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Arbitration on trial:
The US and UK's fear of the supranational

The courts and panels that help shape global trade are being urged

To adapt to a different political climate

By Alan Beattie

Brandishing the pen with which she has marked Britain's uncrossable red lines, Theresa May is sallying forth into the Brexit negotiations with the EU. One of the prime minister's trickiest demands is that Britain escapes the jurisdiction of the European Court of Justice, the EU's highest judicial body, whose rulings Brexiters regard as an unconscionable infringement on national sovereignty.

Dislike of supranational courts that force changes in domestic policy is not confined to the UK's rejection of the ECJ. The World Trade Organisation's dispute arbitration system is under fire from US President Donald Trump's administration, which has threatened to ignore its rulings. Protest against the burgeoning system of investor-state dispute settlement, in which companies can

sue governments for damages, nearly sank a flagship EU-Canada trade deal last year.

Governments and lawyers are discovering that along with a widespread questioning of globalisation comes increased scrutiny on the transparency and fairness of the arbiters that shape it. The judicial branch of the world economy may be essential to its operation, as international regulations and their enforcement have become ever more important to global trade.

But it is under attack, with two prominent countries — the US and the UK — in particular objecting to what they see as over-reach. "You hear the word sovereignty a lot from governments like the US and UK who are in a reactive mood," says Lorand Bartels, a law academic at Cambridge university and senior counsel at the law firm Linklaters.

"Over the past 20-30 years, issues that used to be domestic are regulated at an international level, and this is the back end of that."

Indeed, the UK's resentment of the ECJ is one of the most problematic issues in the Brexit negotiations. The court hears cases brought by individuals, companies, member states and official EU institutions, and can exact fines and compel governments that break EU law to change course. It has long been an object of hate for Eurosceptic UK politicians and newspapers, which blame activist judges for destroying British fisheries and interfering in immigration policy. Robert Lighthizer, Donald Trump's new trade representative, in 2010 said 'WTO commitments are not religious.

When the ECJ ruled in 1999 that UK law protecting British fishing companies against Spanish competition contravened EU rules and fined the UK government, a column in the Daily Mail roared: "Our courts and our parliament are now slaves to a system which cares nothing for Britain's interests." Some of this reflects the expanding role of the ECJ, which in recent years has taken on the task of ruling on social and human rights as well as its original function of enforcing economic rules.

Hosuk Lee-Makiyama, director of the European Centre for International Political Economy, says: "The ECJ was created to knock down barriers to the single market, and then increasingly it gained competence in areas it was never supposed to have."*The process of the UK sloughing off the ECJ underlines the challenge of maintaining sovereignty in a country integrated into the global**

economy. Unless it can seamlessly slip into a free-trade agreement with the EU it will need some way to interpret the large body of EU law incorporated into British law. At least partially, and for an unknown duration, the UK will very likely have to accept some jurisdiction of the ECJ.

Even when that transition is over, the issue of judicial oversight will not disappear. Trade agreements typically contain a dispute settlement system that includes independent judicial panels to rule on possible violations of the deal.

