), for the excessive debt procedure (corrective arm) and forbids the Union from assuming liability for Member States' public debt (no-bail out clause).[18] In 1997, two regulations fleshed out these rather scant treaty rules.[19] However, due to their excessive rigidity, they were later modified in 2005.[20] After the outbreak of the sovereign debt crisis, they were further amended and complemented in order to streamline the excessive deficit procedure and to enhance surveillance and macroeconomic coordination.[21] EU fiscal discipline applies in its entirety to Member States that adopted the Euro. However, non-Euro States are nonetheless subject to the regulations on the excessive deficit procedure and the surveillance of budgetary positions.[22]

Against this background, EU policies impact on Member States' renewable energy policies can be regarded in two contrasting ways. On the one side, the

[18]See Articles 121, 125 and 126 TFEU; Article 1 of the Protocol No. 12 of the TFEU sets the criteria for assessing Member States debt and deficit.

[19]Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, *OJ* 1997 L209/1; Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, *OJ* L209/6. See Morris et al. (2006).

[20]Council Regulation (EC) No 1056/2005 of 27 June 2005 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, *OJ* L174/5.

[21]These measures are referred to as the "Six Pack" and the "Two Pack". The former comprises Regulation (EU) 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, *OJ* L306/12; Council Regulation (EU) 1177/2011 of 8 November 2011 amending Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, *OJ* L306/33; Regulation (EU) 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area, *OJ* L306/1; Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the member States, *OJ* L306/41; Regulation (EU) 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, *OJ* L306/25; Regulation (EU) 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, *OJ* L306/8. The "Two Pack" includes Regulation (EU) 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, *OJ* L140/1; Regulation (EU) 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the member States in the euro area, *OJ* L140/11. On 2 March 2012, 25 EU member States concluded the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

[22]Notably, they are subject to regulations 1466/97 and 1467/97 and their amendments. Some non-Euro countries, such as Sweden, Denmark and Poland, are parties to the TSCG.

progressive liberalisation of the energy market and the ambitious objectives of the climate and energy policy encourage Member States' support to renewable energies. On the other side, EU State aid and fiscal policy significantly reduce the margins for State intervention. Yet, it seems that the second tendency has prevailed in recent times, thereby nudging the vast majority of EU Member States towards more market-friendly and cost-effective renewable energy policies.[23]

4 The Unpleasant Consequences of Renewable Energy Policy Reforms

Several EU Member States and, notably, Spain, Italy, and the Czech Republic, have recently started to reform their PV energy policies. Spain enacted a number of measures aimed at reining in tariff deficit and reforming its PV energy policy between 2008 and 2013. After having reduced the FITs in 2008 and 2010,[24] it also curtailed the amount of production hours covered by the FIT for all the PV installations put in place after 2007 thereby retroactively cutting tariffs.[25] In addition to this, Spain (1) suspended the FIT for PV systems installed on and after 1 January 2012, (2) levied a 7 % tax on income from electricity production and (3) retroactively modified the index adopted to calculate the amount of the FIT.[26] Similarly, the Czech Republic substantially reduced its support to PV energy by introducing a tax that applied to all PV installations built after 2009 and discontinuing the FIT scheme.[27] Italy also enacted a number of measures to curb tariff deficit. In particular, it substantially reduced the support for photovoltaic energy and imposed a special tax on firms operating in the energy and oil industry.[28] Unsurprisingly, these measures elicited reactions from PV investors. Numerous

[23]See EPIA (2013); OECD (2014a), p. 19; OECD (2015), p. 26; OECD (2014b), p. 15. See also Johnson (2014) and Wynn (2014).

[24]Royal Decree 1578/2008 [2008] BOE 234; Royal Decree 1565/2010 [2010] BOE 283.

[25]Royal Decree 14/2010 [2010] BOE 312.

[26]Royal Law-Decree 1/2012, [2012] BOE 24; Ley 15/2012, [2012] BOE 312. Royal Law-Decree 9/2013 [2013] BOE 167.

[27]EPIA (2013), p. 10.

[28]Ministerial Decree of 5 July 2012 [2012] GU No. 159; Decree-law No. 69 of 21 June 2013 [2013] GU No. 144; Law No. 98 of 9 August 2013 [2013] GU No. 194.

arbitral proceedings have been initiated against Spain,[29] the Czech Republic,[30] and Italy[31] since 2011.

5 Possible Grounds for Investors' Claims

With this factual background in mind, let us now attempt to identify the ECT dispositions that could constitute grounds for the investors' claims.

In the circumstances at hand, foreign investors are likely to invoke the fair and equitable treatment (FET) standard under Article 10.1 of the ECT. This standard comprises the following elements: (1) duty of transparency, (2) protection of

[29] *AES Solar v. Spain*, UNCITRAL Rules of Arbitration; *Antin Infrastructure v. Spain*, ICSID Case No. ARB/13/31; *RREEF Infrastructure v. Spain*, ICSID Case No. ARB/13/30; *Charanne v. Spain*, SCC Rules of Arbitration, SCC Case; *CSP Equity Investment v. Spain*, SCC Rules of Arbitration, PCA Case; *Eiser Infrastructure Limited v. Spain*, ICSID Case No. ARB/13/36; *Isolux Infrastructure Netherlands v. Spain*, SCC Rules of Arbitration, SCC Case *RENERGY v. Spain*, ICSID, Case No. ARB/14/18; *RWE Innogy v. Spain*, ICSID, Case No. ARB/14/34; *NextEra Energy v. Spain*, ICSID Case No. ARB/14/11; *InfraRed v. Spain*, ICSID Case No. ARB/14/12; *Masdar Solar & Wind v. Spain*, ICSID Case No. ARB/14/1; *Stadtwerke München v. Spain*, ICSID Case No. ARB/15/1; *STEAG v. Spain*, ICSID Case No. ARB/15/4; *Landesbank Baden-Württemberg v. Spain*, ICSID Case No. ARB/15/45; *Watkins Holdings v. Spain*, ICSID Case No. ARB/15/44; *Hydro Energy v. Spain*, ICSID Case No. ARB/15/42; *SolEs Badajoz v. Spain*, ICSID Case No. ARB/15/38; *OperaFund Eco-Invest v. Spain*, ICSID Case No. ARB/15/36; *Cavalum v. Spain*, ICSID Case No. ARB/15/34; *JGC Corporation v. Spain*, ICSID Case No. ARB/15/27; *KS Invest v. Spain*, ICSID Case No. ARB/15/25; *Mathias Kruck v. Spain*, ICSID Case No. ARB/15/23; *Cube Infrastructure Fund v. Spain*, ICSID Case No. ARB/15/20; *BayWa r.e. v. Spain*, ICSID Case No. ARB/15/16; *9REN Holding v. Spain*, ICSID Case No. ARB/15/15; *Alten Renewable Energy Developments BV v. Spain*, SCC; *E.ON SE, E.ON Finanzanlagen GmbH and E.ON Iberia Holding GmbH v. Spain*, ICSID Case No. ARB/15/35; *Eurus Energy Holdings Corporation and Eurus Energy Europe B.V. v. Spain*, ICSID Case No. ARB/16/4; *SunFlower Olmeda GmbH & Co KG and others v. Spain*, ICSID Case No. ARB/16/17; *Infracapital F1 S.à r.l. and Infracapital Solar B.V. v. Spain*, ICSID Case No. ARB/16/18; *Sevilla Beheer B.V. and others v. Spain*, ICSID Case No. ARB/16/27.

[30] *Voltaic Network v. Czech Republic*, UNCITRAL Rules of Arbitration; *I.C.W. Europe Investments v. Czech Republic*, UNCITRAL Ad Hoc; *Photovoltaik Knopf Betriebs v. Czech Republic*, UNCITRAL Rules of Arbitration; *Antaris Solar v. Czech Republic*, UNCITRAL Rules of Arbitration, PCA Case; *Natland Investment Group v. Czech Republic*, UNCITRAL Rules of Arbitration; *Jürgen Wirtgen v. Czech Republic*, UNCITRAL Rules of Arbitration; *WA Investments-Europa Nova Limited v. Czech Republic*, UNCITRAL; *ICW Europe Investments Limited v. Czech Republic*, UNCITRAL.

[31] *Blusun v. Italy*, ICSID Case No. ARB/14/3; *Silver Ridge Power v. Italy*, ICSID Case No. ARB/15/37; *Greentech Energy v. Italy*, SCC Rules of Arbitration, SCC Case; *Belenergia v. Italy*, ICSID Case No. ARB/15/40; *Silver Ridge Power v. Italy*, ICSID Case No. ARB/15/37; *ESPF Beteiligungs GmbH, ESPF Nr. 2 Austria Beteiligungs GmbH, and InfraClass Energie 5 GmbH & Co. KG v. Italy*, ICSID Case No. ARB/16/5; *Eskosol S.p.A. in liquidazione v. Italy*, ICSID Case No. ARB/15/50. It is worth noting that Italy notified its withdrawal from the ECT on 31 December 2014. However, it will be subject to the ECT for the next 20 years by virtue of Article 47.3 of the ECT. See De Luca (2015), pp. 9–11.

investors' legitimate expectations, (3) due process, and (4) freedom from coercion and harassment.[32] The legitimate expectations doctrine is likely to play a crucial role in the cases under consideration. Under this doctrine, host States must maintain commitments undertaken *vis-à-vis* foreign investors.[33] Arbitral case law found that host State's commitments may stem from (1) representations and assurances,[34] (2) contract or licenses[35] and, in some circumstances, from (3) laws and regulations.[36] Having outlined the possible sources of commitment, it is worth dwelling on the last category and, in particular, on whether a change in the regulatory framework existing at the time of the investment may result in the violation of the investor's legitimate expectations. Arbitral practice provides mixed guidance in this respect. Some arbitral tribunals found that the protection of investors' expectations could justify an almost blanket limitation to the host State's right to regulate.[37] Some others, instead, took a more deferent stance by affirming that modifications to the regulatory framework do not violate legitimate expectations as long as they are reasonable and proportionate.[38] Recent ECT practice seems to uphold the latter approach. In *Electrabel*, the Tribunal assessed whether the withdrawal of a regulated price regime for production, transmission, and supply of electric energy violated the investor's legitimate expectations. In this regard, it found that:

> While the investor is promised protection against unfair changes, it is well established that the host State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest. Consequently, the requirement of fairness must not be understood as the immutability of the legal framework, but as implying that subsequent changes should be made fairly, consistently and predictably ... Fairness and consistency must be assessed against the background of information that the investor knew and should reasonably have known at the time of the investment and of the conduct of the host State.[39]

What is more, the Tribunal held that, in the context of a progressive transition to a liberalised energy market, the abolition of a regulated price regime does not

[32]Leben (2015), pp. 322–342; Schreuer (2005a), pp. 373–384.

[33]Valenti (2014), pp. 39–45; Snodgrass (2006), p. 36.

[34]*Total v. Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, para 119; *Gami Investments v. Mexico*, UNCITRAL, Final Award, 15 November 2004, para 93; *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award on Merits, 16 December 2002, para 128.

[35]*SGS v. Paraguay*, ICSID Case No. ARB/07/29, Award, 10 February 2012, para 134. See also *Noble Ventures v. Romania*, ICSID Case No. ARB/01/11, Award, 12 October 2005, para 182.

[36]*Bayindir v. Pakistan*, ICSID Case No ARB/03/29, Award, 27 August 2009, para 240; *Occidental v. Ecuador*, LCIA Case No UN3467, Award, 1 July 2004, para 191; *Saluka v. Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para 307.

[37]*CMS v. Argentina*, Case No. ARB/01/8, Award, 12 May 2005, para 277; *TECMED v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para 154.

[38]*Total*, *supra*, n. 34, paras 122–123.

[39]*Electrabel v. Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, 30 November 2012, paras 7.77–7.78.

frustrate investors' legitimate expectations.[40] On the contrary, investors should expect these kinds of changes to the regulatory framework in such circumstances. That being said, it cannot be excluded that future arbitral tribunals might choose to distance themselves from this interpretation of legitimate expectations under Article 10 of the ECT. Whether the above measures are consistent with the FET standard depends on which of these views the arbitral tribunals will take. Should they choose the former, they would in all likelihood find a violation of the FET standard. However, assuming that they would adopt the latter, some of the retroactive measures enacted by the EU Member States could be nonetheless inconsistent therewith.[41]

Besides being a crucial part of the fair and equitable treatment standard, the legitimate expectations doctrine can also be invoked in relation to violations of the prohibition against illegal expropriation.[42] Under Article 13 of the ECT, in order to be considered lawful, an expropriation should (1) pursue a public interest objective, (2) be non-discriminatory as well as (3) consistent with the due process of law, and (4) be followed by a prompt, adequate and effective compensation. As is well-known, expropriation may be direct and indirect. The former occurs through State action, namely a State *takes* foreign property.[43] Whereas the latter is the result of regulatory measures that destroy or significantly reduce the value of the investment.[44] However, the distinction between measures amounting to expropriation and regulatory measures can be quite blurry. Thus, legal scholarship and arbitral practice have adopted a number of criteria to better identify indirect expropriations with legitimate expectations being one of them.[45] Arbitral practice has often interpreted quite restrictively the legitimate expectations doctrine. In particular, it has been found that the legislative framework existing at the time of the investment does not *per se* give rise to legitimate expectations unless the host State expressly *assures* that it will remain unchanged.[46]

Be that as it may, it cannot be excluded that some of the arbitral tribunals may consider the amendments to renewable energy policies as a violation to investors' legitimate expectations that could result in an indirect expropriation.

[40]Ibid., para 7.140.

[41]*Total*, *supra*, n. 34, para 129. See also Kläger (2011), p. 224. However, it should be noted that, in *Charanne*, the arbitral tribunal interpreted the legitimate expectations doctrine in a restrictive manner. See De Luca (2016), pp. 273–275.

[42]*Thunderbird v. Mexico*, UNCITRAL, Separate Opinion, 1 December 2005.

[43]Salacuse (2015), pp. 322–324.

[44]Schreuer (2005b), pp. 28–29; Carreau and Juillard (2013), pp. 549–551; Dolzer (2002), p. 79.

[45]See Carreau and Juillard (2013), pp. 570–573; Nouvel (2002), p. 89; De Luca (2014), pp. 62–65; Higgins (1982), pp. 276–277; OECD (2004), pp. 19–20.

[46]*Parkerings v. Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, para 334.

6 Between Scylla and Charybdis: EU Member States Obligations Under EU Law and the ECT

The recent wave of intra-EU investors' claims brought to the fore the possible conflict between EU law and the ECT. This conflict does not take the form of a mere logical incompatibility between two norms, but that of a *policy conflict*, that is to say a contrast between the objectives pursued by the two systems.[47] At first glance, this may appear somewhat outlandish and unexpected. For one thing, both TFEU provisions on free movement of capital, freedom of establishment and free provision of services and the substantive standards under Chapter III of the ECT pursue economic integration by protecting cross-border investments.[48] However, a closer look reveals that the EU and the ECT underlie a different idea of economic integration.[49] Though investment protection is certainly one of the fundamental objectives of the EU Single Market, it is balanced with a variety of equally important policies.[50] The ECT is a much simpler instrument of international economic integration, which by its very nature puts more emphasis on investor protection.[51] Thus, it is not surprising that the two systems may differently interact with the same domestic measure and come into conflict. Confronted with this issue, arbitral tribunals may in principle apply different interpretative approaches, namely (1) the public international law-centred approach, (2) the ECT-centred approach, or (3) the *hybrid* approach.

6.1 The Public International Law-Centred Approach

According to the first perspective, the conflict between ECT and EU law must be regarded as a conflict between two international treaties. Therefore, it can be solved through the interpretative tools contained in Articles 54, 59 and 30 of Vienna Convention on the Law of Treaties (VCLT). Article 54(b) stipulates that a treaty may be terminated or suspended when the parties, after consultation, agree to do so.[52] This provision must be read in conjunction with Article 59 of the VCLT, whereby new agreements concluded between the same parties on the same subject

[47]UN doc. A/CN.4/L.682, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law. Report of the Study Group of the International Law Commission Finalized by Martti Koskenniemi, 16 April 2006, paras 21–26.

[48]See Poulain (2007), pp. 812–814; Dutheil de la Rochère (2011), pp. 37–38.

[49]Ibid.

[50]Kleinheisterkamp (2012), p. 97; Reinisch (2012), p. 169.

[51]It should be admitted that the ECT, as opposed to BITs, pursues, to a certain extent, interests other than investment protection. See Schill (2014), pp. 273–280.

[52]This provision is a reflection of the *pacta sunt servanda* principle enshrined in Article 26 of the VCLT. Chapaux (2006), p. 1927.

can displace old agreements provided that they are intended to do so or are in any case incompatible.[53] Article 30 of the VCLT stipulates that the same rule governs conflicts between individual treaty dispositions.[54] Applied to the cases under consideration, these principles could generate unreasonable outcomes. ECT obligations would prevail over EU law *vis-à-vis* Spain and Italy, as they entered into the Energy Charter Treaty after having joined the EU. But they would not do so in relation to the Czech Republic, as it became a EU Member being already party to the ECT. Furthermore, it should be noted that several arbitral tribunals found that such principles do not apply to the conflict between EU law and intra-EU BITs, as BITs and EU law do not cover the same subject matter and are not incompatible with each other.[55] Arguably, the tribunals dealing with PV investors' claims might deploy these arguments to reject this approach.

