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L E G A L

Investor-State Dispute Settlement

New Accountability through Vietnam's Free-Trade Matrix

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1. The Big Picture: Investor-State Dispute Settlement Mechanisms in Vietnam

Vietnam is constantly making headlines as the new rising star in foreign direct investment (FDI) into Southeast Asia. Strategically tied in with most large global economies by multilateral free-trade agreements (FTAs), increasing numbers of Multinational Companies (MNCs) and Small and Medium-Sized Enterprises (SMEs) are discovering Vietnam as their gateway into Asia. Indeed, the country has managed to position itself well in the shadow of its overpowering northern neighbour China, still entangled in an unpredictable trade war and diplomatic disaccord with the USA and other western economies.

The sudden disruption of international supply chains due to the COVID-19 pandemic caused a further shift of global trade and investment streams to Vietnam's benefit. Rising uncertainty about the future of international trade has made Vietnam even more attractive, especially to those who priorly deemed Vietnam to be a 'high-risk' investment. Therefore, it is not a coincidence that Vietnam was one of the few economies globally that managed to expand by 2.9%, according to World Bank statistics.¹

Much of this success can be attributed to the Vietnamese government's efforts to conclude a series of highly beneficial FTAs with regional and global partners. These treaties generally contain investment protection agreements (IPAs), which increase the accountability of member states by introducing new rules for dispute settlement in case of unilateral breach of the agreed bilateral investment conditions. Extrapolating these developments, most forecasts agree that Vietnam is heading towards a bright economic future supported by staggering growth and hefty investments into its logistics and energy infrastructure. Large-scale projects such as refurbishing the electric grid, installing large capacities for the domestic generation and storage of renewable energy, and improving ports, roads, and bridges for a new decade of industrialisation require copious amounts of capital and know-how. Vietnam is poised to attract these funds and other resources in the form



of FDI, continuing its successful strategy of the last decade.

IPAs play a crucial role in tilting the scales of investment decisions favouring developing countries, where the efficiency and transparency of local laws and practices can pose a significant concern. Being familiar and able to understand the complex structures of international treaties, FTAs, and IPAs has thus become a staple of doing business in emerging markets.

This legal update discusses Vietnam's most important IPAs and summarises the advantages of investor-state

¹ See for more information:
<https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=VN>

dispute settlement (**ISDS**) mechanisms for foreign investors. We have chosen the EU-Vietnam Free Trade Agreement (**EVFTA**) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (**CPTPP**) as guiding examples for outlining available ISDS mechanisms. These FTAs are the most sophisticated and relevant treaties which include the bulk of Vietnam's global investment partners.

2. Summary: What is ISDS?

Many developing countries are entering into a growing number of bilateral investment treaties (**BITs**), FTAs, and regional trade agreements (**RTAs**). Significant differences distinguish them in scope and members, while most of them include provisions for the protection of foreign investors through ISDS. The value of these treaties lies in the ratifying countries' mutual commitment to providing beneficial conditions for investment based on *most-favoured-nation*, *national treatment*, and *fair and equitable treatment* principles. Within the realm and scope of FTAs, ISDS mechanisms form a complementary dispute resolution regime. As the foreign investor's *procedural tool kit*, ISDS permits to sue signatories of international treaties for alleged discriminatory practices in their capacity as hosts of foreign investment. The substance of such procedures is typically an alleged breach of favourable treatment clauses by a host country to the detriment of a specific foreign direct investment. Members states usually convene on an ISDS scheme in addition to an FTA. However, there are also several FTAs that do not contain ISDS mechanisms or explicitly exclude them. When available, ISDS rules ascertain mutual compliance with agreed trade and investment conditions and endow foreign investors with a legal instrument to enforce their claims abroad.

Under global free trade policies, goods and services may be bought and sold across international borders with little or no government tariffs, quotas, subsidies, or prohibitions. FTAs and other treaties set out these preferential trade and investment conditions. They provide trade partners with commercial and regulatory advantages over their competition in countries not subject to such preferential treatment. However, these advantages are only as valuable as the legal enforcement instruments that support them.

