Yuriy Rudyuk,
The Brussels office of the Van Bael & Bellis, partner
(Brussels, Belgium)

HOW THE TRADE DISPUTES BETWEEN EU AND UKRAINE WILL BE SETTLED UNDER THE EU-UKRAINE ASSOCIATION AGREEMENT?

The Article deals with the Dispute Settlement Mechanism (DSM) under the EU-Ukraine Association Agreement setting out the main procedural elements of the DSM and comparing them with the DSM of the WTO. The article analysis the important departure of the current quasi-judicial DSM from the previously used DSM under the EU-Ukraine Partnership and Cooperation Agreement which essentially relied on the diplomatic negotiation. The author concludes that while the EU-Ukraine AA DSM sets a very efficient, transparent and prompt framework for the dispute settlement, it is yet to be seen whether the Parties would actually choose to resort to it for settling their trade dispute instead of solving a dispute in already familiar WTO forum.

Keywords: dispute settlement mechanism, association agreement, procedure, international trade, Ukraine, EU, WTO.

Рудюк Ю. Яким чином торговельні спори між ЄС та Україною будуть вирішуватися згідно з Угодою про асоціацію між ЄС та Україною? — Стаття.

Стаття присвячена питанням Механізму вирішення спорів (DSM) відповідно до Угоди про асоціацію між Україною та ЄС, визначаються основні процедурні елементи DSM та порівнюються з аналогічними елементами

DSM СОТ. В статті аналізуються важливі відмінності сучасного квазі-судового DSM від раніше використовуваного DSM відповідно до Угоди про партнерство та співробітництво між Україною та ЄС, який повністю покладався на дипломатичні переговори. Автор зазначає, що хоча DSM відповідно до Угоди про асоціацію України та ЄС встановлює дуже ефективну, прозору та швидку основу для врегулювання спорів, поки що незрозуміло, чи будуть сторони на практиці обирати її для врегулювання своїх торговельних спорів замість врегулювання спорів у більш знайомих органах СОТ.

Ключові слова: механізм вирішення спорів, угода про асоціацію, процедура, міжнародна торгівля, Україна, ЄС, СОТ.

Рудюк Ю. Каким образом будут решаться торговые споры между ЕС и Украиной в соответствии с Соглашением об ассоциации между ЕС и Украиной? — Статья.

Статья посвящена вопросам Механизма разрешения споров (DSM) в соответствии с Соглашением об ассоциации между Украиной и ЕС, определяются основные процедурные элементы DSM и сравниваются с аналогичными элементами DSM ВТО. В статье анализируются важные различия современного квази-судебного DSM от ранее используемого DSM в соответствии с Соглашением о партнерстве и сотрудничестве между Украиной и ЕС, который полностью полагался на дипломатические переговоры. Автор отмечает, что, хотя DSM в соответствии с Соглашением об ассоциации Украины и ЕС устанавливает очень эффективную, прозрачную и быструю основу для урегулирования споров, пока не ясно, будут ли стороны на практике выбирать ее для урегулирования своих торговых споров вместо урегулирования споров в более знакомых органах ВТО.

Ключевые слова: механизм разрешения споров, соглашение об ассоциации, процедура, международная торговля, Украина, ЕС, ВТО.

Introduction

The EU-Ukraine Association Agreement (hereinafter: «EU-Ukraine AA» or «AA») is widely considered to be «*the most ambitious agreement the European Union has ever offered to a non-Member State»* [1].

The EU-Ukraine AA consists of more than 2,000 pages including 46 annexes, 3 protocols and a joint declaration [2] covering a very wide spectrum of the EU-Ukraine relations, including economic cooperation, convergence in the fields of common foreign and security policy, cooperation in the area of freedom, security and justice. The EU-Ukraine

AA was ratified during a synchronized session by the *Verkhovna Rada* and the European Parliament on 16 September 2014 and it has been provisionally applied since 1 November 2014 in anticipation of the ratification by all the EU Member States before it can enter into force. Following the ratification of the EU-Ukraine AA by the Dutch Senate on 30 May 2017, it is expected that the Agreement will enter into force in July this year following the EU-Ukraine Summit in Kyiv. In a statement, Jean-Claude Juncker, the president of the European Commission, said «We are nearly there. Our association agreement… is now one step closer to being ratified. I would like to see the process now being finalized swiftly, in time for the EU-Ukraine Summit in July» [3].