6.2 The ECT-Centred Approach

This approach presupposes the completeness and the self-sufficiency of the ECT legal system. Put differently, the ECT would contain the rules to solve the conflict between itself and other international treaties. Under Article 26.6 ECT, investment disputes should be decided in accordance with the rules set out therein as well as the applicable rules and principles of international law. Thus, EU law is not applicable to ECT investment disputes.[56] Viewed from this angle, the conflict between the two systems does not even arise. When adjudging intra-EU investor-State disputes, EU law is only a *fact* to be taken into consideration unless Article 16 of the ECT applies.[57] This disposition stipulates that Parts III (Investment Protection) and V (Dispute Settlement) of the ECT may be derogated by another international treaty so long as the latter provides a more favourable treatment. However, given the relatively limited protection granted by EU law to investors, it is unlikely that this provision would ever apply.[58]

[53]Dubuisson (2006), p. 2094.

[54]It has been observed that this distinction may be somewhat artificial. See Dubuisson (2006), pp. 2118–2119.

[55]See *Eastern Sugar v. Czech Republic*, SCC Case 088/2004, Partial Award, 27 March 2007, paras 160–169; *Binder v. Czech Republic*, UNCITRAL, Award on Jurisdiction, 6 June 2007 (not public); *Eureko v. Slovak Republic*, UNCITRAL Rules of Arbitration, PCA Case No. 2008-13, Award on Jurisdiction, Arbitrability and Suspension, 26 October 2010, paras 231–267. See also Reinisch (2012), pp. 165–174; Cf. Poulain (2007), pp. 812–816.

[56]See *AES v. Hungary*, ICSID Case No. ARB/07/22, Opinion Expert, 30 October 2008, para 21. Giardina (2011), pp. 150–156.

[57]*AES v. Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010, para 7.6.12.

[58]Happ and Bischoff (2011), p. 162.

6.3 The Hybrid Approach

The *hybrid approach* seeks to reconcile EU law and the ECT as far as possible. Though neither the ECT nor the EU treaties require doing so, this approach would be the most suitable in light of the links between the two systems. As explained above, both the ECT and the EU promote, albeit in different ways, economic integration and free competition.[59] In addition, the ECT has always been considered by the EC/EU as an instrument to pursue its foreign and energy policies.[60] Following this approach, an arbitral tribunal recently concluded that, if a conflict between EU law and the ECT arises, such treaties should be construed in such a way as to avoid incompatibility.[61] What is more, it held that the assessment of the compatibility of a State measure *vis-à-vis* the ECT must take into account whether it was enacted to fulfil EU law obligations.[62] Put another way, EU law operates as a *screen* placed between the domestic measure and the ECT.[63] It follows that the ECT should not represent an instrument to circumvent EU law obligations.[64] Mindful of the fact that this harmonious interpretation might not solve the problem, the Tribunal added that EU law must prevail over the ECT in case of persisting contrast.[65] Notably, by virtue of a broad interpretation of Article 351 of the TFEU, the Tribunal found that EU law overrides all treaties concluded between Member States, including the ECT.[66] In doing so, the Tribunal arguably sought to ensure consistency between the two systems while preserving a certain degree of autonomy for the ECT.[67] Although this approach may look suitable, it only reflects the position of an arbitral tribunal that is not binding on other tribunals.[68] Therefore, the tribunals called on to decide on the cases concerning PV energy reforms are not bound to adopt it.

[59] Weiler and Wälde (2003), p. 35.
[60] Behrens and Egenhofer (2008), p. 241.
[61] *Electrabel*, *supra*, n. 39, para 4.167.
[62] Ibid., para 4.169.
[63] Laazouzi (2013), p. 492.
[64] Ibid.
[65] *Electrabel*, *supra*, n. 39, para 4.189.
[66] Ibid.
[67] Laazouzi (2013), p. 492.
[68] Sacerdoti (2010), pp. 240–246; Kauffman-Kohler (2007), pp. 368–369.

7 Beyond the Hermeneutic Solutions to the Conflict: Some Modest Proposals

The above analysis demonstrates that, due to the lack of the binding precedent doctrine and the great heterogeneity of approaches adopted by arbitral case law, the conflict between ECT and EU law obligations cannot be satisfactorily resolved through interpretative means. It is thus necessary to envisage an alternative approach. To this end, this article suggests a twofold strategy to overcome the persisting conflict between EU and the ECT in intra-EU cases.[69]

7.1 Long-Term Strategy

The enduring conflict between the ECT and EU law is due to the overlap between the two systems in intra-EU cases. This could be avoided if EU Member States would *disconnect* themselves from the ECT *vis-à-vis* cases falling within the scope of application of EU law.[70] In this respect, it is possible to envision two alternative courses of action. First of all, they might agree not to apply ECT substantial and procedural rules to intra-EU energy investment disputes. As a result, these disputes would be exclusively subject to EU law. Such an international agreement would be subject to the rules set out in the VCLT. In particular, Article 41 of the VCLT stipulates that the parties to a multilateral agreement may agree to modify it as between themselves on the condition that it is permitted or at least not prohibited by the multilateral agreement itself. In the latter case, such agreements should not impair the enjoyment of other parties' rights and be inconsistent with its object or purpose. As such an agreement would not impede the application of ECT investment and dispute settlement provisions to non intra-EU investment claims, the first condition would probably be met. However, whether such an agreement between EU Member States would satisfy the second condition is doubtful. Notably, one could argue that an investor-State dispute settlement mechanism is key to achieving the investment liberalisation objective enshrined in the ECT preamble. In addition, an agreement between EU Member States with such a far-reaching scope would not be the most appropriate and politically viable option to solve the conflict. Other ECT contracting States could raise objections or enter into similar agreements that would eventually undermine the ECT. Thus, it is submitted that a renegotiation of the ECT involving all its contracting States would be the best long-term option, even though the road leading to such an agreement would be long and fraught with difficulties. In the meantime, it is worth asking whether Member States ineluctably bear the heavy financial burden caused by this conflict or whether the Union should

[69]Needless to say, this strategy can be applied *mutatis mutandis* also to intra-EU BITs. See Mariani (2014), pp. 280–284.

[70]Kleinheisterkamp (2012), pp. 104–105; Dutheil de la Rochère (2011), p. 44.

intervene to alleviate their position. The more the number of intra-EU ECT-based arbitral proceedings grows, the greater the need for a prompt and fair solution.

7.2 Short-Term Strategy

The EU legal system contains the instruments to address this problem. Regulation 912/2014 sets out the rules for apportioning the financial responsibility ensuing from investor-State dispute settlement tribunals established by treaties to which the Union is party.[71] In particular, Article 3 of the Regulation stipulates that the financial responsibility must be attributed according to the principle of the "origin of the treatment".[72] That is to say that the Member States and the Union respectively bear the financial responsibility ensuing from their actions. More importantly, the Union will be also financially responsible for Member States' conducts that are "required by EU law". Admittedly, the rather vague language of this last criterion might create a great deal of uncertainty.[73] It is somewhat unclear what "required by EU law" means. Does it exclusively refer to the obligations consisting in the implementation of EU legislation through domestic measures? Does it refer to a wider range of obligations? For instance, one could wonder whether the financial responsibility of the EU could be invoked with respect to Member States measures adopted under the impulse of EU fiscal policy. This interpretative question can be solved by construing Article 3 in light of the objective of the regulation, namely a fair apportionment of financial responsibility between the Union and the Member States. In particular, recital No. 5 of the Regulation reads as follows:

> It would as a consequence be inequitable if awards and the costs of arbitration were to be paid from the budget of the Union where the treatment was afforded by a Member State, unless the treatment in question is required by Union law.[74]

By the same token, it can be argued that it would be unfair if the financial responsibility of the EU would arise only when a Member State violates investors' rights by transposing and implementing EU legislation. In addition, a restrictive interpretation of this disposition would be at odds with the fundamental principles of loyal cooperation and good faith enshrined in the EU legal order.[75]

[71]Regulation (EU) No 912/2014 of the European Parliament and of the Council of 23 July 2014 establishing a framework for managing financial responsibility linked to investor-to-State dispute settlement tribunals established by international agreements to which the European Union is party, *OJ* L257/121.

[72]European Commission, Explanatory Memorandum—Proposal for a Regulation establishing a framework for managing financial responsibility linked to Investor-State dispute settlement tribunals established by international agreements to which the European Union is a party, COM (2012) 335, 21 June 2012, p. 9.

[73]Tietje et al. (2013), pp. 20–21.

[74]Recital No. 5 of the Regulation 912/2014, *supra*, n. 71.

[75]See Klamert (2014), p. 63; Gormley (2008), p. 304.

Consequently, financial responsibility of the EU should also arise when Member States adopt measures to fulfil *all kind* of obligations stemming from EU law. However, this interpretation of the apportionment criteria contained in the Regulation 912/2014 would be of little help in the cases under consideration. In fact, this Regulation applies to arbitral proceedings initiated on or after 17 September 2014 and concerning treatments occurred after that date.[76] As a result, Member States are still exposed to financial responsibility for the claims brought in relation to the amendments to their renewable energy policies. Although there is no clear information on the amount of these claims, investment claims, particularly in the energy sector, can amount to hundreds of millions or even billions of dollars.[77] In the cases under consideration, the impact on host States budget might be even larger as several parallel arbitral proceedings were initiated. Thus, the already deteriorating situation of public finances of the respondent States might be further aggravated by this new financial burden. In brief, the financial consequences of this wave of arbitral proceedings might—at least partially—outweigh the beneficial effects on national budgets produced by the reforms of renewable energy policies, thereby compromising the compliance with EU fiscal discipline. The principles of fairness, good faith and loyal cooperation, immanent in the Regulation 912/2014 and in the EU legal order, should induce EU institutions to address this paradoxical situation.[78] All sums of money paid by Member States in the above cases, either awarded by arbitral tribunals or agreed upon as part of a settlement, should be rendered irrelevant for the purposes of the excessive deficit procedure, as they are *de facto* required by EU law. To this end, EU fiscal rules should be construed to neutralise the effects of the financial responsibility stemming from the violation of the ECT.[79] This would be possible at two different stages of the procedure.

First, the financial burden stemming from ECT violations might come into play when the Commission issues a report pursuant to Article 126.3 of the TFEU. In such a report, the Commission must weigh up the factors contained in the said provision as well as in Article 2.3 of the Regulation on the excessive deficit procedure.[80] Of particular relevance for our purposes are the expenses aimed at achieving the "objectives of the Union". There is little doubt that Member States pursue the objectives of the Union by enacting measures required or prompted by

[76]Article 24 of the Regulation 912/2014, *supra*, n. 71.

[77]For instance, the claims brought against Germany in reaction to its decision to discontinue the Nuclear Energy Programme amount to USD 1 billion. See generally Bernasconi-Osterwalder and Hoffmann (2012). See also *Anatolie Stati v. Kazakhstan*, SCC, Award, 19 December 2013 (USD 497.68 million); *EDF International v. Argentina*, ICSID Case No. ARB/03/23, Award, 11 June 2012 (USD 136.13 million).

[78]See Klamert (2014), pp. 41–46.

[79]It is worth noting that Member States pleaded for a flexible application of EU budgetary rules in order to absorb the costs associated with the migrant crisis. See Valero, EU drags on Stability and Growth Pact reform, Euractiv (2015), http://www.euractiv.com/sections/euro-finance/eu-drags-revised-stability-and-growth-pact-318395 (accessed December 2015).

[80]Regulation 1467/1997, *supra*, n. 19.

EU law, even though they are inconsistent with the ECT. Therefore, the Commission should take into account the financial responsibility stemming from the aforementioned arbitrations when preparing the report under Article 126.3 of the TFEU.

Second, the financial responsibility ensuing from violations of the ECT may be relevant when assessing compliance with the deficit and debt thresholds. According to Article 2.4 of the Regulation on the excessive deficit procedure, the Commission and the Council shall carry out these assessments by taking all the relevant factors into consideration. However, if the debt/GDP ratio exceeds the 60 % threshold, they can only consider the factors that do not bring about an excessive and permanent divergence from the reference values when assessing compliance with the deficit threshold. Applied to the cases under consideration, this disposition would lead the Commission and the Council to consider Member States financial responsibility as a crucial mitigating factor. In so doing, they would not only relieve Member States of the burdensome consequences ensuing from possible excessive deficit procedures, but also implicitly recognize the responsibility of the Union for these violations.

8 Conclusions

The recent wave of challenges brought by European investors against EU Member States PV energy policies uncloaked new possible conflicts between the ECT and EU law.

This article has shown that this conflict cannot be satisfactorily accommodated through hermeneutic means due to the variety of approaches adopted in arbitral practice and the lack of the binding precedent doctrine in international investment arbitration. This is because a *political* solution should therefore be preferred. EU Member States should renegotiate the ECT in order to *disconnect* themselves from this treaty with respect to intra-EU cases. Since this renegotiation is likely to be a long and complicated process, the EU should, in the meantime, undertake financial responsibility stemming from Member States' measures adopted to comply with EU law. Despite the lack of clarity of some of its provisions, the Regulation 912/2014 represents an important step forward in this respect. The origin of treatment criterion, if properly interpreted, may ensure a fair allocation of financial responsibility between Member States and the Union.

However, this regulation does not cover the recent cases that arose out of PV energy policy reforms in the EU. The financial responsibility ensuing from the arbitrations and the settlements that do not fall within the scope *ratione temporis* of the Regulation might even worsen the problematic situation of the public finances of the respondent States. Thus, this article has suggested that the rules governing the excessive deficit procedure should be interpreted in order to neutralise the effects of such a financial responsibility on Member States' budgetary positions.

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Part IV
Investment and Finance

The Final Volcker Rule and Its Impact Across the Atlantic: The Shaping of Extraterritoriality in a World of Dynamic Structural Banking Reforms

Elisabetta Cervone

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Abstract The Volcker Rule could potentially apply to the global structure of a foreign bank with US branches or any business of foreign banks with US counterparties. Concerns of an adverse extraterritorial impact—while mitigated in the implementing regulations—still matter. This Chapter, in considering the different approaches adopted by the United States and the European Union toward extraterritoriality, emphasizes the fact that, even when there is no global standard, mutual recognition based on equivalence would be a slow, complex process toward harmonization, but it might work. The purpose of this Chapter is to explore the prospects of harmonization and the development of global standards via extraterritoriality in banking structural measures, providing a view on the role national regulations as potential source of international financial law.

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1 Introduction

Extraterritoriality has become a hot topic in banking structural reforms, especially with the intensification of regulation in both sides of the Atlantic.

In the years since the crisis, we are confronted with the adoption, or planned adoption, of structural banking measures in several jurisdictions to impose restrictions on the scope of banking activity, limiting and overseeing proprietary trading. These initiatives include the so-called "Volcker rule"[1] and its implementing measures (hereinafter "Final Rule")[2] in the United States, the Banking Reform Act (implementing the "Vickers report")[3] in the United Kingdom and the European Commission Proposal on banking structural reform (hereinafter "European Commission Proposal")[4] based on recommendations from the Liikanen report.[5]

There have not been similar initiatives at the international level. In 2008, the Group of Twenty (G20) met in Washington, D.C., and committed to reform the global financial system.[6] Since then, the G20 has, among other things, implemented new liquidity and capital adequacy requirements for banks, taken steps toward regulating over-the-counter derivative markets and made recommendations for regulating the shadow banking industry.[7] However, markedly absent from the G20 agenda is a regulation of proprietary trading.

This Chapter focuses on the reforms in the United States, United Kingdom and the European Union because thy will create most concerns in terms of their impact on systemic stability in other countries. The Volcker rule's implementing measures went into effect in April 2014, ring-fencing in the United Kingdom will come into

[1]"Volcker Rule" is the colloquial name for Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (21 July 2010), which is codified as Section 13 of the Bank Holding Company Act of 1956, 12 U.S.C. §1851 (BHC Act).

[2]OCC, Federal Reserve, FDIC, and SEC, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5536 (10 December 2013).

[3]The reform in UK was passed in December 2013, implementing the key recommendations of the 2011 report by the Independent Commission on Banking (the "Vickers" report).

[4]European Commission, Proposal from the Commission for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions, COM (2014) 43. The proposal was first transmitted to the Council on 29 January 2014. It has been hotly debated both in the ECON Committee and the Council and is facing a great deal of criticism. On June 19th 2015 the ECOFIN Council agreed its negotiating stance.

[5]The High-Level Expert Group, chaired by Erik Liikanen, Governor of the Bank of Finland, was mandated by Commissioner Barnier to assess the need for structural reform of the EU banking sector. The so called "Liikanen report" was presented in October 2012. European Commission, Commission Staff Working Document Impact Assessment Annexes 1–4. Brussels, 29.1.2014, SWD (2014) 30. www.cdep.ro/afaceri_europene/CE/2014/SWD_2014_30_EN_DOCUMENTDETRAVAIL_f.pdf. Accessed 18 Jan 2016.

[6]See letter from Mark Carney, Chairman of the Financial Stability Board, to the G20 Leaders, Carney (2013), p. 1.

[7]G20 (2013).

force in 2019 and the EU rules are still subject to negotiations, after being rejected in May 2015 by the European Parliament.[8]

In dealing with "global banks", extraterritoriality issues arise. The Volcker Rule could potentially apply to the global structure of a foreign bank with US branches or any business of foreign banks with US counterparties. Numerous provisions regulate foreign banks' operations both inside and outside the United States, giving the US regulators the right to intervene in foreign banks' business. The exemptions granted for business that has clearly been transacted outside the United States are subject to a few conditions which in practice turn out to be restrictive. On the EU side, although the EU Proposal is intended to be applied to non-EU banks' branches, it gives the Commission the option of recognizing a non-EU country's legal system as equivalent.