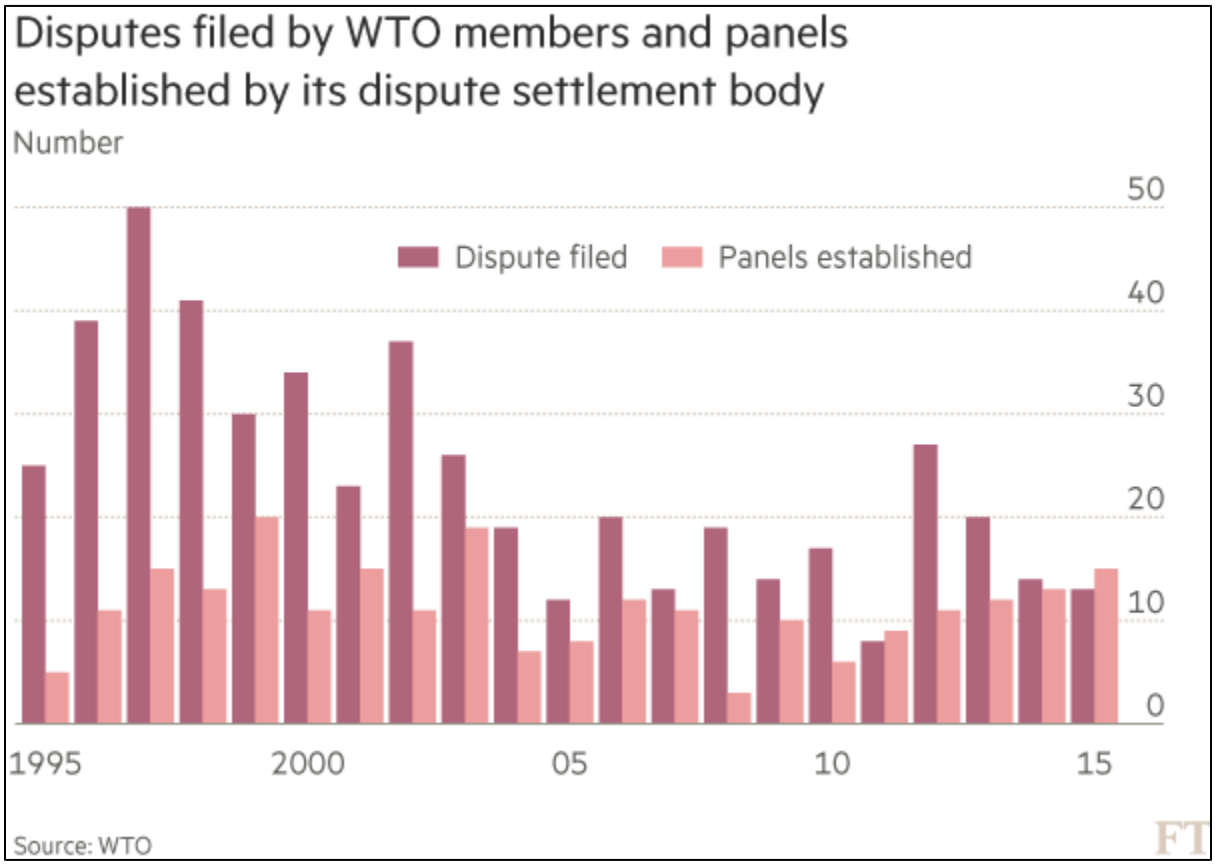
Bitter disputes over fishing rights led to discord between the EU and Britain some ways those systems are less intrusive than the ECJ. Private individuals and companies can start ECJ cases, but in most trade disputes only governments can begin litigation — and the sanctions are typically less onerous.

The judicial panels used in trade agreements can authorise complainant governments to impose retaliatory tariffs or other trade restrictions if violations are not addressed, but in general they cannot levy monetary fines as the ECJ does.

Yet they can also end up being more remote and unpredictable. The ECJ is a permanent court sitting in Luxembourg with full-time judges interpreting a body of law and interacting with domestic courts. By contrast, dispute settlement mechanisms in FTAs are standalone institutions traditionally modelled on commercial arbitration. Typically they involve ad hoc panels of three members drawn from a roster of lawyers with no automatic right of appeal.

Eurosceptics chafe at the restrictions of the ECJ, but their reaction to such a panel ruling against, say, the UK's right to use state aid to support its industry, could be apoplectic. Certainly, similar arbitration systems, such as the WTO's dispute settlement process, have had problems with legitimacy.

The system was created in 1994, and by the end of the 1990s it was under intense criticism from development campaigners for cases that appeared to ignore environmental concerns. More recently its reputation has improved, and the system has *won praise for mediating China's integration into the world trading system* with a series of rulings restraining its use of trade-distorting regulations. But recently WTO dispute settlement has acquired a potentially more powerful enemy in the form of the Trump administration.



Mr Trump's new trade representative, Robert Lighthizer, is a veteran trade lawyer who has often represented the US steel industry and consistently criticised the WTO for restraining the US's ability to keep out dumped and subsidised imports. This chimes with Mr Trump's focus on trying to reshore US manufacturing jobs and attacking unfair Chinese trade practices.