Typical regulations incorporated in ISDS mechanisms are:

- **Scope** of ISDS (who and what?);
- **Preconditions**: Alternative Dispute Settlement or cooling-off period;
- **Composition of Tribunal** (Ad Hoc Arbitration or Standing Tribunal);
- Reference to **Procedural Rules** of international institutions or United Nations Commission on International Trade Law (**UNCITRAL**);
- **Rules for enforcement** of arbitral awards under ISDS; and
- **Statutes of Limitation** for ISDS claims.

The ISDS agreement forms the basis of any ensuing legal proceeding. The conditions and regulations under these agreements may vary. Typically, in IPAs, investors will find a notice provision requiring a prospect claimant to notify the host state of an arising dispute in writing. In some variations, an ISDS clause may impose a "cooling-off period", during which the counterparties must attempt to resolve the dispute amicably. In other cases, claimants may also have to exhaust any available local (legal or other) remedies during this period. Once this period has expired – assuming no other preconditions apply (e.g. mediation) – the claimant may commence arbitration. Typically, ISDS agreements stipulate the rules that will apply to their proceedings. Less commonly, the agreement may permit the claimant to select a set of rules that the host state has pre-approved (e.g., the ICSID Arbitration Rules, ICSID Additional Facility Rules, UNCITRAL Arbitration Rules, and ICC or PCA Rules of Arbitration).

The ISDS agreement may include a reference to a particular seat of arbitration. In the absence thereof, the Arbitral Tribunal has discretion over its seat according to the applicable rules. This choice can be consequential because it establishes the supporting legal framework for the arbitration, including how and when the seat courts may intervene and the legal grounds and procedure for challenging a resulting award.

3. Scope: Who is Eligible to Enter ISDS Procedures?

ISDS provisions form part of many international agreements, including FTAs, BITs, multilateral investment agreements, national investment laws,

and investment contracts. They can provide different levels of protection to their users, but all contain procedural regulations that allow investors to prosecute the violation of rules for cross-border investment. Although parties usually invoke ISDS under a catch-all term, they are subject to a wide variety of differences in scope and procedure.

At their very core, ISDS provisions aim to avoid state-to-state conflicts, protect citizens abroad, and instill confidence in potential investors that their respective counterparts will respect the Rule of Law. They act as political and diplomatic lubricants poured into a legal vessel to depoliticise disputes between investors and promote inbound investment flows.

Eligibility, therefore, generally depends on only three base conditions:

- Claimant's origin in a member state of the underlying IPA;
- Allegations against a Member State in breach of an international (investment) treaty; and
- Claim raised within the applicable statutes of limitation.

4. Advantages: How Do ISDS Mechanisms Compare to Traditional Dispute Resolution?

In the absence of a complementary IPA, foreign investors enjoying the benefits of an FTA can only turn towards their home jurisdiction to litigate damages. Without supporting ISDS provisions to enforce its rights, an investor would typically need to seek its own government's intervention to settle any arising dispute of this nature. Appropriate constellations may also allow foreign investors to try their luck with the

domestic court system of their investment's respective host country. Unfortunately, in developing countries like Vietnam, local procedures and laws usually lack the sophistication needed to deal with complex international investment disputes and do not promise much success.

Under ISDS mechanisms, investors facing undue discrimination in violation of an international treaty that binds both the investor's home country and the host country of the investment has legal recourse against the recipient of his investment.

The specific rules that govern these disputes are advantageous for the investor from several different perspectives. They typically allow foreign investors (i.e., individuals and companies) to allege treaty violations by suing the violating state through invoking ad hoc arbitration clauses contained in IPAs. Arbitral tribunals settle disputes through private panels composed of one or several party-appointed legal professionals. Another decisive advantage of international arbitration is that national legal precedent does not bind the ruling Tribunals. This means Tribunals may pass their decision based on international legal standards and trade customs without regard to local particularities.