These reforms differ in scope and strictness. There is the possibility that not adopting uniform approaches would affect efficiency and competitiveness of financial institutions and may even create new opportunities for regulatory arbitrage. Almost all participants, home and host, advanced and emerging markets, acknowledged the potential for significant cross-border spillover and expressed concern regarding the cost implications of multiple national rules imposed on internationally active banks.

It is, however, questioned the need for global standards to avoid regulatory fragmentation. There is also scepticism about the slow pace of international soft law and in international regulators' ability to have the right incentives to control systemic risk. In addition, territoriality, especially in banking structural reforms, often matters. Some diversification in national approaches is inevitable, reflecting existing differences in banks' business models, size and concentration of banking system, level of development of financial markets and prevalence of non-bank financial intermediaries. A decision to apply a domestic framework

[8]The proposal was first transmitted to the Council on 29 January 2014. The proposal has been hotly debated both in the ECON Committee and the Council and is facing a great deal of criticism. The ECON Committee published a draft report on the Commission's proposal: the Hökmark report on Bank Structural Reform. The European Parliament's rapporteur on bank structure reform, Gunnar Hökmark, in his draft report, proposed a number of significant amendments, including changes that would weaken the objectives, scope, definitions, mechanism and sanctions in the Commission's original proposal. The justification provided is that universal banks play an important role in financing commercial investments and that the drivers are residual systemic risks (i.e. risks that may remain even after the application of existing frameworks such as capital requirements or resolution planning). However, the vote in Committee which took place 26 May 2015 resulted in the ECON Committee rejecting the report by one vote: 30-29 with one abstention. The decision on future progress will be left to the ECON coordinators, which usually meet with the ECON Chair during every Strasbourg week to decide on the major procedural steps for the Committee. There remains the necessary political intention to make progress on bank structural reform, so the idea that this file will be withdrawn by the Commission is somewhat exaggerated. On June 2015 the ECOFIN Council agreed its negotiating stance. On the basis of this mandate, the incoming Luxembourg presidency will start negotiations with the European Parliament as soon as the latter has adopted its position. Better Regulation (2016).

extraterritorially may depend on whether this is necessary to achieve the (largely domestic) goal of the regulation.

The purpose of this Chapter is to explore the prospects of harmonization and the development of global standards via extraterritoriality in banking structural measures, proposing a view on the role of national regulations as potential source of international financial law. Although scholars have long recognized the extraterritorial effects of various financial rules, extraterritoriality is generally examined in the context of the conflicts of law literature.[9] This Chapter intends, instead, to explore the possibilities of extraterritoriality as a regulatory strategy, specifically looking at equivalence clauses used to export the national regulatory model.

While the strict extraterritoriality of the Volcker Rule has been reduced in the Final Rule implementing it, too much rigidity still exists. While the Final Rule does offer some concessions to non-US banking organizations (so called "Foreign Bank Organizations" or FBOs), at the same time, it introduces them into a US-centric compliance and reporting regime that will inevitably conflict with home country customs and requirements. This rigid approach to regulation may hinder future crisis management.

2 Transatlantic Structural Reforms

2.1 Basic Rationale of Structural Reforms

Restrictions on banks' business lines have been relaxed since the 1970s, in parallel with the deregulation of financial markets. There was a broad consensus that universal banks can provide the largest economic benefits in a rapidly growing global economy.[10] Diversification of business lines, innovations in risk management, market-based pricing of risks and market discipline were seen as effective safeguards against financial risks associated with the rapid expansion of large universal banks.[11]

After the financial crisis of 2007, economic costs and benefits of the involvement of universal banks in proprietary trading and other securities markets activities have been reassessed. Many large universal banks shifted too many resources to trading books, supported by cheap funding.[12] The complexity of many banks weakened market discipline, while their interdependence increased systemic risk, contributing to contagion within and across firms. Though the crisis has shown the need to strengthen market-based pricing of risk and market discipline, the heavy burden of

[9]On the diverse approaches used by US courts, see, for example, Buxbaum (2001), pp. 225–226; McConnaughay (1999), p. 262; Symeonides (2001), p. 1; Trautman (1961), p. 617.

[10]Gambacorta and Van Rixtel (2013), p. 1.

[11]Ibid.

[12]Ibid.

bank losses imposed on taxpayers has raised questions about the separation of certain banking activities.

A number of jurisdictions have then taken initiatives to address the above concerns. In the last years some EU Member States have engaged in reforms (including Germany, France, the United Kingdom and Belgium).[13] The United States has adopted the Volcker Rule.

The basic rationale for these reforms is to insulate certain types of financial activities, regarded as especially important for the real economy or significant on consumer/depositor protection grounds, from the risks that emanate from potentially riskier, but less important activities. These initiatives are designed to reduce these risks in several ways. *First*, and most directly, they can shield the institutions carrying out the protected activities from losses incurred elsewhere. *Second*, they can prevent any subsidies that support the protected activities (e.g. central bank lending facilities and deposit guarantee schemes) from lowering the cost of risk-taking and encouraging moral hazard in other business lines. *Third*, they can reduce the complexity and possibly size of banking organizations, making them easier to manage, more transparent to outside stakeholders and easier to resolve; this in turn could improve risk management, contain moral hazard and strengthen market discipline. *Fourth*, they can prevent the aggressive risk culture of the riskier activities from infecting that of more traditional banking business, thus reducing the scope for conflicts of interest. *In addition*, smaller institutions would reduce the risk of regulatory capture.

The common element of all the regulatory initiatives is to restrict universal banking by drawing a line somewhere between "commercial" and "investment" banking businesses. The proposed changes do not go as far as the previous strict separation of commercial from investment banking that existed in some jurisdictions, such as the United States.[14] Restrictions on universal banking would be new, however, for many countries, notably a number of continental European ones.

2.2 *Regulatory Disparities: Volcker Rule v. European Commission Proposal*

Beyond their basic similarities, structural reform initiatives differ in scope and strictness.[15]

The Dodd-Frank Act was enacted on 21 July 2010.[16] Section 619 of the Act added a new Section 13 (the "Volcker Rule") to the BHC Act. The Volcker Rule

[13]On the economic underpinnings of the reforms, Vickers (2012) and Lehmann (2014).

[14]Gambacorta and Van Rixtel (2013), p. 1.

[15]Ibid., pp. 8 ff.

[16]Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

consists of two parts: one prohibits any bank[17] from engaging in proprietary trading, the other prohibits any bank from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (so called "covered funds rule"), subject to certain exemptions.[18]

In December 2013, five financial regulatory agencies[19] adopted the long-awaited Final Rule, which implements the Volcker Rule. The Final Rule prohibits any bank from engaging in proprietary trading[20]; requires firms with significant trading operations to report to the relevant Agency a number of quantitative measurements that are designed to assist the Agencies and banks in identifying prohibited proprietary trading that might occur in the context of exempt activities[21]; prohibits any bank from acquiring or retaining an ownership interest in, or having certain relationships with, a hedge fund or private equity fund ("covered fund"), subject to some exemptions[22]; requires banks to establish an internal compliance program designed to help ensure and monitor compliance with the prohibitions and restrictions of the statute and the Final Rule.

By including virtually all dealing positions, the Volcker rule definition of "proprietary trading" is extremely broad. *However*, this prohibition is subject to exemptions for underwriting,[23] market-making activities,[24] risk-mitigating

[17]The term "banking entities" includes FDIC-insured depository institutions, US bank holding companies, non-US banks with a US branch or agency, and any affiliates of the foregoing around the globe, whether or not they are organized or located in the United States.

[18]On the covered funds rule, on the choice by the legislator and regulators to use Investment Company Act definitions to set the scope of the rule and on the critical implications of this choice, Gerding (2015).

[19]The Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) (collectively, the "Agencies"). On the Volcker Rule's complex regulatory framework involving five government agencies, which was undoubtedly a factor in delaying the Rule's time to adoption, Baker (2015), p. 433. On the implementation of the Volcker Rule as a singular test for reconciling the complementary approaches of US financial regulators, Dombalagian (2015).

[20]Under the statute, "proprietary trading" involves acquiring or taking positions as principal in any security, derivative, option or contract for sale of a commodity for future delivery for the purposes of selling the security or position in the near term or otherwise with the intent to resell to profit from short-term price movements.

[21]The reporting requirements would be phased in based on the type and size of the firm's trading activities.

[22]Exemptions are for investments made in connection with organizing and offering a covered fund, making and retaining *de minimis* investments in a covered fund, activities of FBOs solely outside the United States and certain other activities.

[23]This exemption would require that a bank acts as an underwriter for a distribution of securities (including both public and private offerings) and that the trading desk's underwriting position be related to that distribution.

[24]Under this exemption, a trading desk would be required to routinely stand ready to purchase and sell one or more types of financial instruments. A market-making desk may hedge the risks of its market-making activity under this exemption.

hedging,[25] activities of FBOs solely outside the United States and certain other activities. The Final Rule makes other exemptions[26] and clarifies which activities are not considered proprietary trading,[27] provided certain requirements are met. Similar to the Volcker Rule, the Final Rule limits these exemptions if they involve a material conflict of interest, a material exposure to high-risk assets or trading strategies or a threat to the safety and soundness of the bank or to financial stability in the United States.

Because of the reach of the term "banking entity", all of a covered banking organization's operations around the world may be subject to the Volcker Rule's restrictions, even if the organization, or the activities in question, has limited connection with the United States. However, the Final Rule does offer some concessions to non-US banking organizations (hereinafter "FBOs"). These concessions and the extraterritorial effects of the Final Rule will be analysed in the next session of this Chapter.

Compared to the Final Rule, the EU Proposal differs in scope and strictness.

In 2014 the European Commission, following the Liikanen Report, proposed a set of structural reforms prohibiting certain large EU banks from operating standalone proprietary trading desks. The EU Proposal introduces the concept of "core credit entity" and requires trading activity or the holding of shares in a hedge fund to be located outside this core entity. The two entities can reside within one group, but the core credit entity would not be permitted to hold equity in the trading entity.

The EU Proposal is somewhat broader in scope than the Volcker Rule: it seeks to carve out both proprietary trading and market-making, without drawing a distinction between the two.[28] It is also less strict: it allows these activities to coexist with other banking business within the same group as long as these are carried out in separate subsidiaries.

The EU Proposal is narrow in its content. *First*, the Proposal prohibits only large banks and banking groups from carrying out proprietary trading and certain related activities. *Second*, in view of the challenges derived from the difficult distinction between proprietary trading and other similar trading activities, market making in particular, a narrow definition of activities subject to the prohibition is provided. *Third*, the EU Proposal allows national authorities broad ability to grant exceptions. *Finally*, most importantly for extraterritoriality effects, the European Commission

[25]This exemption applies to hedging activity that is designed to reduce specific, identifiable risks of individual or aggregated positions of the bank.

[26]For example, it is allowed trading on behalf of a customer in a fiduciary capacity or in riskless principal trades and activities of an insurance company for its general or separate account.

[27]Such activities include trading solely as an agent, broker, or custodian; through a deferred compensation or similar plan; to satisfy a debt previously contracted; under certain repurchase and securities lending agreements; for liquidity management in accordance with a documented liquidity plan; in connection with certain clearing activities; or to satisfy certain existing legal obligations.

[28]Gambacorta and Van Rixtel (2013), p. 8.

can approve an exemption for banks in a jurisdiction where an equivalent regime is in place since January 2014 (including foreign branches and subsidiaries).

The Volcker Rule appears to differ from the EU Proposal in a number of significant respects.

Compared with the European Commission Proposal, the Final Rule seems to be narrow in scope, but it is quite strict in general. The Final Rule applies a broader definition with respect to European Union rules of prohibited trading: it forbids the coexistence of such trading activities and other banking activities in different subsidiaries within the same group; it similarly prevents investments in, and sponsorship of, entities that could expose institutions to equivalent risks, such as hedge funds and private equity funds. Also, the current legislation in the United States does constrain the activities of depository institutions. For example, it restricts banks' dealings with affiliates, which can be seen as a degree of ring-fencing.[29]

2.3 *The Final Volcker Rule and Its Application to Foreign Banks*

According to the Volcker Rule, any non-US bank that operates a branch or agency office in the United States, or that controls a US subsidiary bank, and the parent of each such entity, is subject to the Final Rule's restrictions.

Likely, fears of an adverse extraterritorial impact of the rule have been eased when financial regulators jointly issued the Final Rule. The case for the extraterritorial application of the Volcker Rule to FBOs seems limited, when compared to the Proposed Rule.

First, to limit the broad extraterritorial scope of the proprietary trading provisions, the Final Rule permits FBOs to engage in otherwise prohibited proprietary trading under the a "solely outside of the United States" trading exemption (so-called SOTUS exemption). The proposal would have prohibited proprietary trading where the transaction in question was entered into outside of the United States by a FBO if the trade "touched" the United States in any of a number of ways, including if it cleared through a US exchange. The Final Rule, instead, is less restrictive in interpreting the SOTUS exemption. It adopts a risk-based, rather than transaction-based, approach to the SOTUS standard and generally does not apply to activity that does not involve decisions made, or risk booked, in the United States.[30] Foreign transactions conducted by FBOs may be exempted from the restriction if no

[29] 12 CFR 223—Transactions between Member Banks and Their Affiliates (Regulation W), implementing Sections 23A and 23B of the Federal Reserve Act of 1933. Such sections have been substantially widened and strengthened by section 608 of the Dodd-Frank. See Vickers (2012), p. 16.

[30] Preamble, p. 5541.

financing for the transactions is provided by US affiliate and the purchase is not conducted through any US entity. In addition, transactions could be exempted if FBOs use exchanges based in the United States, central counterparties or unaffiliated market intermediaries: clearing a trade through a US exchange or swap execution facility on an anonymous basis does not impact SOTUS status under the Final Rule. This risk-based approach is consistent with the SOTUS exemption for proprietary trading in the statute, which focuses on trading as principal where the purpose is to benefit from short-term price movements.

Second, the Final Rule differs from the Proposed Rule on trading sovereign debt. Foreign authorities and banks were concerned about the adverse impact of the Proposed Rule on the liquidity of sovereign debt markets. The Final Rule appears to have mitigated these concerns: foreign sovereign bonds are now exempted from the ban on trading by FBOs (within reasonable limits). Trading is permitted by the US operations of a FBO (other than an insured depository institution) in obligations of the home authority of the FBO[31]; in addition, the Final Rule provides an exemption which would permit foreign subsidiaries (or foreign securities broker-dealer) of US banks trading in obligations of the host country of the foreign subsidiaries (or foreign broker-dealer).[32]

Third, the Final Rule permits a FBO to acquire or retain any ownership interest in, or act as sponsor to, a covered fund so long as the activity is conducted "solely outside of the United States" and no ownership interest in the covered fund is offered for sale or sold to a resident of the United States.

Fourth, the Final Rule differs from the Proposed Rule on foreign public funds. Closely related to the foreign fund exemption is the definition of foreign public funds in the Final Rule. The Proposed Rule did not define as covered funds US mutual funds and similar retail investment structures, but captured highly similar non-US structures (such as non-US mutual funds). While some commenters suggested that FBOs could organize and invest in those structures pursuant to the foreign fund exemption, the Final Rule definitively clarifies that such structures are not covered funds and are then entirely outside the scope of the Final Rule.[33]

[31]This exemption promotes safety and soundness and financial stability by allowing the US non-insured depository institution operations of FBO to facilitate the depth and liquidity of sovereign debt of the home country of the FBO.

[32]This exemption similarly promotes safety and soundness and financial stability by allowing US banks to own and operate banks and securities broker-dealers overseas that are permitted to facilitate liquidity in the sovereign debt of the host country of the foreign entity.

[33]Milbank (2013), p. 8.

3 "Localization", Extraterritoriality and the Aim for Effective Global Standards and Coordination

3.1 Economic History and the Unavoidability of "Localization"

In view of the proliferation of reform initiatives in this context, and with a view to prevent overlapping or incompatible measures affecting internationally active banks, the G20 leaders in Saint Petersburg called on the Financial Stability Board to assess cross-border consistencies and global financial stability implications of structural banking reforms.[34]

However, there is scepticism about creating a system that is regulated by a single rule. It would create a system that is vulnerable to a single set of risks.[35] There is also scepticism about the slow pace of international soft law and international regulators' ability to have the right incentives to control systemic risk.

The importance of preserving national regulatory regimes has been highlighted by the G20 St Petersburg Summit.[36]

Local regulatory reforms are influenced by the different shapes of national banking systems, which largely reflect economic history and the different roles banks have played in financing economic development. Banking systems have developed differently in Anglo-Saxon countries compared to continental Europe. Whereas nearly all attention as regards structural reform has focused on the Volcker Rule, that rule builds on a long history in the United States of bank structural regulation.[37] A discussion of the Volcker rule should be placed in that broader context.[38]

Restriction and isolation of the core banking activities within broader financial groups constitute one of the three pillars on which structural regulation in the United States is built. The other two pillars are the separation of banking from commerce[39] and limits on the institutional concentration of the banking and financial sector.[40]

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[34]G20 Leaders (2013).

[35]Whitehead called it "destructive coordination". Whitehead (2011), p. 323.

[36]The G20 Leaders agreed that "jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes". G20 Leaders (2013).