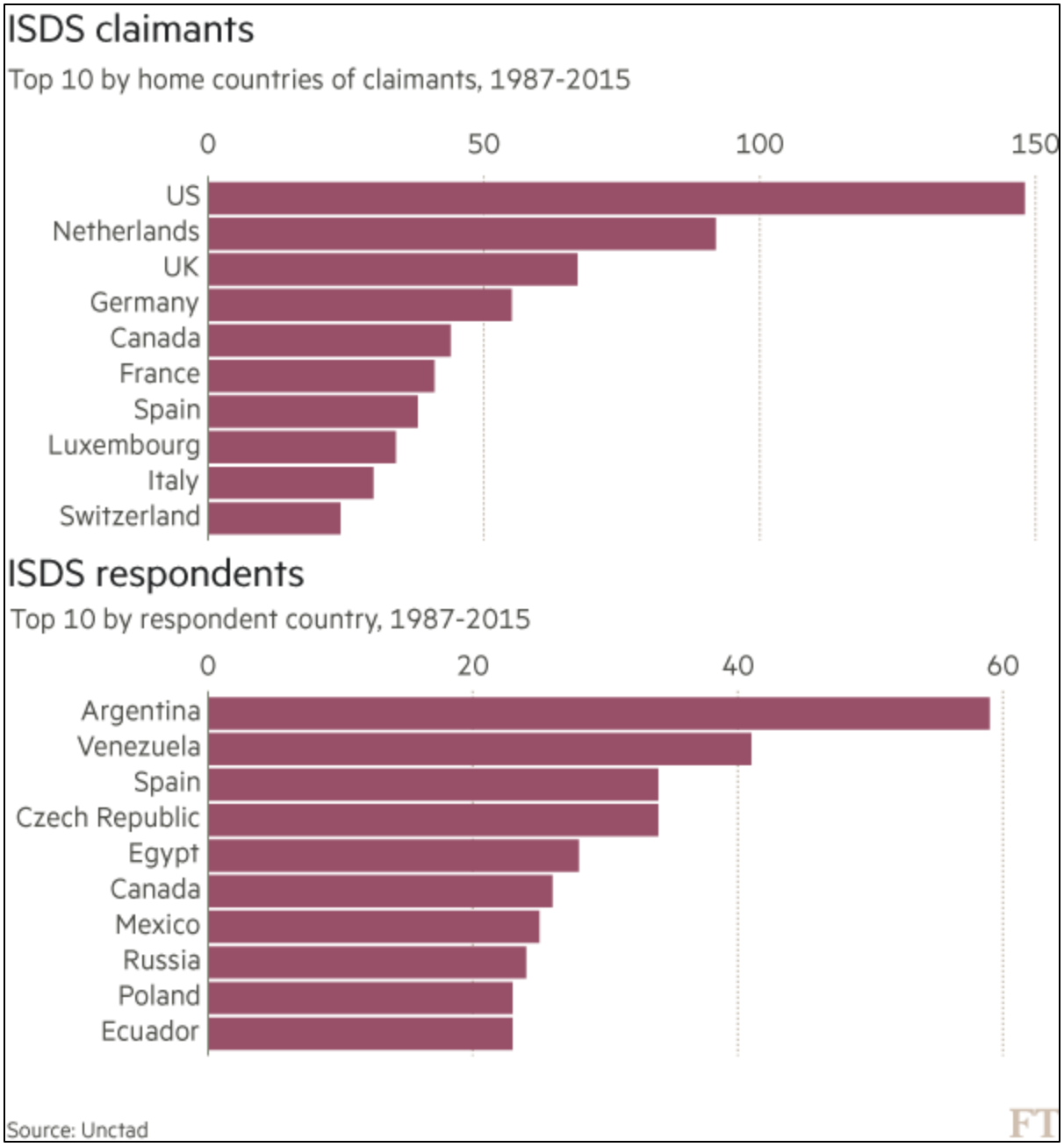
US administrations have long complained about WTO judicial over-reach, but Mr Trump is threatening to go far further by ignoring its rulings. Mr Lighthizer told a Congressional hearing in 2010: "WTO commitments are not religious obligations . . . and are not subject to coercion by some WTO police force."

Lighthizer's objections go to the heart of questions about legitimacy that often plague international tribunals. Critics of the WTO say that by repeatedly striking down US anti-dumping rules, the dispute settlement system is creating new laws — a function it was never supposed to fulfil.