Depending on the proposed case scenario and the scope of the claimant's prayers for relief, Arbitral Tribunals' competence may reach as far as ordering interim remedies that national courts less commonly issue. Primarily where an investor seeks monetary awards for damages, such injunctive relief can be pivotal for the litigation strategy and the related chances of success.



5. Vietnam's ISDS: What are the available ISDS Mechanisms for Investors in Vietnam?

5.1 Legal Foundation

Vietnam has recognised the procedural and material rights of foreign investors on multiple levels of its national law. Generally, international treaties override more restrictive national laws, which apply to those investors who do not enjoy preferential treatment under any available IPA. The laws and treaties discussed below form the most important pillars of Vietnam's legal framework for ISDS.

5.1.1 Law on Commercial Arbitration (2010)

Because all ISDS ultimately leads to arbitration between investors and opposing host states of their investment, the 2010 Law on Arbitration (**LoA**) remains an important source of legal guidance. Wherever the acknowledgement or enforcement of foreign arbitral awards is in question, the LoA provides available legal procedures and formalities. These regulations apply to all disputes settled by arbitration, with the seat of arbitration being Vietnam, including investment disputes.

Under Article 9 of the LoA, parties may freely negotiate and agree on the settlement of their dispute. During arbitral proceedings, they may also request an arbitral tribunal to conduct conciliation for the parties to reach an agreement on the settlement of their dispute. If the parties reach an agreement on dispute settlement through conciliation conducted by the Arbitral Tribunal, the proceedings usually end with a decision on the costs. The Tribunal does not rule on the parties' settlement.

5.1.2 Law on Investment (2020)

The 2020 Law on Investment (**LOI**) has entered into force at the beginning of 2021 and bears a wad of significant amendments for foreign investment in Vietnam. Regarding settling investment disputes involving Vietnamese administrative bodies, the LOI allows litigating related claims in Vietnamese arbitration by the Vietnamese arbitral institutions, including the Vietnam International Arbitration Center (**VIAC**), or via the Vietnamese national court system. Article 14 of the LOI specifically mentions foreign investors and foreign-invested (i.e. Vietnamese)

companies as possible claimants in arbitration against Vietnam's regulatory agencies.

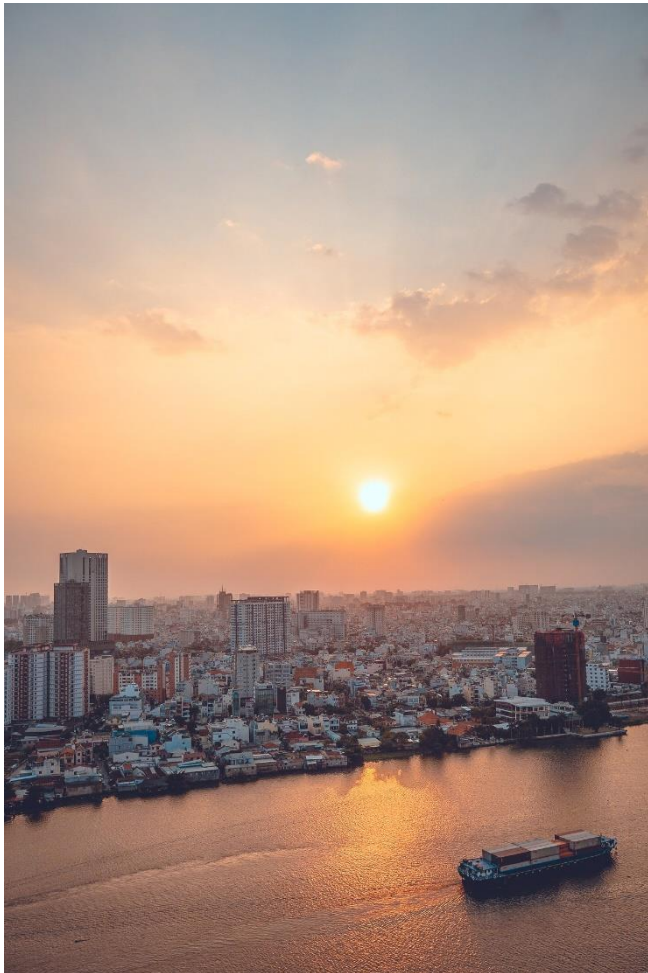
Implementing regulations published in the form of Decrees since early 2021 give further guidance on the LOI, adding definitions, specifying their interpretation, or providing details on related procedures. Notably, Article 9 of Decree No. 31-2021-ND-CP (**Decree 31**) lists various administrative and procedural steps to resolve disputes before they arise. It allows investors to escalate any quarrels with government agencies to higher levels of the administration before resorting to investment-related arbitration. Amongst these steps are reporting difficulties and propositions to administrative bodies and filing administrative complaints to courts and other competent authorities. Before suing in ISDS arbitration, the LOI also permits investors to exploit the Vietnamese court system and initiate domestic administrative lawsuits.