[37]European Commission, COM (2014) 43, *supra*, n. 4, p. 6.

[38]Ibid., p. 7 and Brown (2014), pp. 1038 ff.

[39]In the United States, a company that controls a bank holding company cannot engage in activities of a commercial nature, be it directly or indirectly through a subsidiary.

[40]Market concentration in the United States has historically been limited by e.g. geographic restrictions that limited the ability of banks to establish or buy branches in other States. The 1994 Riegle-Neal Act liberalized these interstate branching limits. European Commission, COM (2014) 43, *supra*, n. 4.

In continental Europe, industrialization occurred later and substantial amounts of capital were needed to catch up with the industrial forerunners. Given that capital markets were less developed, banks became the main source of financing to the large corporates who required a universal set of services.[41]

The universal banking model, which has therefore long historical roots in the European Union, prior to the start of the financial crisis, had accordingly gained prominence internationally.[42]

3.2 The Danger of "Unilateral Extraterritoriality"

This "localization", and differences in local regulatory reforms that depend on it, could be a serious threat to banks. Such reforms, even when well designed, may make the system as a whole more, instead of less, risky. There could be a tendency to negotiate specific one-off exceptions. Migration and fragmentation are constantly issues for the private sector, with pressures on their regulators to favour their own jurisdiction.

While the rationale behind the extraterritorial effects of the Volcker Rule is that these activities involve a high degree of risk and would pose systemic risk to the US financial system, when the United States regulates a US entity's conduct, wherever that conduct takes place and whether conducted by the US-based parent or its non-US affiliates, it regulates conduct outside the United States in a manner that may be inconsistent with the rules applicable in the jurisdiction in which the conduct takes place.

The Final Rule has a more "open" regulatory philosophy, which would encourage competition and enhance liquidity[43] and transparency[44] in the markets. However, the approach adopted is still too restrictive and, cutting off US financial markets from foreign capital, it would result in the financial markets moving offshore.

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[41]For further details, European Commission, COM (2014) 43, *supra*, n. 4.

[42]For details about the historical evolution of national banking systems, see Casserley et al. (2010), pp. 15–23; Morrison (2010); De Young (2010); Goddard et al. (2010); Goodhart (2013).

[43]Allowing FBOs to access to US exchanges and clearing facilities prevents the potential adverse impacts from possible reductions in competitiveness of or liquidity available on these regulated exchanges and facilities, which could also harm other US market participants who trade on these exchanges and facilities. This approach is also consistent with and reinforces the goals of the central clearing framework of Title VIII of the Dodd-Frank Act. See Federal Reserve Staff (2013), p. 16.

[44]Prohibiting FBOs from trading on US exchanges and clearing facilities would likely reduce transparency for trading in financial instruments in the United States. At the same time, to the extent US intermediaries that might be counterparty to FBOs as participants in the exchange or central counterparty are US banks subject to section 13 of the BHC Act, those US banks would remain subject to all the restrictions of the Final Rule. Consequently, the exemption would not introduce new risks to the US financial system. See Federal Reserve Staff (2013), p. 16.

The Final Rule, in fact, permits an FBO to rely on the exemption (without having to show that the trade falls into another compliance-laden exemption, such as market-making, etc.) only if: the FBO acts as principal in the purchase or sale outside the United States; the personnel of the bank (or its affiliates) that arrange, negotiate, execute or decide to undertake the trade are not located in the United States; the bank that makes the decision to purchase or sell is not located in the United States; no financing for the bank's purchase or sale is provided by a US affiliate of the FBO; and the purchase or sale is not conducted with or through any "US entity", which includes any entity (including a branch of a foreign bank) that is located or organized in the United States, or is controlled by or acting on behalf of another US entity (with some exceptions).

The above assertion of unilateral extraterritoriality would enhance the concern that the US approach ignored national sovereignty and represented a return to prior tradition of US imperialism.[45]

First, the definition of US entity is broad, reaching both the US-based broker-dealer affiliates of FBOs and any affiliate of any US banking organization or broker-dealer. Thus, any trade intermediated or facing those entities would not qualify for SOTUS.

Second, it does not appear that the SOTUS exemption for trading with US entities through market intermediaries is broad enough to allow access to the US market without use of the other exemptions. The exemption requires the transaction to be cleared, but there will remain a wide variety of transactions, especially in the OTC derivatives field, that will remain bilateral. If trading desks of FBOs outside the United States must use the exemptions for market-making, underwriting or hedging to trade in uncleared instruments with counterparties inside the United States, they apparently will be forced to implement the detailed US-specific Volcker compliance regime in their home (and other host) countries. Their only alternative will be to access the liquidity of the US markets through the non-US offices of United States banks.

Third, the availability of the SOTUS exemption continues to depend on the physical location of FBO's personnel involved in a trade. If an FBO's personnel located in the United States "arrange, negotiate or execute" a trade, SOTUS is unavailable for that trade. This location-based restriction means that US-based personnel cannot solicit, sell or arrange trades—no matter how little involvement such people otherwise had with the trade—without triggering the more onerous compliance obligations of the Final Rule.[46] This focus on personnel location presents an obstacle for FBOs that wish to manage part of their business in the United

[45]On the inadequacy of the SOTUS exemption to take into account the existing framework for trading activities under US law and market structure, Massari (2015), which analyses its application to two types of securities transactions—trades on US securities exchanges and internalized trades—conducted by a hypothetical bank.

[46]Though such personnel could engage in back-office functions such as trade clearing or settlement, without being seen to be arranging, negotiating or executing a trade. Preamble, p. 5655, fn 1521.

States while booking trades outside. Although the stated purpose of this provision is to keep the risk of non-US proprietary trades outside of the United States, it is hard to see how having US personnel perform some (or any) function as part of a trade increases any risk in the United States. This provision appears to contradict a statement in the Preamble, relating to non-US trading activities of US banks, that "[t]he risks of proprietary trading would continue to be borne by the US bank whether the activity is conducted ... through units physically located inside or outside of the United States".[47] That statement recognizes that risk lies where trades are booked, rather than where some personnel sit. Consequently, the Final Rule will require FBOs to use one of the other exemptions from the proprietary trading ban if any personnel or entities based in the United States are modestly involved in the transaction.

Fourth, the Final Rule adds a requirement, to be satisfied in order to be qualified for a SOTUS exemption, that the trade not be financed "directly or indirectly" by the US branch or agency of an FBO. It is difficult to justify this provision: the Preamble merely states that it is not intended to restrict the ability of US branches and agencies of FBOs to provide funding to their foreign head offices.[48]

Finally, notwithstanding the Agencies adopted many of the comments submitted by FBOs on the Proposed Rule, the Final Rule still creates significant compliance and reporting burdens for FBOs, in the absence of any interpretative guidance from the Agencies and with very little deference to the equivalence of home country legislation. FBOs with substantial trading operations in the United States will have to submit to the relevant Agency periodic reports on the proprietary trading activities that each trading desk conducts under available exemptions. These reports are intended to assist the Agencies in determining whether the bank is complying with the proprietary trading provisions of the Final Rule.[49] Notably, the Final Rule requires this data on a trading desk basis, which is defined in part as the "smallest discrete unit of organization" of an FBO that trades a financial product. So, even if an FBO currently collects any of this data on a consolidated basis, it may still face considerable systems challenges to reorganize the data on a trading desk basis.[50]

The Volker rule's restrictions could raise concerns on an intrusive application of US rules extraterritorially. Extraterritoriality needs to be selective. It should be limited to instances where there are genuine jurisdiction-specific issues to be addressed. On the US side, there was the fear that absent extraterritoriality coverage, major financial institutions could park their higher risk operations outside the United States and thus escape one of the main goals of the Dodd-Frank Act: financial stability.

However, here the Dodd-Frank Act may reach too far. The case for the extraterritorial application of the Volcker Rule to foreign banks is limited: it should

[47]Preamble, p. 5656.

[48]Ibid., p. 5655, fn 1522.

[49]Milbank (2013), p. 9.

[50]Ibid.

extend only to the offshore activities of US banks (and their subsidiaries and affiliates) and possibly to foreign banks with a major presence in the United States. Only to the extent that the counterparty's failure can endanger a US institution does a basis exist (even under the statutory language of the Dodd-Frank Act) for the United States to bar the foreign entity from proprietary trading. Even if the foreign bank's trading activities were planned and orchestrated in the United States, they do not seem likely to threaten the safety and soundness of the US financial markets.

3.3 Toward Equivalence and Mutual Recognition (or Substituted Compliance) in Developing Global Standards

Being major financial jurisdictions, the United States and the European Union have the right incentives to curb systemic risk. They are exposed to it. Their assertion of extraterritorial jurisdiction is necessary to create a governance structure under which highly mobile financial institutions cannot flee to less regulated venues. However, authorities with such high-quality regulatory regimes should more frequently rely—rather than on the "unilateral extraterritoriality" approach adopted by the United States in the Volcker Rule—on mutual recognition arrangements with one another and on bilateral negotiations among them and with other major financial centres. The "unilateral extraterritoriality" approach differs consistently with the EU approach to the regulation of foreign banks in banking structural reforms.

The European Union adopts a mutual recognition approach based on equivalence decisions. The EU Proposal *does* have extraterritorial effects. It will apply to EU credit institutions and their EU parents, their subsidiaries and branches, including in third countries. It will also apply to branches and subsidiaries in the European Union of banks established in third countries. Such a broad territorial scope is justified to ensure a level playing field and avoid the transfer of activities outside the Union to circumvent these requirements. However, differing from the Volcker Rule, the EU Proposal has *no* unilateral extraterritorial effects. Foreign subsidiaries of EU banks and EU branches of foreign banks could be exempted if they are subject to measures that in the opinion of the Commission are deemed to have equivalent effect to those in the Regulation.[51] Article 4.2 foresees another potential exemption: supervisors have been granted the power to exempt from separation foreign subsidiaries of groups with an EU parent if those are autonomous (with autonomous geographic decentralized structure pursuing a so called "Multiple Point of Entry" resolution strategy) and if the impact of their failure would have limited effects on the group as a whole. By applying the separation requirement throughout the global corporate group irrespective of geographic location, the

[51]European Commission, SWD (2014) 30, *supra*, n. 5, arts 4 and 27.

potential for banks circumventing separation by locating particular activities outside the European Union is eliminated.

An alternative route to mutual recognition is through the concept of "substituted compliance", which has been introduced and advocated by prominent doctrine[52] in the United States and applied for the first time explicitly in the Commodity Futures Trading Commission (CFTC) interpretive guidance on cross-border application of some swap provisions.[53] According to the "substitute compliance" approach, a foreign entity may comply as to certain entity level requirements with its home country rules provided those are comparably robust. Mutual recognition and substituted compliance agreements allow market participants from one jurisdiction to operate in another as long as they comply with their (essentially equivalent) home country rules. In principle, US financial regulators could have potentially pursued a "substituted compliance" or mutual recognition approach, with respect to the Volcker Rule, but they did not.

By supplementing the broad territorial coverage with a third country equivalence regime, the possible extraterritorial concerns of third country jurisdictions are mitigated. In requiring foreign banks to separate their operations in the European Union, a level playing field in the internal market is also ensured and thereby the risk of unfair competition is minimized.

The EU Proposal does not envisage each party making binding declarations of the equivalence of the other's entire regulatory and supervisory framework, but rather carrying out a detailed assessment of the consistency of the implementation of each standard.[54] To ensure compliance, formal adoption of legal requirements has to be complemented with an assessment of supervisory and enforcement tools in the country.[55] The growth of domestic and regional macro-prudential supervisory authorities such as the Federal Stability Oversight Council in the United States and the European Systemic Risk Board in the European Union should be able to reinforce supervision and enforcement of banks operating cross-border.

This approach allows the parties to respect each other's regulatory models and legal traditions, without need of changing the existing legislation and without slowing down the current regulatory process. Incidentally, cross-border comparison will also provide an opportunity for domestic self-assessment.[56] At the same time, this approach can ensure, if certain conditions are met, that different rules can work together, provided that they are made consistent.[57] Instead, subjecting the global banking industry to a single set of global rules would greatly increase convergence

[52]Tafara and Peterson (2007), p. 32. Greene and Pothia (2012), p. 310; Greene and Pothia (2013), p. 338.

[53]CFTC (2013).

[54]Preamble of the EU Proposal, p. 19.

[55]Jackson (2015), p. 185.

[56]Ibid., p. 195.

[57]Gallagher (2015).

in the banks behaviour, which may result in the development of a system vulnerable to the same risks.

In recent regulatory reforms dealing with international actors, such as credit rating agencies,[58] the European Union has taken care that mutual recognition is not perceived to depend upon the direct equivalence, clause by clause, of the foreign regulations to be recognized; rather it has been judged in terms of consistency of goals and comparability of outcomes. Requiring highly literal, provision-by-provision "equivalence" determinations can paradoxically increase rather than decrease extraterritorial effects, and, at worst, lead to extraterritorial conflicts among jurisdictions.

This approach realizes that a strict equivalence regime would be difficult to achieve today, when all countries are tasked with upgrading their financial systems. Mutual recognition and substituted compliance were developed in an environment in which countries would incentivize each other to raise standards by offering foreigners easier access to domestic markets once regulations in their home countries were equivalent to their own. In a world of dynamic market reform, instead, mutual recognition and substituted compliance programs should become more robust, and provide procedural mechanisms for coordinating rule-making and administrative processes in an ongoing, collaborative process.

It is impossible for one jurisdiction to recognize another's regulatory regime as equivalent if the latter has not yet taken any commensurate action. However, we should not expect that, absent extraterritorial regulation by the United States, EU banks will be unregulated. All countries, and private actors within them, have incentives to cooperate to a certain extent, in order to minimize the possibility of another financial crisis. There is a "consonance of interests"[59] to "expand gains from cooperation",[60] based on the interconnectedness of domestic economies. If all States agree at least to not go beyond a minimum level of shared expectations, they would tend to prevent a regulatory "race to the bottom". Their continuous work together will help to develop the blueprint for the international architecture of banks cross-border activity.

To the extent that regulators have considerable discretion in appraising functional equivalence, then it seems relevant that the European Union has developed a functionally similar (while far from strictly equivalent) structural protection that parallels the Volcker Rule: the "ring-fencing" safeguard limits which entities within banks may engage in proprietary trading.

On the one hand, both the US and the EU jurisdictions appear to be adopting different standards and approaches with regard to the regulation of FBOs. The UK Regulation and the European Commission Proposal, respectively, would "ring-fence" proprietary trading and market-making outside of the retail bank, but not

[58]On extraterritoriality issues and legal assessments based on equivalence in the credit rating industry, Cervone (2015).

[59]Brummer (2010), p. 634.

[60]Raustiala (2002), p. 2.

exclude them from the banking organization as a whole. We therefore still face a situation in which US rules prohibit banks from conducting particular activities while UK and EU rules would instead ring-fence particular activities from the banking group.

On the other hand, however, at least they both aim to same goal of reducing systemic risk. Financial stability is a global public good[61] that provides a rationale for a more aggressive approach to extraterritorial financial regulation. From this perspective, the United States may be justified in prohibiting the affiliates and subsidiaries of US banks from engaging in proprietary trading abroad, but it has much far less justification in seeking to preclude FBOs from doing so. At most, it can assert that proprietary trading within the United States endangers its interests. Thus, a more limited reach of the Volcker Rule with respect to FBOs should be endorsed.

4 Conclusions

This Chapter has investigated the practical complexities and inefficiencies arising from the extraterritorial reach of the Volcker Rule. Such "unilateral extraterritoriality" leads to regulatory fragmentation. In addition to the costs imposed on banks and the loss of efficiency in the market, it impinges on the sovereignty of jurisdictions different from the United States and may conflict with their own regulatory regimes and policy goals.

This Chapter has then analysed the extraterritorial regime based on "enlightened equivalence"—as opposed to "unilateral extraterritoriality"—which has been applied in the EU banking structural reforms. In terms of curving systemic risk—which is the principal purpose of both the Volker Rule and the EU Proposal—the two sets of legislation are functional equivalent. While those specific regulations may differ, both the US and the EU regulators can have confidence in one another's regimes to achieve broadly comparable outcomes. If global standards existed, mutual recognition among those regulators would have greatly increased regulatory effectiveness and efficiency, especially given the increase of complexity of regulations affecting cross-border transactions and firms. Where a common, cross-jurisdiction issue is identified but there is no global standard—as in current structural reforms—it is equally important that policymakers work toward mutual recognition of local standards.

The ability of one jurisdiction either to determine equivalence or to enter into mutual recognition arrangements with third countries will have a material impact on the ability of cross-border financial services activity to flourish in the post-financial crisis era. Once the ground rules are set by those jurisdictions with the right incentives—which should be proactive in opening a dialogue to define what

[61] Trachtman (2010), p. 721.

should constitute "sufficient" functional equivalence—they should then approach other countries to follow their standards, rather than await a global consensus and harmonization.

The "enlightened" equivalence regime, as envisioned in this Chapter, would lead to more (not less) financial stability in banking structural reforms. It would close loopholes, avoid regulatory arbitrage, stop efforts to force the European Union and the United States into a competitive downgrading of regulation, establish better mechanisms for supervisory cooperation and swift reaction to market developments, provide more predictable, consistent and stable regulatory approaches. Ultimately, this assertion of "enlightened" extraterritorial authority may be an interim stage in the longer-term development of adequate international "soft law" standards. Mutual recognition of equivalent standards process is slow, complex, but it might work, also in a new area such as the one of banking structural reforms.