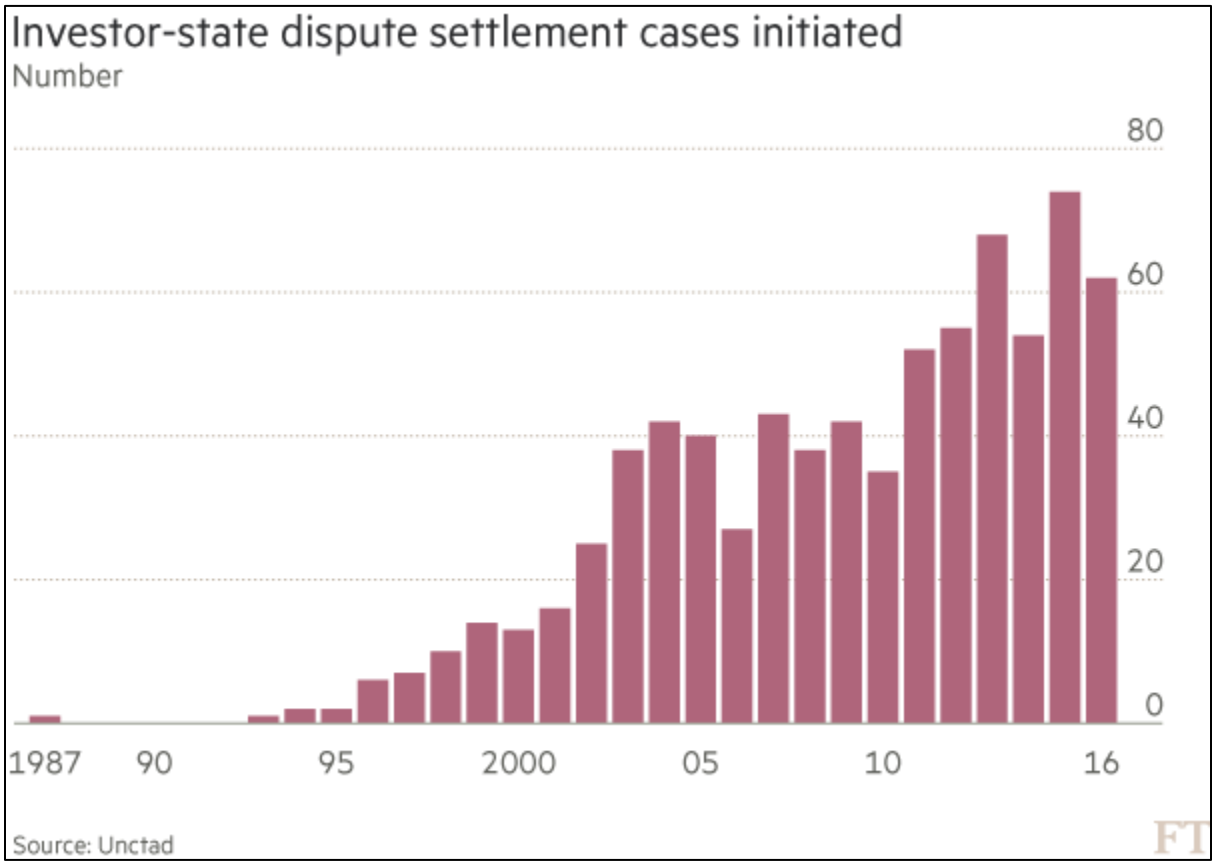
Defenders say the WTO is forced to rule on the basis of general principles because the member governments of the organisation have failed to agree on a fundamental revision of laws since the "Uruguay round" of talks concluded in 1994. Robert Howse, professor of international law at New York University, says: "Impasses over negotiating new rules pass the ball to the WTO system, which has to fill the gap."

It remains to be seen if the Trump administration will routinely ignore WTO rulings — which will allow its trading partners to retaliate with sanctions — or try to reduce its influence. In the face of this challenge to its authority, there is little the WTO dispute settlement system can do except emphasise its transparency and commitment to due process and hope the storm passes.

The WTO's system is not the only high-profile international tribunal under scrutiny. The previously obscure ISDS process, which allows companies to sue governments directly for unfair treatment, has faced a huge rise in public opprobrium over the past decade. To much amusement, the ground breaking *Comprehensive Economic and Trade Agreement between the EU and Canada*, which included an ISDS mechanism, was held up last autumn by the parliament of Wallonia, a region of southern Belgium with less than 1 per cent of the EU's 500m population.