Against the backdrop of this national Vietnamese legal framework for ISDS engrained in the LOI, international treaties containing ISDS clauses grant investors preferential treatment. Their priority over national law renders claims founded on ISDS clauses preferable for foreign investors. ISDS arbitration is therefore, a welcome alternative to oftentimes intransparent and possibly lengthy national preliminaries as prescribed by Article 9.

Due to the LOI's relative novelty, the body of relevant precedent for the law and its implementing regulations (such as Decree 31) remains slim. However, a consequential interpretation of the system established by these new regulations seems to benefit investors from countries that have signed investment protection agreements with Vietnam.

5.1.3 EU-Vietnam Investors' Protection Agreement

The EU-Vietnam Investors' Protection Agreement (**EVIPA**) is a supplement agreement flanking the EVFTA that protects European investors' rights in Vietnam (and vice versa). After its approval in August 2020, it is currently pending endorsement of the European Union's (**EU**) Member States' parliaments. As of September 2021, eight of the 27 EU member states have ratified the EVIPA.



5.1.3.1 *Dispute Settlement under the EVIPA*

The EVFTA, an FTA that binds Vietnam and all members states of the EU, is supported by a comprehensive ISDS mechanism woven into the accompanying EVIPA. It sets out four methods for settling disputes between investors and the Vietnamese government within its scope: negotiation, conciliation, consultation, and submitting a claim to an investment tribunal.

5.1.3.2 *Compulsory Consultation Procedure*

As a legal instrument, the EVIPA's ISDS mechanism proposes a new *modus operandi* compared to traditional ISDS. Unlike the investment protection mechanism in other (and older) treaties, the EVIPA's ISDS contains a hybrid system that resembles a standing court and includes a compulsory consultation procedure. Accordingly, the parties in dispute must (attempt to) enter consultations to seek an amicable

solution before qualifying for bringing the claim to arbitration.

In the spirit of avoiding controversy and giving priority to party negotiations, EVIPA explicitly states that it encourages an amicable resolution to resolve any arising dispute. The time limit for such preliminary party consultations is 60 days.

Within six months from sending the request for consultation, the claimant may submit the dispute to the investment tribunal for resolution if the conflict remains unresolved.

Unlike more conventional investment arbitration methods, the investment tribunal provided for in EVIPA features (i) a two-level trial of first instance and appeal and (ii) settlement conducted by a tribunal consisting of three members, pre-selected by the Agreement authority.

5.1.4 CPTPP

5.1.4.1 *Dispute Settlement under the CPTPP*

The CPTPP is an FTA between Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore, and Vietnam. All eleven countries signed it on 8 March 2018 in Santiago, Chile. The CPTPP entered into force on 30 December 2018 for Australia, Canada, Japan, Mexico, New Zealand, and Singapore. Vietnam joined them on 14 January 2019.

Under the CPTPP, ISDS appears in Section 9B of Chapter 9, which sets out a multi-tiered dispute resolution mechanism between investors and the receiving host states.