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More Than a Friend? The European Commission's *Amicus Curiae* Participation in Investor-State Arbitration

Olga Gerlich

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Abstract The European Commission sought participation as *amicus curiae* in a number of recent Investor-State arbitrations. The European Commission's *amicus* participation differs substantially from the participation of the traditional *amici curiae* in investment arbitration, in particular due to the European Union's direct interest in the result of the proceedings. This Chapter examines the differences between *amicus curiae* participation and intervention through an analysis of the European Commission's *amicus* participation in four investment arbitrations: *Eureko v. Slovakia, EURAM v. Slovakia, Electrabel v. Hungary, AES v. Hungary,* and *Micula v. Romania*. The author of this Chapter argues that the European Commission's *amicus curiae* participation closely resembles another form of third party participation, namely intervention, and may mark a development in third party participation in international investment arbitration.

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1 Introduction

Amicus curiae participation in international investment arbitration has undergone a substantial development over the last years. In the ground-breaking *Methanex* case,[1] a North American Free Trade Agreement (NAFTA) tribunal for the first time accepted an *amicus curiae* submission in Investor-State arbitration proceedings deriving its power to do so from its general discretion to "conduct the arbitration in such manner as it considers appropriate".[2] Since then we have observed a progressive opening of investment arbitration proceedings to third party participants. International investment arbitration rules have formalised and established criteria for *amicus* participation.[3] Among the actors appearing as *amici* in arbitration proceedings, the European Commission is a particularly distinctive one.

The European Commission has submitted a number of *amicus curiae* briefs in the past[4] as well as in the ongoing international investment arbitrations.[5] The Commission's participation in the proceedings differs substantially from the

[1] *Methanex v. the United States*, (NAFTA) UNCITRAL, Decision of the Tribunal on Petitions from Third Persons to Intervene as *Amici Curiae*, 15 January 2001.

[2] Art 15(1) of 1976 UNCITRAL Arbitration Rules, now art 17(1) of the UNCITRAL Arbitration Rules (as revised in 2010).

[3] NAFTA Free Trade Commission, Statement of the Free Trade Commission on Non-disputing Party Participation (7 October 2003) 44 ILM 796; Rule 37(2) of the ICSID Arbitration Rules (2006); UN doc. A/RES/68/109 UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, 16 December 2013, (UNCITRAL Transparency Rules); UN doc. A/RES/69/116, United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (adopted on 10 December 2014, not yet in force) (UN Transparency Convention).

[4] *Achmea B.V. v. Slovakia*, UNCITRAL, PCA Case No. 2008-13 (formerly *Eureko B.V. v. Slovakia*), Award, 7 December 2012*; AES Summit Generation Limited and AES-Tisza Erömü Kft v. Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010; *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015; *Ioan Micula, Viorel Micula, S.C. European Food S.A, S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania*, ICSID Case No. ARB/05/20, Award, 11 December 2013; *European American Investment Bank AG v. Slovakia*, UNCITRAL, PCA Case No. 2010-17, First and Second Award on Jurisdiction, 22 October 2012, 4 June 2014; *U.S. Steel Global Holdings I B.V. v. Slovakia*, UNCITRAL, PCA Case No. 2013-6, discontinued, 16 June 2014; *EDF International S.A. v. Hungary*, UNCITRAL, Award, 4 December 2014.

[5] According to the Investment Arbitration Reporter, the Commission sought to participate in five arbitration proceedings initiated by renewable energy investor against the Czech Republic: *Antaris and others v. the Czech Republic,* UNCITRAL administered by the PCA (registered 8 May 2013); *Natland Investment Group and others v. the Czech Republic*, UNCITRAL *ad hoc* (registered 8 May 2013); *I.C.W. Europe Investments Ltd v. the Czech Republic*, UNCITRAL *ad hoc* (registered 8 May 2013); *Voltaic Network GmbH v. the Czech Republic*, UNCITRAL *ad hoc* (registered 8 May 2013); *Photovoltaik Knopf Betriebs-GmbH v. the Czech Republic*, UNCITRAL *ad hoc* (registered 8 May 2013); *WA Investments-Europa Nova Limited v. the Czech Republic*, UNCITRAL *ad hoc* (registered 8 May 2013); see Peterson (2014a). According to the same source, the Commission is likely to have participated as *amicus curiae* in investment arbitrations against Spain involving solar power investments. See Peterson (2014b).

participation of the usual *amici*, in particular in terms of the European Union's (EU) direct interest in the outcome of the proceedings. Furthermore, in contrast to cases where public interest groups appeared as *amici curiae*, the Commission's position has an actual impact on the tribunals' reasoning in that the arguments raised by the Commission tend to be carefully analysed by the tribunals.[6] In fact, it can be argued that the European Commission's *amicus* participation comes close to another form of third party participation, namely, intervention. Intervention is not available under the arbitration rules applicable in investment arbitration.[7] The Commission's resourceful use of the *amicus curiae* mechanism may mark a new stage of the development of third party participation in investment arbitration as it shows that the *amicus curiae* mechanism may be used in an intervener-like manner.

The present Chapter seeks to explore the European Commission's use of *amicus curiae* mechanism in Investor-State arbitration and compare it to intervention in other types of international adjudication. The article is divided into two sections. The first section will introduce the concept of third party participation and its two forms: *amicus curiae* and intervention. The second section will present an overview of the European Commission's *amicus* participation in international investment arbitration and analyse its distinct features. It will focus on the concluded cases in which materials concerning the Commission's participation have been released (*Eureko v. Slovakia*, *EURAM v. Slovakia*, *Electrabel v. Hungary*, *AES v. Hungary,* and *Micula v. Romania*).

2 *Amicus Curiae* and Third Party Intervention: Two Forms of Third Party Participation

The notion of third party participation denotes participation in the proceedings of a party who is neither a claimant nor a respondent. The reasons for allowing third party participation relate to the recognition of the fact that, although the decision is binding only between the parties to the dispute, the outcome of the proceedings can influence the position of third parties. The involvement of these parties in the disputes can mitigate the risk of repetitive proceedings and making contradictory determinations based on similar facts. Including third parties in the proceedings

[6]On the impact of the submissions of other *amici curiae* on the decisions of the investment arbitration tribunals, see Ishikawa (2010), pp. 406–409.

[7]With the exception of the 1899 and 1907 Conventions for the Pacific Settlement of International Disputes which provided that in arbitrations involving the "interpretation of a Convention to which Powers other than those in dispute are parties", those powers had a right to intervene in the dispute. Article 56 of the Convention for the Pacific Settlement of International Disputes (adopted 29 July 1899, entered into force 4 September 1900) 32 Stat. 1779; art 84 of the Convention for the Pacific Settlement of International Disputes (adopted 18 October 1907, entered into force 26 January 1910) 36 Stat. 2199. The right of intervention under these conventions has never been invoked. See Baetens (2013), p. 336.

also allows to avoid a situation where the adjudicator determines their rights as a possible preliminary issue in a dispute that they are not parties to. The concentration of participants is particularly significant if the decision is likely to be treated as a *de facto* precedent by other adjudicators. With regard to third party participation in international investment arbitration the notions of *amicus curiae* and third party intervention are sometimes used interchangeably.[8] However, in some domestic and international jurisdictions these two terms refer to distinct procedural mechanisms. This section will demonstrate that both forms of participation differ in their function and scope of application.

2.1 Amicus Curiae

The term *amicus curiae* (Latin for "friend of the court") is used to describe a third party who has an interest in the subject matter of a dispute and has been allowed by the adjudicators, at their discretion, to participate in the proceedings. *Amicus* participation is justified on the basis that the third party is in a position to provide the court or tribunal with an additional perspective or expertise regarding the dispute. *Amici curiae* are commonly heard in the common law jurisdictions.[9] The English *amicus curiae* is an independent lawyer, advocating no position in the dispute, who is appointed by the court to address an issue of law on which it lacks assistance.[10] The role of such *amicus* resembles a court-appointed expert.[11] However, in the United States, the role of *amicus curiae* has shifted to become a form of advocacy for a third party interest on part of certain public interest group.[12] *Amici curiae* in the second meaning have appeared before some of the international adjudicatory bodies. While the International Court of Justice (ICJ) does not allow *amici* to participate in the proceedings, their participation is widely accepted in judicial and *quasi*-judicial bodies such as the European Court of Human Rights and the World Trade Organization (WTO).[13] *Amici curiae* who most frequently seek participation in international dispute settlement proceedings are NGOs, industry associations, academic institutions and private individuals. The forms of participation of *amici curiae* in these proceedings vary between different fora. They can include requests to make written and oral submissions, to obtain access to case materials, as well as to attend hearings.[14]

[8] See, e.g. Levine (2011), p. 201.

[9] Mourre (2006), p. 257.

[10] Blackaby and Richard (2010), p. 257.

[11] Ibid.

[12] Ibid. See also Steger (2002), p. 420.

[13] For an overview of *amicus curiae* participation before international courts and tribunals see Bartholomeusz (2005).

[14] Ibid.

Initially, arbitration rules applicable in Investor-State arbitration did not provide for a possibility of *amicus curiae* participation in the arbitration proceedings. This is connected with the fact that arbitration rules applicable in Investor-State arbitration are primarily designed for commercial arbitration which is a mechanism for settling purely private disputes. One of the hallmarks of this type of arbitration is its confidentiality.[15] The controversy lies in the fact that, unlike most commercial arbitrations, investment arbitrations often concern implementation of governmental policies promoting important public interest objectives.[16] Some commentators suggested that *amicus curiae* participation and increased transparency could remedy the problems of the frequently assumed deficits of legitimacy and accountability in international investment arbitration.[17] As a response, in recent years a gradual "opening of the doors" of arbitral tribunals to third party participants can be observed. Due to the lack of specific arbitration rules allowing for their participation, the first appearances of *amici curiae* in arbitration proceedings were based on general discretion of arbitral tribunals.[18] These developments were followed by the formalisation of the rules on *amicus* participation via the NAFTA Free Trade Commission Statement,[19] the amendment to the ICSID Arbitration Rules in 2006,[20] the inclusion of the provisions on *amicus* participation in international investment agreements,[21] and most recently, in the adoption of the UNCITRAL Rules[22] and the Convention on transparency.[23]

On the basis of the current regulations on *amicus* participation under the arbitration rules, the following general admission criteria for *amici curiae* can be distinguished:

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[15]Levine (2011), p. 204.

[16]Ibid., p. 200.

[17]See, e.g.: VanDuzer (2007); Zachariasiewicz (2012). Generally, on legitimacy deficit in Investor-State arbitration Franck (2005).

[18]In *Methanex* the Tribunal based its ability to accept *amicus* submission on its competence to "conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at any stage of the proceedings each party is given a full opportunity of presenting his case" under art 15.1 of the UNCITRAL Arbitration Rules, *supra*, n. 1. Likewise, in *Suez v. Argentina*, the first ICSID case where an *amicus* brief was accepted, the Tribunal derived its power from ICSID Arbitration Rule 44 which provides that "... [i]f any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question". *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. the Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition for Participation as *Amicus Curiae*, 19 May 2005, paras 10–16.

[19]*Supra*, n. 3.

[20]Ibid.

[21]See, e.g. art 39 of the Canadian 2004 Model Foreign Investment Promotion and Protection Agreement (2004) http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf (accessed 29 January 2016); art 29 of the US Model Bilateral Investment Treaty (2012) http://www.italaw.com/sites/default/files/archive/ita1028.pdf (accessed 29 January 2016).

[22]*Supra*, n. 3.

[23]Ibid.

– the submission must assist the tribunal in its determination of factual or legal issues by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;
– the submission must address a matter within the scope of the dispute;
– the *amicus* has a significant interest in the proceeding.[24]

Amici curiae in Investor-State arbitrations often request to file written submissions, to obtain access to case materials and to be heard at (or, at least, attend) hearings.[25] However, in Investor-State arbitration the participation of *amici* is often limited to written submissions.[26] The extent of *amici*'s rights in investment arbitrations depends not only on the scope of rights granted to *amici* in the applicable arbitration rules. Some procedural rights of the *amici*, like attending the hearings, are dependent on the discretionary decisions of the parties to a dispute.[27]

2.2 Intervention

Intervention signifies a third-party participation in the proceedings due to the third party's direct interest in the underlying legal issue and upon the initiative of the third party.[28] Generally, intervention in international dispute settlement is limited to States.[29] Two types of intervention can be distinguished in the instruments prescribing jurisdiction of international courts and tribunals: (1) intervention where a third party considers that it has an interest which may be affected by the decision and (2) intervention where the interpretation of a treaty to which one or more third States also are party is in question. These two types of intervention are clearly

[24]Art 37.2 of the ICSID Arbitration Rules, *supra*, n. 3; art 4 of the UNCITRAL Transparency Rules, *supra*, n. 3; paragraph 6 of Statement of the NAFTA Free Trade Commission on non-disputing party participation, *supra*, n. 3.

[25]Bastin (2014), p. 133.

[26]Ibid., pp. 140–141, 142–143.

[27]E.g. in accordance with Rule 32(2) of the ICSID Arbitration Rules, unless the parties to the dispute agree otherwise the hearings are held *in camera*.

[28]Zimmermann (2006), para 1.

[29]See arts 62 and 63 of the Statute of the International Court of Justice (adopted 26 June 1945, entered into force 24 October 1945) 1 UNTS 993; art 36.1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (4 November 1950, entered into force 3 September 1953) ETS 5, UNTS 221; art 10 of the Dispute Settlement Agreement Understanding (15 April 1994, entered into force 1 January 1995) 1869 UNTS 401, 33 ILM 1226. Art 42.3 of the ICJ Rules of Court which allows an intervention by a public international organisation and the appearances of the European Communities in WTO dispute settlement proceedings (the European Communities are a WTO Member) should be noted as an exception to this general rule.

distinguished in arts 62 and 63 of the ICJ Statute and are sometimes referred to as "discretionary intervention" with regard to the first type and "intervention as of right" with regard to the second.[30]

The type of interest qualifying a third party participant to pursue the first type of intervention varies depending on a particular forum. Article 62 of the ICJ Statute requires an intervener to demonstrate a legal interest in the dispute which may be affected by the decision in the case.[31] Under art 10 of the Dispute Settlement Understanding (DSU) manifesting a substantive factual interest in the matter before a panel suffices for a WTO Member to participate in the proceedings as a third party.[32] Intervention under art 36.1 of the European Convention on Human Rights (ECHR) gives a third party a right to intervene in the proceedings only to a home State of an applicant; under art 36.2 other contracting parties to the ECHR may intervene upon discretion of the President of the Court if such intervention is in the interest of the proper administration of justice.[33] The second type of intervention implicitly recognises the interest of a non-disputing third party in a bilateral dispute through the interpretation of its treaty commitments.

The intervention of a non-disputing party to investment arbitration based on its direct interest in the dispute is absent from the rules applicable in investment arbitrations. However, the rules for the second form of intervention can be found in some international investment agreements, for example in art 1128 of the NAFTA.[34] Pursuant to this provision, on written notice to the disputing parties, a non-disputing NAFTA party may make submissions to a tribunal on a question of interpretation of the Agreement.

Once allowed to participate, an intervener can participate in the proceedings only with regard to the subject matter of the intervention. Unless explicitly provided otherwise, the decision delivered in the proceedings in which a non-disputing party has intervened does not have a *res judicata* effect on the third party.[35] By being allowed to intervene a State does not acquire the status and privileges of a party to the dispute. Therefore, for example, third parties are not entitled to nominate an *ad hoc* judge in the ICJ or to object to the composition of a panel in the WTO. They enjoy a limited range of procedural rights aimed at communicating their interest in

[30]Chinkin (1986), p. 496.

[31]*Supra*, n. 29.

[32]Arend (2006), p. 376.

[33]*Supra*, n. 29.

[34]See also art 5 of the UNCITRAL Transparency Rules, *supra*, n. 3.

[35]See art 62.2 of the ICJ Statute, *supra*, n. 29.

the matter to the adjudicator. In accordance with arts 85 and 86 of the ICJ Rules of Court,[36] a third party whose submission to intervene was accepted is supplied with copies of parties' pleadings and documents annexed to them. It is also allowed to make written and oral statements on the subject-matter of the intervention. The scope of rights of an intervener under art 36 of the ECHR includes a right to submit written comments and to take part in hearings.

2.3 *Two Forms of Third Party Participation: The Case of the WTO*

The *amicus curiae* participation and intervention are easily distinguishable in the WTO dispute settlement procedure. Moreover, the WTO dispute settlement is a forum where both forms of participation are frequently used. Therefore, the practice of the panels and Appellate Body (AB) provides a useful illustration of the diverging natures of *amicus curiae* participation and intervention.

The DSU does not contain a specific provision dealing with *amicus curiae* participation in the proceedings. The AB derived its competence to accept *amicus* briefs from the comprehensive nature of a panel's "right to seek information and technical advice from any individual or body which it deems appropriate" under art 13.1 of the DSU.[37] The competence of the panels to accept *amicus* submissions relates to their duty to make an objective assessment of the matter in dispute.[38] *Amicus curiae* submissions in the WTO are an instrument that serves to assist the panels and the AB in gathering the necessary information and expertise, not a devise protecting the interests of private parties appearing as *amici*. NGOs and private individuals do not have rights of participation in dispute settlement proceedings; therefore they have no right to be heard by the panel.[39] It is within the panel's discretionary authority either to accept and consider or to reject *amicus* submissions.[40] Thereby, a panel has no obligation to take into account *amicus curiae* submissions.