<u>There are thousands of investment treaties in existence.</u> They aim to provide protection from unfair actions by governments — whether arbitrary seizure of assets or simply unfair regulations — to foreign investors when local courts are insufficient.



In recent years, there has been a rise in cases brought under the treaties, including many arguing that particular government regulations violate the investment law principle of "fair and equitable treatment".

Some ascribe this rise simply to globalisation creating more cross-border investment.

More sceptically, some campaigners and investigative journalists argue that a *clique of public international lawyers* is urging companies to sue and encouraging elastic concepts of fairness in panels that traditionally meet in secret. Helped by some high-profile cases, the treaties' ISDS provisions became one of the main targets for European campaigners aiming to stop the Transatlantic Trade and Investment Partnership with the US. The CETA deal between the EU and Canada was widely seen as a proxy for TTIP.

Philippa Charles, head of international arbitration at Stewarts Law in London, says: "There is a strong sense within the arbitration community that the system is under pressure, and [that there is] less complacency than before

about its perceived legitimacy." Several emerging markets, including India, South Africa and Indonesia, have declined to sign new treaties when existing ones come up for renewal, or changed them to reduce their liability.

Defenders of the arbitration system realise it needs to change, particularly in the area of transparency. Support for allowing the public to attend hearings and for publishing rulings and even the amount of monetary awards is rising.

For its part, the EU, surprised by the ferocity of complaints about ISDS, has come up with a new system designed to restore confidence in investment arbitration. Rather than ad hoc panels, Brussels has proposed a multilateral investment court with a permanent panel of judges more like the ECJ.

Whether such an initiative will find many takers among governments is questionable. Lawyers active in the current system say finding experienced judges will be difficult, especially when EMs with little experience of an independent judiciary are brought into the framework, and that it will create complex parallel systems. It is even harder to see what courts and panels such as the ECJ and the WTO dispute settlement body, which are already committed to transparency and accountability, can do to enhance their legitimacy.

Marietje Schaake, a Dutch member of the liberal ALDE group in the European Parliament, says of ISDS: "The key is to modernise the system, *turning a treaty into an institution and creating an international set of rules.*"

But for established courts such as the ECJ, Ms Schaake says there is little solution but for governments to defend the system. She blames successive generations of British politicians, including the former prime minister David Cameron, for using the ECJ as a scapegoat, and says it is largely uncontroversial in other EU member states. It was probably inevitable that the extension of international judicial authority over domestic economic policy would create a backlash.

The ECJ, WTO and ISDS systems have differences, but all face challenges to their legitimacy.

Containing that criticism is a problem for the courts and the governments that founded them. The arrangements that emerge from Brexit will be an interesting test case on whether it is possible to create institutions that rapidly command legitimacy among a sceptical public. Thus far, the jury is out. Often

a court or other judicial body can happily operate for years without attracting much attention. Then a high-profile case touching on an emotive issue will suddenly make the institution a subject of intense focus, often amid some misunderstanding.

The fisheries case between the UK and the European Court of Justice, which began in 1989 and dragged on for more than a decade, became a touchstone for Eurosceptics. In response to a complaint from a Spanish fishing company, the ECJ ruled that UK laws protecting British fishermen from competition were illegal, and forced the UK government to pay compensation.

For dispute settlement at the World Trade Organisation, the pivotal ruling was in 1998. The arbitration panel criticised a US measure that required all wild-caught shrimp sold in the US to be harvested in nets with special holes to let sea turtles escape. At the WTO meeting in Seattle in 1999, which collapsed in ignominy, the conference venue was surrounded by dozens of environmental protesters dressed in turtle costumes. The WTO panel had ruled that the US was perfectly entitled to pass the law but that it had discriminated between different countries when enforcing it. Such subtleties were, however, lost on the environmentalists, who focused on the fact that the US had lost a battle rather than grasping the reality that it had won the war.

For investor-state dispute settlement, the key case was one in which the *tobacco giant Philip Morris sued Australia in 2011* for requiring plain packaging on cigarettes (left), rather adventurously claiming that this constituted damage to its intellectual property. To do so, it first moved its Asian headquarters from Australia to Hong Kong, thus neatly underlining campaigners' complaints that ISDS gives more rights to foreign investors than domestic ones. The panel finally rejected the claim in 2015, but not before the legitimacy of the overall system was damaged.