5.1.4.2 *Six-Months' Cooling-off Period*

Prior to commencing arbitration, the claimant is required to serve a *written request for consultations setting out a brief description of facts regarding the measure or measures at issue*. Disputing Parties are then required to engage in consultations and negotiations for six months from the respondent's receipt of the claimant's written request for consultations. The claimant is also required to serve a written notice of intent to submit a claim to arbitration containing specified details on the respondent 90 days before submitting a claim to arbitration.

5.1.5 The Regional Comprehensive Economic Partnership

The Regional Comprehensive Economic Partnership (**RCEP**) currently is the world's most expansive FTA (by the number of its members) excludes ISDS dispute settlement mechanisms for foreign investment under its Chapter 10. However, Article 10.18 of the RCEP provides that the parties shall discuss this topic within two years after the treaty enters into force. Recent news suggests that such an RCEP ISDS mechanism might already be in the making among its Member States.

In the wake of these negotiations, some want to interpret the RCEP's Chapter 19 as investors' opportunity to cloak their claims in state-to-state litigation, thereby circumventing Chapter 10's restrictions to investor-to-state disputes. While this loophole might be a viable option in some cases, most investors under the RCEP will have to await the introduction of an explicit ISDS mechanism under Article 10.18 in the coming years.

5.1.6 Vietnam's other FTAs

Vietnam has signed several other FTAs with states and supranational organisations that contain ISDS mechanisms. Noteworthy amongst them stand the agreement between the UK and Vietnam (**UKVFTA**) and the Vietnam-Eurasian Economic Union Free Trade Agreement (**VN-EAEUFTA**). Vietnam is also a member of the Association of Southeast Asian Nations (**ASEAN**) treaties and, therefore, a signatory of the 2009 ASEAN Comprehensive Investment Agreement.

5.1.7 Vietnam's Bilateral Investment Treaties

While Vietnam still has several BITs in place with countries worldwide, many of them have now been replaced by superseding multilateral agreements, like the EVFTA. Overlapping BITs like those with the Netherlands, Germany, France, and others, who formerly entertained bilateral trade relations under favourable conditions with Vietnam, will be amalgamated under superseding FTAs with a larger scope.

As the EVFTA's accompanying IPA, the EVIPA has not yet entered into force. For the transition phase, Article 4.20 of the treaty states that pre-existing ISDS clauses

in BITs between Vietnam and Member States of the EU remain effective. Conversely, Article 4.20 of the EVIPA also provides that overlapping BITs (listed in its Annex 6) shall be terminated and superseded by the EVIPA, upon ratification. Annex 6 contains pre-existing BITs between 21 EU-Member States and Vietnam.

Remaining active BITs (e.g. with Thailand, Taiwan, United Arab Emirates) also contain ISDS mechanisms available to mutually foreign investors. Their scope and particularities vary and require a case-by-case basis examination concerning remedial measures and procedures.

5.2 Practice

5.2.1 Frequency

From a practical perspective, investors are not frequently forced to invoke ISDS to hold Vietnam accountable for violations of bilateral investment policies. The true strength of ISDS mechanisms lies in their inherent threat potential, which seems to instil a high degree of compliance in member states to their treaty commitments. The risk of being held accountable for discriminative actions and fears of potential economic knock-on effects of such disadvantageous publicity have made popular investment destinations like Vietnam wary of infringements and increased transparency and compliance with treaty commitments.

5.2.2 Confidentiality

In practice, arbitration – including ISDS procedures, which are generally subject to the same set of rules – are confidential procedures that take place outside of the public venue. The parties to such proceedings habitually have to commit not to disclose any details, including the contents of the final award. Consequently, there is not much precedent for cross-border arbitration instigated under IPAs in the public domain. Nevertheless, recent examples of successful litigation against Vietnam that have leaked into the public domain awarded damages to investors.

Increasing volumes of expert commentary propose the sensibility of rolling back confidentiality obligations in arbitration proceedings in an ISDS context. In legal practice, precedence creates predictability and increases transparency, essential components of investors' confidence in an investment destination.