Article 10.2 of the DSU explicitly allows for intervention by third parties in the WTO proceedings:

> Any Member having a substantial interest in a matter before a panel and having notified its interest to the DSB (Dispute Settlement Body) . . . shall have an opportunity to be heard by

[36]International Court of Justice, Rules of the Court (adopted 14 April 1978, entered into force 1 July 1978) (1978) 17 ILM 1286.

[37]WTO doc. WT/DS58/AB/R, Appellate Body Report, *US – Import Prohibition of Certain Shrimp and Shrimp Products*, 12 October 1998, paras 102–110.

[38]Steger (2002), p. 421.

[39]WTO doc. WT/DS58/AB/R, *supra*, n. 37, paras 40–41.

[40]Ibid., para 108.

the panel and to make written submissions to the panel. These submissions shall also be given to the parties to the dispute and shall be reflected in the panel report.

The possibility of intervention is restricted to the WTO Members only. The substantial interest in terms of art 10.2 which allows a third party to intervene is not to be understood as a legal interest, but as any factual interest in the matter at issue.[41] The scope of rights granted to third parties under art 10 and Appendix 3 of the DSU encompasses the right to make third party submissions, to present their views during a session of the first substantive meeting of the panel set aside for that purpose, and to receive parties' submissions to the first panel meeting.[42] Third parties who have notified their interest in the panel proceedings may make submissions to, and have an opportunity to be heard by the AB at the appellate review of the panel report.[43] Article 10 of the DSU makes clear that third parties do not become disputing parties. Third parties cannot make claims before a panel[44] and they cannot appeal a panel report.[45] If a third party considers that a measure which is subject to an ongoing panel proceedings impairs its rights under the WTO covered agreements, it may take recourse to normal dispute settlement procedures and become a party to the proceedings.[46]

The example of the WTO dispute settlement mechanism shows that *amicus curiae* participation and intervention differ in their function. *Amicus curiae* participation is justified on the basis of the adjudicator's duty to seek information in order to ensure an objective assessment of the matter.[47] The function of intervention is to ensure that the interests of the WTO Members who are not parties to the proceedings are taken into consideration. Permitting an *amicus curiae* to file a submission lies within the discretionary power of the adjudicator. Unlike third parties, *amici curiae* do not become participants in the dispute. Thus, unlike third parties, they do not have *a right to be heard by the panel*.[48] Even if the panel allows for *amicus* briefs, it is under no obligation to take them into consideration, while art 10.2 of the DSU provides that third party submissions "shall be reflected in the panel report". The more limited scope of *amici*'s procedural rights as compared to third parties follows their non-participant status in the dispute.

[41] Arend (2006), p. 376.

[42] Art 10.2 and Appendix 3, para 6 of the DSU.

[43] Art 17.4 of the DSU.

[44] Arend (2006), p. 374.

[45] Art 17.4 of the DSU.

[46] Art 10.4 of the DSU.

[47] Steger (2002), p. 420, see art 11 of the DSU.

[48] WTO doc. WT/DS138/AB/R, Appellate Body Report, *US – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, 10 May 2000, para 41.

2.4 Assessment

The first and main difference between the position of an *amicus curiae* and an intervener is the rationale justifying their participation in the proceedings—an *amicus curiae* has no protected legal interest which would entitle him to take position as to the underlying legal issue in the dispute.[49] *Amici curiae* cannot be considered interveners as they do not vindicate their own rights.[50] Their participation in the proceedings is justified by their ability to assist the adjudicator in making factual and legal determinations in the case. This leads to the second difference, which is that the participation of *amici curiae* is always left to the discretion of the adjudicator. Only the adjudicator can determine whether the participation of a particular *amicus* would assist it in making its decision. Conversely, at least at some instances, the participation of an intervener in the proceedings constitutes a right of the non-disputing party whose rights might be affected by the decision in the dispute. Thirdly, because of their indirect interest in the dispute, the extent of the procedural rights granted to interveners is wider than that granted to *amici curiae*.

The instrument of *amicus curiae* is known to Investor-State arbitration. It has developed dynamically over the past years. The rules applicable in investment arbitration did not envisage a possibility of intervention of a non-disputing party based on its direct interest in the dispute which would be equivalent to the intervention under art 62 of the ICJ Statute. However, there are provisions granting a right of intervention based on construction of an investment agreement to which an intervener is a party, such as art 1128 of the NAFTA.

3 The European Commission as *Amicus Curiae* in Investor-State Arbitration

3.1 The Commission's Amicus Curiae Participation in Investor-State Arbitrations

The European Commission filed *amicus* submissions in past as well as in ongoing Investor-State arbitrations. The cases involving the Commission's participation can be divided into two groups: the cases arbitrated under intra-EU bilateral investment agreements and the cases decided under the Energy Charter Treaty.[51] Within the first group, *Eureko* and *EURAM* arose from the Slovak government's regulatory restrictions imposed on the health insurance market that previously underwent a

[49]Zimmermann (2006), para 1.

[50]Francioni (2009), p. 741.

[51]Energy Charter Treaty (adopted 17 December 1994, entered into force 16 April 1998) 20 UNTS 95.

substantial liberalisation.[52] In *Micula* the claimants contested the withdrawal and amendment of certain regional investment incentives by the Romanian government as part of harmonisation with the EU legal order.[53] With regard to the second group, the arbitrations initiated by *Electrabel* and *AES* against Hungary concerned termination of long-term power purchase agreements by Hungarian authorities in the power generation sector.[54] This termination was a result of the European Commission's finding that these generous deals operated as a form of State aid, contravening EU competition law.

The tribunals in these arbitrations had to deal with the issue of an overlap between EU law and international investment treaties. The European Commission made observations on jurisdiction, applicable law, and enforceability of the awards.

The European Commission's commented on the implications of accepting EU law as part of the applicable law in the disputes. The Commission claimed that in accordance with the principle of supremacy of EU law, EU law takes precedence over any other inconsistent norm of an international agreement to which an EU Member State is a party.[55] Because of the supremacy of the EU legal order over other international law obligations of the EU Member States, the principle of *pacta sunt servanda* does not apply to BITs concluded between the EU Member States.[56] With regard to the jurisdiction, the courts of the EU are the only courts which can decide a dispute involving questions concerning the application of EU law. Under art 344 of the Treaty on the Functioning of the EU, the EU Member States are forbidden to subject disputes involving the questions of EU law to any other method of dispute settlement than the proceedings before the Court of Justice of the EU.[57] Furthermore, allowing an EU investor to bring claims against an EU Member State could lead to a discrimination between investors from different Member States which is prohibited under EU law as some investors are covered by BITs and granted the opportunity to resort to investment arbitration while others are not.[58] The Commission warned that the arbitrations where the investor's claims arose in

[52] *Achmea B.V. v. Slovakia*, Award on Jurisdiction (formerly *Eureko B.V. v. the Slovak Republic*), UNCITRAL, PCA Case No. 2008-13, Award on Jurisdiction, Arbitrality and Suspension, 26 October 2010; *European American Investment Bank AG v. Slovakia*, UNCITRAL, PCA Case No. 2010-17, Award on Jurisdiction, 22 October 2012.

[53] *Ioan Micula, Viorel Micula, S.C. European Food S.A, S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania*, ICSID Case No. ARB/05/20, Award, 11 December 2013.

[54] *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 20 November 2012; *AES Summit Generation Limited and AES-Tisza Erömü Kft v. Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010.

[55] *Eureco*, *supra*, n. 52, para 180; *Electrabel*, *supra*, n. 54, para 4.109, *EURAM*, *supra*, n. 54, para 118.

[56] *Eureco*, *supra,* n. 52, para 180, *EURAM*, *supr*a, n. 54, para 118.

[57] Ibid., para 178; *Electrabel*, *supra*, n. 54, para 5.20; *Eureco*, *supra*, n. 52, para 178.

[58] *Eureco*, *supra*, n. 52, para 183.

connection with the adjustments of domestic legislation to EU law could result in unenforceable awards.[59] If a tribunal was to make a decision that would conflict with the obligations of a Member State arising from EU law, the award could not be implemented on the grounds of public policy which includes the principle of supremacy of EU law.[60]

3.2 More Than a Friend? Assessment

In the examined cases the European Commission represented the EU's interest. The Commission presented itself as a guardian of the exclusive jurisdiction of the Court of Justice of the EU on adjudging disputes involving questions of EU law and supremacy of the EU's legal order over other international obligations of the Member States. Indeed, the Commission's function accorded to it by the EU treaties is to promote the general interest of the EU and oversee the application of EU law.[61] Although the Commission referred to several other general objectives in its submissions, such as preventing the fragmentation of international law and forum shopping,[62] they seem only ancillary in the light of the primary goal of protection of the EU legal order.

The role of the Commission as *amicus curiae* is far from the definition of *amicus* as "a form of advocacy for a third party interest on part of certain public interest groups" cited above.[63] The European Commission's direct interest in the outcome of the proceedings differentiates it from the traditional *amici* who are public interest groups. The requirement of a "significant interest in the proceedings", being a prerequisite for participation as *amicus curiae*, can be interpreted to allow participation of *amici curiae* representing a broad public interest as well as those whose rights would be directly affected by the arbitral decision. The nature of involvement of the latter category of *amici* resembles that of intervention before international judicial bodies.

The example of the European Commission shows that where the procedural rules do not allow for a proper intervention, the *amicus curiae* mechanism can be used in an intervention-like manner. A precedent for such use of the *amicus* instrument was established in WTO *EC – Sardines* case.[64] In this case a WTO Member, Morocco, filed an *amicus curiae* brief to the AB. Morocco could not participate in the AB proceedings as it did not notify its interest as a third party in

[59] *Electrabel*, *supra*, n. 54, paras 4.110 and 5.16; *Micula*, *supra*, n. 53, paras 334–336, *EURAM*, para 116.

[60] Ibid.

[61] Art 17(1) of the Treaty on Functioning of the European Union.

[62] *Eureco*, *supra*, n. 52, para 85.

[63] See *supra*, para 2.1 of this Chapter.

[64] WTO doc. WT/DS231/AB/R, Appellate Body Report, *EC – Trade Description of Sardines,* 26 September 2002, para 164.

the earlier proceedings before the panel.[65] The AB found itself competent to accept such *amicus* submission. However, the AB also stated that it is under no obligation to treat a WTO Member who acts as *amicus* in a more favourable manner than any other *amicus curiae*.[66] It emphasised that it was Morocco's choice to act not as a third party, but as an *amicus curiae* and this entails the restriction of its rights in the proceedings.[67] The AB found that it is under no obligation to consider such *amicus* submission.[68]

The European Commission's *amicus* participation in the investment arbitration is not only a substitute for a possibility of a proper intervention, but also a substitute for achieving its immediate goal within the EU. The European Commission's involvement in the investment arbitrations follows its inability to achieve the termination of all intra-EU BITs by the EU Member States.[69] Effectively, a similar result could be accomplished if the investment arbitration tribunals would determine a general lack of jurisdiction in the intra-EU BIT disputes because of the issues of EU law involved in the disputes.

The European Commission is not the only *amicus* that seeks to promote its own immediate interest in investment arbitration. A direct interest in the outcome of arbitration was the rationale for participation of indigenous groups as *amici curiae* in several Investor-State arbitrations. In *Glamis Gold* the Quechan Indian tribe filed an *amicus* brief with the tribunal.[70] The tribe opposed the investor's project because it would destroy the "Trail of Dreams", being part of a network of tribal ceremonial paths and sacred sites, in consequence preventing the tribe from practicing its cultural and religious traditions. In the more recent *Bernhard von Pezold* case, four indigenous communities, the Chikukwa, Ngorima, Chinyai, and Nyaruwa peoples, sought participation in proceedings against Zimbabwe.[71] These cases raised a discussion as to whether intervention would not be a more suitable instrument of participation than *amicus curiae*, to protect the immediate interest of indigenous peoples in investment arbitrations.[72]

However, the European Commission's participation differs from other *amici curiae* representing their direct interests. Unlike the indigenous groups, the EU is an actor in the field of international investment law. The Lisbon Treaty which entered into force in December 2009 granted the EU the exclusive competence in the field

[65] See art 17 of the DSU.

[66] WTO Doc. WT/DS231/AB/R, *supra*, n. 64, para 164.

[67] Ibid., para 166.

[68] Ibid., paras 167, 170.

[69] See *Eureko*, *supra*, n. 52, para 82.

[70] *Methanex*, *supra*, n. 1.

[71] *Border Timbers Limited, Border Timbers International (Private) Limited, and Hangani Development Co. (Private) Limited v. Zimbabwe*, ICSID Case No. ARB/10/25, Procedural Order No 2, 26 June 2012.

[72] See Triantafilou (2009); Wieland (2011).

of foreign direct investment.[73] The European Commission is now responsible for negotiating and concluding investment treaties to which the EU is a party.[74] In accordance with the recently adopted regulation, the Commission will also represent the Member States in the arbitration proceedings resulting from breaches of these agreements.[75] The involvement of the EU as an actor in the field of international investment law is evident in the example of Energy Charter Treaty. As duly noted by the tribunal in *Electrabel*, the EU is not only a party to the Energy Charter Treaty, but it was also its main architect. Despite of its broad investment competence, the EU will struggle against the institutional structure of international investment arbitration system which is not suited for the participation of a supranational organisation. For instance, the proceedings under the ICSID Convention are open only to States.[76]

Amici's assistance in an Investor-State arbitration is only as effective as the tribunal's willingness to take their position into account. The submissions of public interest groups, the traditional *amici*, usually do not find broader reflection in the awards made. This is different in the case of the Commission's submissions. The tribunals extensively cite and analyse the submissions of the Commission in their awards.[77] There is no doubt about the Commission's superior expertise on the matters concerning the application of EU law. However, the Commission's impact on the tribunals' reasoning might also be reinforced by the recognition of the EU's stake in the arbitration. As stated by the tribunal in *Electrabel*:

> it is unfortunate that the European Commission could not play a more active role as a non-disputing party in this arbitration, given that ... the European Union is a Contracting Party to the ECT in which it played from the outset a leading role; and, moreover, that the European Commission's perspective on this case is not the same as the Respondent's and still less that of the Claimant. In short, the European Commission has much more than "a significant interest" in these arbitration proceedings.[78]

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[73] Art 207 of the Treaty on Functioning of the European Union.

[74] Ibid.

[75] Regulation (EU) No 912/2014 of the European Parliament and of the Council of 23 July 2014 establishing a framework for managing financial responsibility linked to Investor-to-State dispute settlement tribunals established by international agreements to which the European Union is party, *OJ* L 257/121.

[76] Convention on the Settlement of Investment Disputes Between States and Nationals of other States (adopted 18 March 1965, entered into force 14 October 1966) 575 UNTS 159, art 67. However, the EU textual proposal for the investment chapter of the Transatlantic Trade and Investment Partnership envisages arbitration in accordance with the ICSID Convention. See art 6.2 of the EU textual proposal for the Transatlantic Trade and Investment Partnership, Chapter II Investment, 12 November 2015 http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf (accessed 19 April 2016).

[77] *Electrabel*, *supra*, n. 54, paras 4.89–4.110, 5.8–5.20; *Eureko*, *supra*, n. 55, paras 175–196; *EURAM*, *supra*, n. 52, paras 116–120. However, the arguments raised by the European Commission were not analysed in a similar manner by the tribunal in *AES v. Hungary* arbitration. It only indicated that: "[t]he Tribunal also acknowledges the efforts made by the European Commission to explain its own position to the Tribunal and has duly considered the points developed in its *amicus curiae* brief in its deliberations". *AES*, *supra*, n. 54, para 8.2.

[78] *Electrabel*, *supra*, n. 54, para 4.92.

The Commission's singular position does not cause it to be granted a wider spectrum of rights than the usual *amici*. For instance, the tribunal in *AES* denied the Commission's request to receive copies of the parties' written submissions as the parties to the dispute had not reached an agreement on this issue.[79]

4 Conclusions

Technically, the European Commission is not an intervener in Investor-State arbitrations, but neither is it a typical *amicus curiae*. The European Commission's participation combines the rationale used for intervention in other types of international adjudication with the extent of rights available to *amici curiae* in investment arbitration. It also has a more significant impact on the tribunals' awards that any other *amicus* in investment arbitrations. The atypical nature of the Commission's *amicus* participation relates to the singular position of the EU on the international plane.

The European Commission's involvement marks a new development in the use of *amicus curiae* instrument in Investor-State arbitration. The European Commission's resourceful use of *amicus* participation which supplements a procedure for intervention that is absent in Investor-State arbitration also provides an illustration of the dynamics in this not yet mature legal field. From the outset, *amicus curiae* has served as an instrument remedying the deficiencies of the institutional design of international investment arbitration. The European Commission *amicus* participation demonstrated its ability to adjust to the changing reality of international investment arbitration and to address the evolving needs of its actors. The analysed cases could constitute a new stage in the development of third party participation in Investor-State arbitration.

The Commission's *amicus* participation should also open a discussion on whether there is room for intervention as a more advanced form of third party participation in Investor-State arbitration. This article identified that one form of intervention is present in Investor-State arbitration. It allows a non-disputing party who is a party to the investment agreement in question to present its views on the interpretation of the agreement. It should be considered whether the rules applicable in Investor-State arbitration should include a second type of intervention—introducing a special category of third party participants who have a direct stake in the disputes. The immediate interest of these interveners in the dispute would be recognised by the tribunals by according them a wider range of procedural rights than those usually granted to *amici curiae*.

The need for a more advanced form of third party participation in investment arbitration was addressed by the EU in its textual proposal for the Transatlantic Trade and Investment Partnership Agreement.[80] Intervention is one of the forms of

[79] *AES*, *supra*, n. 54, para 3.22.

[80] *Supra*, n. 76.

third party participation envisaged in the proposal, along with the non-disputing party[81] and *amicus curiae* participation.[82] Article 23 of the proposal allows for intervention of "any natural or legal person which can establish a direct and present interest in the result of the dispute (intervener)". Article 23(3) and (4) of the proposal specify the extent of procedural rights granted to interveners. An intervener has a right to receive a copy of every procedural document served on the disputing parties, submit a statement of intervention, attend hearings, make an oral statement, as well as to intervene before an Appeal Tribunal in case that an appeal was filed.

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[81] Ibid., art 22.

[82] Ibid., art 18. Art 18.1 of the proposal incorporates by reference the UNCITRAL Transparency Rules, *supra*, n. 3.

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Sovereign Wealth Funds as Socially Responsible Investors

Xenia Karametaxas

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Abstract Sovereign Wealth Funds (SWFs) are public investment vehicles, owned and managed directly or indirectly by governments and set up to achieve a variety of macroeconomic purposes. As institutional investors, SWFs have the fiduciary duty to act in the best long-term interest of their beneficiaries. In this context, socially responsible investment may enable a SWF to increase its financial profitability. However, the fiduciary duties of SWFs towards their beneficiaries go beyond the economic maximization of returns on their investments. In the aftermath of the financial crisis, SWFs have established themselves as important financial markets participants. This paper will, first, address the existing international regulatory frameworks that govern the responsibility and accountability of SWFs, and, second, discuss ways to improve those frameworks in order to enable SWFs to

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become sustainable investors. The focus of the paper is on evaluating the leverage of SWFs in the global economy, as well as their potential to promote corporate social responsibility and, therefore, to lead the financial sector towards greater sustainability.

1 Introduction

Sovereign Wealth Funds (SWFs) are government-owned investment entities acquiring and managing assets in order to achieve a variety of macroeconomic purposes. They are typically either supported by commodity earnings such as a country's natural resources sectors or based on non-commodity financing such as general taxation revenues and foreign currency exchange reserves.[1] Although the first SWF was already established in 1953,[2] SWFs are fairly a new phenomenon. Over the last decade, SWFs have established as a new category of institutional investors. The remarkable growth in SWFs' financial assets has made them appear as powerful actors on financial markets and in the global economy.[3]

Their features make them ideal candidates for leading the financial sector towards sustainability.[4] However, and despite the recognized importance of SWFs for the global economy, only little attention has been paid so far to the ethical footprint of SWFs' investments. Instead, policymakers and most scholars have focused on the question whether or not the foreign investments made by SWFs should be subject to specific measures in recipient countries.[5]

The objective of this Chapter is to assess SWFs' responsibilities in terms of socially responsible investments (SRI). The Chapter is organized as follows: Sect. 2 puts SWFs into their economic and legal context and seeks a definition of the term "sovereign wealth fund". Section 3 explores the causes of SWFs' responsibility. Section 4 addresses the efficiency of existing normative frameworks and inquires to which extent SWFs may appear as standard-setters for responsible investment (RI) practices.

[1] Sarkar (2010), p. 623.

[2] The first SWF was the Kuwait Investment Corporation, which was established in 1953; see Van der Zee (2012), p. 141; Hahn (2012), p. 103.

[3] The OECD estimates the total of SWF assets around US $2.6 trillion, see Blundell-Wignall et al. (2008), p. 121.

[4] Richardson (2013), p. 227.

[5] Yet, there are some exceptions, see Keenan and Ochoa (2009), p. 1151; Cummine (2014), pp. 163–177; Ghahramani (2015), pp. 321–332; Munari (2015), pp. 333–370.

2 Background

2.1 Facts

A glance at the data from the Sovereign Wealth Fund Institute (SWFI) shows to what extent SWFs have established themselves as key players on the international financial markets: by the end of 2015, SWFs held over 7 trillion US $ assets under management.[6] Moreover, their growth is closely related to global macroeconomic instability, which explains why over forty SWFs have been created during the last decade.[7] In the aftermath of the 2007–2009 financial crisis, SWFs were welcomed investors throughout Europe and the United States, given their ability to provide significant cash injections to frail financial institutions in such challenging economic times.[8] For instance, through a substantial capital infusion of US $11.4 billion by the Singapore Investment Corporation, subprime crisis-ridden UBS could avoid bankruptcy.[9] Another well-known investment in an ailing financial institution during the financial crisis was made by Abu Dhabi's SWF (the Abu Dhabi Investment Authority) that acquired US $ 7.5 billion in convertible securities of Citigroup.

Despite, or perhaps because of, this crucial role in the wake of the financial crisis, the activities of SWFs have led to uncertainty and concerns in recipient States, provoking some of them to undertake defensive measures.[10] Almost all Western States have expressed the need to protect key strategic sectors such as the army industry, energy and natural resources, infrastructure and the financial sector. Indeed, in the eyes of recipient countries SWFs' investments bring the risk of being used as political or strategic tools rather than traditional investment vehicles.[11]

[6]See the SWF ranking, available at http://www.swfinstitute.org/sovereign-wealth-fund-rankings (accessed 18 January 2016).

[7]See http://www.swfinstitute.org/sovereign-wealth-fund-rankings/ (accessed 18 January 2016); Senn (2009), p. 4.

[8]See O'Brien (2008), p. 1233; Hahn (2012), p. 84; Senn (2009), p. 4.

[9]The GIC subscribed to a mandatory convertible bond of US $ 11.5 billion issued by UBS, created by conditional capital that has been approved by the UBS shareholders on an Extraordinary General Meeting on February 2008. According to the terms of the agreement and subject to the approval of UBS shareholders, the GIC will become a significant shareholder in UBS when the notes are converted into ordinary shares. See Senn (2010), p. 154.

[10]See O'Brien (2008), p. 1233; Backer (2010), p. 11.

[11]O'Brien (2008), p. 1242; Rose (2008), p. 101.

2.2 Definition

SWFs are not a homogenous set of institutions, which explains the wide range of definitions that can be found in the legal and economic literature, as well as in the practice of international organizations.[12] Yet there seems to be a consensus that SWFs are State-owned investment vehicles that are established and controlled by a sovereign political entity. The difficulty of defining SWFs lies in the ambiguity of SWFs as investment vehicles themselves: as public institutions, SWFs are formally sovereign; nevertheless they are supposed to behave like private investors.[13] Additionally, as they differ in size, funding sources, policy objectives and governance structure, the challenge of finding a global definition of SWFs lies in the heterogeneity of SWFs as an investor group.[14]

In the Santiago Principles, the International Monetary Fund (IMF) together with the International Working Group of Sovereign Wealth Funds (IWG-SWF) characterized SWFs as

> special-purpose investment funds or arrangements that are owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.[15]

The Organization for Economic Cooperation and Development (OECD) has not defined SWFs clearly either, but has instead stated that SWFs are

> government investment vehicles funded by foreign exchange assets that manage those assets separately from official reserves. Some are funded directly through commodity exports with an explicit decision to transfer wealth to future generations, while others result from trying to make the best from official reserve accumulation.[16]

Although the definition of the Santiago Principles is the most common one, it is not entirely satisfactory for the context of this paper, since it excludes funds operating primarily on domestic markets. In fact, according to recent analysis there are several State funds that invest foremost in domestic enterprises or activities.[17] Excluding them would mean not considering an important part of State-owned funds. The Santiago Principles leave out funds investing on domestic

[12]Rose (2008), p. 107; Bassan (2011), p. 31; Van der Zee (2012), p. 142; International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds Generally Accepted Principles and Practices—Santiago Principles, October 2008, http://imf.org/external/np/pp/eng/2008/022908.pdf (accessed 19 January 2016).

[13]Backer (2010), p. 117; Richardson (2013), p. 228.

[14]Bassan (2011), p. 31; Castelli and Scacciavillani (2015), p. 10.

[15]Santiago Principles (2008), *supra*, n. 12, p. 3.

[16]OECD (2007), p. 42.

[17]Balding (2008); Bassan (2011), p. 29.

markets because of their functional rationale, which means that the objective of the Santiago Principles is to assure recipient countries that investments made by SWFs are not based on decisions that are politically or strategically motivated. However, when it comes to SWFs' responsibility, funds investing in domestic assets must also be reviewed, since they are also likely to cause environmental damages and human rights violations through their investments.[18] Hence, in this paper, I define SWFs as investment vehicles that are (a) established and owned solely by the general government; (b) whose investment strategies include the acquisition of foreign and domestic financial assets and that are (c) established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.[19]

2.3 SWF Activities and the Role of Governments in the Private Economy

The heavy reliance by developed-country governments on capital injections from investment vehicles of foreign, emerging market governments, have redefined the role of governments in the global economy. The post-Second World War era, a time characterized by a transfer of power from governments to the private sector, left the governments only a limited regulatory role. In recent decades, however, the growth of budget surpluses due to large foreign exchange reserves, as well as the commodities boom of the early 2000, led to the establishment of SWFs. This new form of State engagement in the global economy puts into question the strict traditional view that States regulate the market and private actors participate in it.[20]

3 SWF and Socially Responsible Investment

3.1 The Financial Mandate of SWFs

By being institutional investors, SWFs have the fiduciary duty to act in the best long-term interests of their beneficiaries.[21] Yet, contrary to other institutional investors (i.e. pension funds, investment funds, insurances), the concept of ultimate beneficiaries in the context of SWFs is somewhat abstract. Since SWFs are managed according to the objectives of the sovereign, the ultimate beneficiary is not a specific individual but rather the government itself, the State, the current or future

[18] Van der Zee (2012), p. 142.
[19] Ibid.
[20] Burgstaller (2011), p. 166; Backer (2010), p. 11.
[21] Anabtawi and Stout (2007–2008), p. 1307.

generations and the taxpayer in general.[22] From that perspective, SWFs manage assets on behalf of the State to meet its citizens' future economic needs, and therefore have the fiduciary duty to invest these assets in their best economic interest.[23] To achieve this overarching goal, SWFs, as any other investors, can exert pressure on the boards of investee companies by submitting proposals for higher dividends, lower executive pay or the removal of failing corporate units.[24]

Socially responsible investment might enable an investment fund to increase its financial profitability. In the long term it is more profitable to allocate resources on ventures with a certain ethical footprint, given that they do not impact negatively upon social, environmental and human rights factors. Companies that are involved in human rights violations or severe environmental damages may face litigation from employees, the community or other stakeholders. They might also get negative press coverage or become the target of non-governmental organizations (NGOs). All this has negative economic consequences such as lower share prices, high litigation costs, damaged corporate reputation, limited market access and a reduced chance to recruit the best employees.[25] Conversely, investing in companies with a positive ethical footprint may result in better economic returns for SWFs. Some authors even deduce broader social benefits from corporate responsibility such as an improved trust between the business and the community and social stability.[26]

3.2 The Ethical Mandate of SWFs

By being State actors, SWFs have not only a financial, but also an ethical mandate towards their beneficial owners that incentivize them to voice their concerns over the companies' ethical conduct. It should, however, be mentioned in this context that the ethical and financial motivations of SWFs may overlap, given that an unethical corporate behavior may jeopardize the financial interests of an SWF. As shareholders, SWFs have an interest to ensure that the managements of their investee corporations do not engage in practices that are likely to influence firm reputation negatively and, subsequently, the firm's profits and share prices.[27]

As pointed out by Richardson, even though SWFs do not formally become parties to international law treaties in the same way as States do and notwithstanding that such treaties do not impose obligations directly on corporations or investors, SWFs can use international treaties "as a moral compass for their RI

[22]Monk (2009), p. 456; see also Collier (2011), p. 111.

[23]Richardson (2013), p. 227.

[24]Ghahramani (2015), p. 322.

[25]Sullivan and Hachez (2012), p. 221; Wen (2013), pp. 178 ff.

[26]See Sullivan and Hachez (2012), p. 221.

[27]Ghahramani (2011), p. 87.

practices".[28] In addition, since SWFs are fully funded with State's resources, SWFs must be regarded as State organs, which distinguishes them from other investment funds. They are acting as extended arms of the States, which in turn have obligated themselves to a series of binding international law principles. Without going into further detail, the purposes of SWFs combined with their feature as State-owned investment vehicles qualifies them as State organs.[29] Therefore, the home State of a SWF can be held responsible for breaches of international law obligations.[30] In any event, as Demeyere correctly noted, it is ultimately and in practical terms up to the State to ensure that its organs comply fully with the international law.[31]

For some SWFs, the ethical mandate stems from the fund's overall investment objective. As a matter of fact, the majority of SWFs have been set up with the purpose of being saving funds for future generations.[32] In the light of their inter-generational investment horizon, saving funds aim at using national wealth to preserve and produce value for future generations, in order to prevent them from the current generation's exploitation of natural resources.[33] High savings are in the interest of future generations, to the extent that they imply less consumption of resources by the current generation and thus more investment that will benefit the future generation.[34] Hence, as long-term investors SWFs have the responsibility to promote sustainable development and social justice through their investment, in order to give future generations the opportunity to reap the awards of the investment.[35]

According to some authors, particularly Sullivan and Hachez, the duty of SWFs to care about responsible investment practices derives directly from the 1948 Universal Declaration of Human Rights (UDHR) under which "every individual and every organ of society should respect and promote, to the extent of its capabilities, the rights set out in the UDHR".[36] Thus, by being societal actors, investors have the obligation to respect and promote human rights.[37] Note, however, that the UDHR, as a resolution of the UN General Assembly, does not impose

[28]Richardson (2013), p. 230.

[29]Demeyere (2011), p. 199; *Emilio Agustín Maffezzini v Spain*, ICSID Case No ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, 25 January 2000, para 77: "... a finding that the entity is owned, directly or indirectly [by the State], gives rise to a rebuttable presumption that it is a state entity".

[30]Demeyere (2011), pp. 199 ff.

[31]Ibid., p. 200.

[32]For a classification of SWFs according to their investment objectives see Kunzel et al. (2010), table 1, 4.

[33]International Forum of Sovereign Wealth Funds, 'Santiago Principles: 15 case studies', Doha November 2014, http://www.ifswf.org/pst/SantiagoP15CaseStudies1.pdf (accessed 20 January 2016); Munari (2015), pp. 339 ff.

[34]Cappelen and Urheim (2012), p. 3; Van der Zee (2012), p. 147.

[35]Van der Zee (2012), p. 147.

[36]Sullivan and Hachez (2012), p. 218.

[37]Ibid.; see also Henkin (1999), p. 25.

binding human rights obligations directly on investors, despite its widely recognized status of customary international law.[38]

The main driving force behind SWFs adopting socially responsible investment policies can be drawn from their status as owners of the corporations they invest in. As a matter of fact, the growth of SWFs' investments implies that they are gaining in importance as capital providers and shareholders, which in turn increases their leverage on the investee corporations. The larger the investment portfolio and the greater the financial risks relating to social and environmental issues, the more likely it is that an investor will apply SRI criteria to its investment decisions. SWFs, as holders of broad portfolios that are diversified across the economy, have no interest in adopting short-term oriented investment strategies that are causing harm to the economic system as a whole.[39]

As any other shareholders, State investors can be active or passive owners and, on that account, may or may not exert pressure on the management of investee companies. Although SWFs make typically minority investments in foreign business enterprises, they have the power to influence the behavior of the investee companies.[40] They can do so in a formal way through the exercise of shareholder voting rights and the submission of proposals at annual general meetings of investee companies or in an informal way through the media and fellow shareholders and by engaging in negotiations with the management of a company having poor corporate social responsibility records. Ultimately, at least in theory, they can put pressure on such companies through disinvestment, that is to say by selling their shares. In practice, however, selling large stakes causes important transaction costs and requires a certain degree of market liquidity, which is often not the case in difficult economic times.[41] On the contrary, given the increase of SWFs investments in Western companies, it might be challenging for those companies to find a balance between maintaining their own internal policies that require compliance with ethical issues and benefiting from the investments of SWFs. Yet, the lack of active ownership and the focus on short-term profits instead of corporate responsibility has in the past contributed to unethical behavior by companies.[42] By being able to substantially influence the management of large companies, the investment behavior of SWFs has important consequences for society as a whole. On that account, SWFs have a responsibility to take action to correct the negative consequences of a corporation's activity and to even promote a sustainable behavior.

[38]Sullivan and Hachez (2012), p. 219.

[39]Davis et al. (2006), p. 18.

[40]Burgstaller (2011), p. 167.

[41]See Coffee (1991), p. 1277; Fairfax (2011), pp. 31 ff.

[42]Gill (2008), p. 459; Rohde (2011), p. 5.

Finally, although SWFs still operate mostly as portfolio investors, they are increasingly oriented towards foreign direct investments (FDI).[43] FDI establishes lasting economic ties between a non-resident investor and a foreign enterprise, "which allows the investor to exercise effective influence in the management of that enterprise".[44] According to the United Nations Conference on Trade and Development (UNCTAD), SWFs FDI flows doubled in 2012 from US $ 10 billion to over US $ 20 billion.[45] At the present time, total FDI by SWFs is estimated at US $ 127 billion, with assets allocated mostly in the finance, real estate and construction sectors and located primarily in developed economies.[46] Nonetheless, compared to the SWFs' total assets under management, cumulative FDI by SWFs remain somewhat low (2–3 %).[47] FDI acts upon economic growth, development and employment and can, on that account, either improve the environmental and human rights condition or harm the situation of individuals. The latter is the case if SWFs are investing directly in corporations that maintain, for instance, business practices with poor employment conditions or that are damaging the environment.[48] Thus, the high percentages of direct investments through SWFs enhance the responsibility of the latter in the global economy.