6. Last But Not Least: What Else Should Investors Know about the Practice of ISDS?

Whenever in scope, ISDS establishes foreign investors' right of action to sue host states in front of ratified private arbitration institutions following pre-defined rules. These rules contain procedural regulations and set out other auxiliary guidelines about the modalities of the trial. ISDS mechanisms are, therefore, the gateway to international arbitration, in which an affected investor may raise his claims against national states directly in front of an impartial legal institution.

6.1 Procedural Side

To determine the procedural rules to a dispute under ISDS (e.g., submission of claims, the constitution of the arbitral Tribunal, taking of evidence, costs, deadlines, etc.), the ISDS clause will indicate the investor's appropriate options. The procedural rules are either tied to an established and reputable arbitral institution (e.g., ICC, SIAC, HKIAC, LCIA, etc.) or may vary, depending on the case and the underlying ISDS clause. Member states to international treaties commonly agree to subject potential claims under ISDS to the *United Nations Commission on International Trade Law (UNCITRAL)*, the *ICSID Convention and Rules of Procedure for Arbitration Proceedings*, and other widely accepted agreements.

6.2 Costs

Tribunals usually attribute the costs of arbitration to the losing party. The unpredictable length and costs of arbitral proceedings under ISDS regimes can still be a solid deterrent to investors. When faced with the choice to bring a claim against a violating host country, these concerns can easily outweigh the proposed advantage of settling a dispute in a single instance without appeal.

The costs of these proceedings, though usually significant, may vary from case to case. Several factors influence the parties' expenses, including the complexity of the claim, whether a party raises any preliminary defences, the extent of disclosure or document production, possible interim injunctions, and whether the proceedings are conducted in one or multiple languages.

Though the loser will usually bear the costs, there is no universal principle for who picks up the bill of ISDS arbitration. The ISDS agreement may stipulate the allocation of costs. If it does not, the applicable rules may specify a principle of cost allocation, such as "loser pays."

More often than not, the share of costs is subject to the Arbitral Tribunal's discretion, which will factor in considerations like the parties' relative success and conduct during the proceedings. Arbitration costs, such as the cost of the Tribunal's fees, any institutional fees, hearing centre rental costs etc., are often treated separately from the costs of prosecuting or defending a claim, which typically include legal fees, expert fees, travel costs etc.



6.3 Enforcement Side

The enforcement of arbitral awards can pose a significant obstacle to the compensation of successful claimants in ISDS arbitration. Vietnam, particularly, has

a reputation of being a fickle territory for the enforcement of foreign awards. By imposing onerous local proceedings that translate to additional costs and unreasonable waiting periods, investors' efforts to recover damages are often without result.

In practice, this means that many claims awarded to foreign investors against Vietnamese counterparties remain uncompensated due to patchy enforcement policies or inadequate acknowledgement by Vietnamese courts. Whether this will improve under novel ISDS mechanisms such as the EVIPA will be the litmus test and a core indicator of these treaties' success.

Final judgments under EVIPA arbitration will be enforced by the respective opposing Member State's courts as if they were the judgment of a domestic court. During the first five years, however, decisions in which Vietnam is the respondent will still be subject to the procedures for recognition and enforcement under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (**New York Convention 1958**).

Under the CPTPP and other less innovative treaties, a victorious party in the arbitration may only seek enforcement of its award under the ICSID Convention, the New York Convention 1958, or the Inter-American Convention.

6.4 Statutes of Limitation

Most ISDS mechanisms subject investors' right to submit claims to a specific time limit. Such Statutes of Limitation (**SoL**) aim to establish legal certainty between the parties of potential disputes and serve as an agent of transparency in ongoing commercial relationships.

In this spirit, the EVIPA contains SoLs that necessitate a request for consultations to be submitted within three years from the date of the claimant's knowledge of the respondent's alleged breach and any incurred loss or damages. Alternatively, claims are also limited to within two years from the date on which the claimant ceases to pursue claims before a tribunal or court under domestic laws but no later than seven years after the date of claimant's knowledge of respondent's alleged breach.

Similarly, the CPTPP's ISDS mechanism truncates any claim to arbitration after three years and six months from the date of the claimant's knowledge of the respondent's alleged breach and any incurred losses or damages.

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