4 SWFs Responsibility Under Private International Normative Frameworks

Over the years, issues connected to sustainable development have contributed to the emergence of voluntary codes of conduct and sets of principles that cannot only be applied by firms, but also by investors themselves. These private regulatory regimes, developed by the financial industry in partnership with intergovernmental entities such as the UN, set normative standards for improved performance and procedures for more effective and informed decision-making.[49] This part examines the four most significant private regulatory regimes in terms of socially responsible investment and questions whether they are suited to promoting best practices for SWFs.

[43] According to the OECD, FDI is "a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The accepted threshold for a FDI relationship is 10 % or more of the voting rights of the investee company. See OECD (2008), p. 234 http://www.oecd.org/daf/inv/investmentstatisticsandanalysis/40193734.pdf (accessed 19 January 2016).

[44] Raeschke-Kessler and Gottwald (2008), p. 587.

[45] UNCTAD (2013), pp. 10–12.

[46] Ibid.

[47] Ibid.

[48] Van der Zee (2012), p. 147. See also Frankental (2012), p. 221.

[49] Richardson and Lee (2015), p. 398.

4.1 UN Principles for Responsible Investment

The United Nations Principles for Responsible Investment (UN-PRI) are the most significant international initiative regarding ethical and responsible investment practices of both private and State-owned investors.[50] Published in 2006 by a group of institutional investors in partnership with the UN Environment Program Finance Initiative and the UN Global Compact, the UN-PRI are supposed to help signatories to integrate "economic, social and governance" (ESG) issues into their strategic decision-making process and investment practices and acknowledge the relevance of a long-term health and stability of the markets as a whole. Especially Principle 2 calls on signatories to become active shareholders and incorporate ESG issues into their ownership policies and practices.[51] Yet the UN-PRI do not explicitly mention human rights considerations, as they are supposed to be covered by the social component of ESG.[52]

Even though the UN-PRI are considered "the most important developed initiative" with regard to responsible investment,[53] they unfortunately lack of acceptance among SWFs. Indeed, in 2014 only three of the 273 asset owners signatories were SWFs (i.e. the New Zealand Superannuation Fund, the Norwegian GPFG and the French Caisse des Dépots et Consignations).[54] With such a low number of adherents, the impact and effectiveness of the UN-PRI is limited regarding SWFs investments. Moreover, given the absence of any implementation mechanism, the UN-PRI have no direct leverage on investors to make sure that they positively influence their investee companies' behavior, whether over human rights violations or other ethical transgressions.[55]

4.2 UN Guiding Principles on Business and Human Rights

The UN Guiding Principles on Business and Human Rights (Guiding Principles)[56] is the first framework focusing on the relation between business and human rights that has been implemented within the UN system.[57] Grown out of the work of UN

[50]Nystuen et al. (2011), p. 3.

[51]Principle 2 UN-PRI.

[52]Cummine (2014), p. 168.

[53]Nystuen et al. (2011), p. 3; Cummine (2014), p. 168.

[54]See the UN-PRI website http://www.unpri.org/signatories/signatories/#asset_owners (accessed 15 January 2016).

[55]Cummine (2014), p. 168; Nystuen et al. (2011), p. 4; Frankental (2012), p. 222.

[56]United Nations, *Guiding Principles on Business and Human Rights*, New York and Geneva 2011, http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf?$32#v=1392752313000/_/jcr:system/jcr:versionStorage/53/b6/9c/53b69c6d-0745-4070-99b2-68e0$32#2dde1b99/1.4/jcr:frozenNode (accessed on 19 January 2016).

[57]Frankental (2012), pp. 221 ff.

Special Representative for Business and Human Rights Professor John Ruggie, who published the "Protect, Respect, Remedy" Framework in 2008, the Guiding Principles focus mainly on the impact of companies on human rights through direct investment.[58] The underlying idea of the UN Guiding Principles is that all businesses, including and especially State-owned enterprises, have a responsibility to respect human rights, which clearly includes investors and thus also SWFs. For that purpose, the UN Guiding Principles determine three channels for addressing corporate human rights violations: (1) the State's duty to protect human rights, (2) the corporate responsibility to respect human rights where they operate and (3) the State's duty to ensure that effective remedies are available for victims of corporate human rights abuse.[59] In its commentaries to the UN Guiding Principles, Professor John Ruggie mentioned that if the business has the leverage to prevent or mitigate the adverse impact of wrongful practices, it should exercise it.[60] From this point of view, also investors can use this framework to assess the human rights performance of companies.[61] Moreover, human rights implications of investment decisions of SWFs may also entail the State's duty to protect its citizens from human rights violation, given that SWFs have been identified as State organs.[62]

4.3 UN Global Compact

The best-known normative framework that deals with Corporate Social Responsibility (CSR) generally and on a global level is the UN Global Compact.[63] This set of principles defines itself as "a strategic policy initiative for businesses that are committed to aligning their operations and strategies with the universally accepted principles in the areas of human rights, labor, environment and anti-corruption".[64]

Like the UN Guiding Principles, the UN Global Compact is a non-binding soft law code that does not adopt the investor's perspective, but addresses companies directly. Here again, the main problem is that the effectiveness of the UN Global Compact remains questionable due to the absence of any enforcement and punitive mechanism.[65] Also, the number of SWFs having joined the UN Global Compact is

[58] See http://www.reports-and-materials.org/sites/default/files/reports-and-materials/Ruggie-report-7-Apr-2008.pdf (accessed 11 January 2016).

[59] Sullivan and Hachez (2012), p. 229.

[60] Guiding Principles on Business and Human Rights, commentary of the Principle 19, p. 21.

[61] Van der Zee (2012), p. 147.

[62] As the commentary of Principle 4 clearly states: "Where a business enterprise is controlled by the State or where its acts can be attributed otherwise to the State, an abuse of human rights by the business enterprise may entail a violation of the State's own international law obligations", Guiding Principles on Business and Human Rights (2011), p. 7.

[63] See www.unglobalcompact.org (accessed on 11 January 2016); for a general overview of the UN Global Compact see Banerjee (2007), pp. 97–99.

[64] See www.unglobalcompact.org (accessed on 11 January 2016).

[65] Banerjee (2007), p. 45; Kaufmann (2013), p. 744.

very low with only three SWFs (Government Pension Fund of Norway; New Zealand Superannuation Fund; National Pension Reserve Fund of Ireland) that committed themselves to integrate these principles into their investment policies.

4.4 Santiago Principles

In October 2008, a working group composed by SWFs (the International Working Group of Sovereign Wealth Funds, IWG-SWF) has launched the Generally Agreed Practices and Principles (GAPP), also called the Santiago Principles under the umbrella of the International Monetary Fund (IMF). The Santiago Principles emphasize accountability, transparency, as well as an equivalent treatment to private funds. Established in order to ease the concerns of recipient countries regarding SWFs' investments, the underlying rationale of this set of principles is to avoid political interference by SWFs.[66]

The Santiago Principles are the only international voluntary framework of investment and operational principles directed specifically at SWFs. Given their exclusive focus, they are the most appropriate to regulate the investment behavior of SWFs. The basic premise of the Santiago Principles is to guarantee transparency, clarity and equivalent treatment to private funds. However, surprisingly, the Santiago Principles do not contain any provision addressing responsible investment practices directly.

Against this background, the question arises whether the incorporation of responsible investment practices within a fund's overall approach is allowed under the Santiago Principles. One of the guiding objectives is "to invest on the basis of economic and financial risk and return-related considerations". Principle 19.1 states that SFWs have to disclose if their investments are on grounds other than "financial and economic considerations", which technically includes social, ethical or religious reasons. Likewise, Principle 21 mentions the exercise of voting rights by SWFs in investee companies, but does not address responsible investment concerns. Instead, it acknowledges that the exercise of voting rights aims to protect the financial value of the investments and merely requires the disclosure of the exercise of voting rights: "[i]f an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments". In my opinion this implies that the avoidance of complicity in unethical conduct or social and environmental harm is part of the protection of the investments' long-term value. Nevertheless, consistent with Principle 21, the consideration of ethical investment practices by SWF must be publicly disclosed and should not reduce the financial benefit of a SWFs' investment.

[66]Nystuen et al. (2011), p. 5.

The incorporation and promotion of responsible investment issues may also be based on Principle 22 under which SWFs are required to establish a framework that identifies, assesses, and manages the risk of its operations. More precisely, the commentary on Principle 22 mentions that one of the risks that SWFs face in their investment operations is the reputational risk, that is to say "the potential that negative publicity regarding an SWF's business practices, whether true or untrue, may cause a decline in investment returns, costly litigation, or loss of counterparties or impair the home country government's international standing". In fact, the investment in a company that allegedly violates human rights or that causes environmental damage could entail the risk of reputational risk.

In view of the foregoing observations it can be concluded that the Santiago Principles allow the incorporation of RI considerations by SWFs, even though they lack to encourage SWFs to do so. Yet, given their wide acceptance and their focus on SWFs, the Santiago Principles would be a good starting point for reconciling the ethical and financial aspirations of SWFs. A first step towards a higher implementation of responsible investment practices for SWFs should therefore be provided by an assessment of the Santiago Principles. In the longer-term, the development of a code of conduct under the supervision of an international body such as the IMF, tailored to meet the specific needs of SWFs would be desirable.

5 Assessment of the Current Normative Framework

Although the evolving and growing framework point to a paradigm shift from the traditional dichotomy between business and social and human rights issues, the above-mentioned general regulatory frameworks are inappropriate tools to implement responsible investment practices among SWFs. They are not taking into account the specific nature of SWF and they are lacking sufficiently recognition of most of the SWFs.

Under the Santiago Principles, as I pointed out, SWFs do not have the direct obligation to consider sustainability and ethical standards in their investment practices.[67] This unsatisfactory situation raises the question of how responsible investment obligations might be imposed on SWFs. A first, yet crucial step is to integrate in the Santiago Principles a requirement for SWFs to include in their investment policies to commit to a responsible investment behavior. Cummine suggested such a clause to the following effect: "The Fund must be invested in a manner consistent with the domestic and international ethical obligations of the owner state". Certainly, the perception of what consists an ethical obligation is likely to vary from one jurisdiction to another. Especially since a high number of SWFs are established in non-democratic countries with poor human rights records, hurdles might arise. We should keep in mind, though, that SWFs have the fiduciary

[67]Cummine (2014), p. 171.

duty to act in the citizens' interests. The respect of human rights, as well as the improvement of the citizens' general living situation and the environment is certainly in their interest.

Nevertheless, compliance with the Santiago Principles has been rather slow and incomplete.[68] The international leverage over sovereign governments is constrained by the reality that SWFs are owned and controlled by sovereign governments. The resulting non-binding character of codes of conduct and lack of any enforcement or punitive mechanism are major hurdles to the effectiveness of the Santiago Principles. Therefore, the principal mechanism of enforcement in the context of SWFs is peer-pressure, which might be reinforced through naming and shaming.[69] Though beyond the scope of this paper, a "comply or explain mechanism" contained in the Santiago Principles could mitigate this problem. Similarly to what is already in use for most other corporate entities in numerous corporate governance codes of conduct, SWFs would have to report how they apply the Santiago principles and to what extent they comply with responsible investment practices. If a SWF does not meet such standards, it should provide disclosure by explaining why it does not apply responsible investment practices.[70]

6 SWFs as Promoters for SRI Practices

Arguably, a responsible conduct of SWFs can contribute to shape the investment practices in the private sector and, thus, set standards in terms of responsible investment. The underlying idea is that by incorporating environmental and human rights considerations into their internal investment policies, SWFs can set best practices and contribute to a change in the investment policies of private sector counterparts.[71] Although, generally speaking, SWFs remain still passive investors,[72] when it comes to implement RI standards in the financial sector, SWFs are in an ideal position. They benefit not only from their large size and potential market leverage, but also from their long-term investment horizons and their widespread public visibility.[73] Since SWFs are able to establish their own investment policies, they have the potential to provoke change beyond SWFs portfolios, by setting best practices for private investors and thereby set global standards of responsible investment.

Through internal ethical guidelines, SWFs express their expectations towards the companies they invest in and set limitations of non-economic nature on the

[68] Dixon (2014), p. 581.
[69] Truman (2010), p. 103.
[70] Ibid.
[71] Van der Zee (2012), pp. 146 ff.
[72] Rose (2013), p. 914.
[73] Richardson (2013), p. 227.

investment decision-making of the fund. As the largest SWF applying SRI criteria, the Norwegian Government Pension Fund Global (NGPF-G) has established itself as the prime example of financial and social sovereign wealth activism.[74] Furthermore, the NGPF-G has influenced the investment practices of several Norwegian private institutional investors such as pension funds and investment funds.[75] In doing so, the NGPF-G not only contributed to the professionalization of RI principles, but exercises also a form of normative pressure for RI on private investors.

In order to comply with its Ethical Guidelines, Norges Bank (as the manager of NGPF-G) pursues two basic strategies. The first strategy is the active exercise of the NGPF-G's ownership rights to safeguard its long-term financial interests.[76] To this end, NGPF-G follows its own internal Ethical Guidelines, which are in turn based on the UN Global Compact and the OECD Guidelines for Corporate Governance and the Guidelines for Multinational Enterprises. The NGPF-G' second strategy consists of the annual release of a company exclusion list. Drawn up by the Council on Ethics, an independent body, this list names companies that should be excluded from Norway's investment universe, based on two types of exclusion criteria.[77] The product-based standards may lead to the exclusion of companies that produce tobacco, weapons that could violate humanitarian norms or sell military goods to certain States that are subject to investment restrictions. Conduct-based criteria assess a company's real or potential involvement in systematic violations of human rights; individual rights violations in conflict or war; severe environmental harm; flagrant corruption; or other violations of basic ethical norms.[78] Whereas the main purpose of the exclusion list is avoiding the fund's own complicity in ethical problematic activities,[79] it might also influence its behavior, in addition to any corporate engagement.[80] In doing so, the NGPF-G not only contributes to the professionalization of SRI principles, but also exercises a form of normative pressure on private investors.

Nevertheless, few SWFs have specific legal mandates to invest ethically. Of the over fifty SWFs only the NGPF-G, the New Zealand Superannuation Funds, the

[74]Ghahramani (2015), p. 323.

[75]Bengtsson (2008), p. 978.

[76]Shemirani (2011), p. 52.

[77]The company exclusion list is available online, see https://www.regjeringen.no/en/topics/the-economy/the-government-pension-fund/internt-bruk/companies-excluded-from-the-investment-u/id447122/ (accessed 5 January 2016).

[78]Guidelines for the Observation and Exclusion of Companies from the Government Pension Fund Global's Investment Universe https://www.regjeringen.no/en/topics/the-economy/the-government-pension-fund/responsible-investments/guidelines-for-observation-and-exclusion/id594254/ (accessed 20 January 2016).

[79]About the notion of complicity and due diligence of SWFs under international norms, see Ghahramani (2015), pp. 329 ff.

[80]Richardson (2013), p. 241.

French Pension Reserve Fund and the recently established Papua New Guinea's Liquefied Natural Gas Fund have the explicit legal obligation to invest ethically.[81] Moreover, their legal mandate limits RI to the means of promoting long-term financial returns. They do not have an explicit duty to invest in sustainability and to actively promote sustainable development or to seek improvements in companies' sustainability performance.[82] According to Richardson the perception of SWFs as RI leaders should, in the future, conduct to the establishment of explicit duties to invest in sustainability.[83]

7 Conclusions

Overall, responsible investment practices play an increasingly important role and reflect a change in the state of mind among large institutional investors such as SWFs, for whom extra-financial factors are becoming as essential as financial performance. Through their leverage and impact, SWFs have the potential to contribute substantially to the improvement sustainability on the financial markets. The fiduciary duties of SWFs towards their beneficial owners, the citizens, go beyond the economic maximization of returns of their investment. The consideration of the citizen's ethical interests by integrating responsible investment practices should become a core part in the funds' investment decision-making.

The existing regulatory framework reflects the growing relevance of environmental, social and governance issues to investment practices of private and public actors. However, among international frameworks, responsible investment obligations of SWFs have not received sufficient attention yet. The Santiago Principles, forming the only existing regulatory framework specifically tailored for SWFs, do not impose any requirement on SWFs regarding the ethical footprint of their investment practices. The numerous codes of conducts, three of which I have discussed briefly, claim for greater social responsibility and can, ultimately, also be applied to institutional investors such as SWFs. Nonetheless, given their focus on the companies' perspective, they are unsuitable tools for SWFs. Moreover, the low number of SWFs among the signatories of such codes of conducts emphasizes that they are not a satisfactory way for SWFs to take responsibility. To that effect, I suggest in the first place amending the Santiago Principles by including a requirement for SWFs to commit to an ethically responsible investment behavior. In the second place, I argue that SWFs should not only avoid investing in companies that cause harm to the environment or that violate human rights, but also act as active promoters of sustainable development.

[81] Ibid., p. 227; Cummine (2014), p. 172.
[82] Ibid.
[83] Richardson (2013), p. 227.

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