Of particular significance is the Deep and Comprehensive Free Trade Area (DCFTA), which forms an integral part of the EU-Ukraine AA and which covers substantially all trade between the EU and Ukraine aiming at the highest possible degree of liberalization by including legally binding legislative approximation commitments. The key instrumental goal of the EU-Ukraine AA, and, in particular, of its trade related part of the DCFTA, is to achieve Ukraine's gradual integration into the Internal Market of the EU (Art.1 (d)).

The DCFTA chapters cover substantive provisions on trade liberalization and economic integration but also contain a number of horizontal mechanisms. One of the most important horizontal mechanisms of the DCFTA is, in my view, the Dispute Settlement Mechanism (DSM). The main research question of this article is to analyze how the DCFTA DSM is expected to function and what are the similarities and differences of this new dispute settlement mechanism when compared with the widely used dispute settlement mechanism under the WTO.

General provisions of the Dispute Settlement Mechanisms under EU-Ukraine AA

A dispute settlement mechanism forms part of the overall structure of the EU-Ukraine AA and its inclusion into the Agreement is crucial because there will inevitably be disagreements concerning the scope and the nature of the commitments that both Parties have made. Obviously, international

trade rules are effective when they are properly applied. Therefore, dispute settlement mechanisms are set up in most trade agreements to ensure that the agreements can be enforced and that disputes can be settled effectively.

Almost all Free Trade Agreements (FTAs) rely in practice on one of the three general types of dispute settlement mechanisms:

— diplomatic settlement by negotiation;

— judgments by standing tribunals;

— the World Trade Organization (WTO) model, in which a panel is established to hear and adjudicate a dispute.

The currently dominant model for FTAs dispute settlement is based on the WTO's dispute settlement system (originally developed under GATT). The WTO's dispute settlement procedures have formed expectations of the governments concerning reliable dispute settlement and enforcement system in trade agreements. Therefore, the FTAs negotiations have frequently resorted to the WTO-like system as the basis for the dispute settlement system in FTAs.

The objective of the EU-Ukraine DCFTA DSM is set out clearly: *«to avoid and settle, in good faith, any dispute between the Parties […] and to arrive at a mutually agreed solution wherever possible» (Art. 303)*.

At the outset, it has to be mentioned that for the disputes concerning the interpretation and application of the non-DCFTA provisions of the EU-Ukraine AA, a standard dispute settlement mechanism is provided in accordance with Article 477 of the EU-Ukraine AA. This mechanism provides that the Association Council can settle disputes after consultations by issuing a binding decision. In cases, when an agreement cannot be reached within the Association Council after a three-month period, the complaining party may take «appropriate measures». Article 478 of the EU-Ukraine AA specifies that in selection of appropriate measures, priority shall be given to those which least disturb the functioning of the AA. Such measures may not include the suspension of any rights or obligations provided for under the provisions of the EU-Ukraine DCFTA. Exceptions apply to violations by a Party of the essential elements of the EU-Ukraine DCFTA (Article 478, para. 3).

The most innovative and advanced elements of the dispute settlement under the EU-Ukraine AA concern with the way disputes are to be settled

with regard to the interpretation and application of the DCFTA provisions. Indeed, Chapter 14 of Title IV provides the basis for a new, separate and prompt DSM. The new DSM clearly departs from the traditional diplomatic approach to dispute settlement which essentially relied on consultations and negotiations as the main tools in order to solve a trade dispute.

The EU-Ukraine DCFTA DSM provides for a modern and «quasi-judicial» model of dispute settlement which has been inserted in all FTAs of the EU since 2000 and which is largely based on the WTO Dispute Settlement Understanding (DSU) [4]. The new model of the DSM was the first time included in 2000 (EU-Mexico FTA). Garcia Barcero (2006), a negotiator for the European Commission, surveys the development of the Commission's thinking on dispute settlement in trade agreements, starting with the traditional diplomatic approach seen in the EU's association agreements and other agreements before 2000, and discusses why the Commission's preferences have shifted toward ad hoc arbitration procedures in the FTAs with Mexico and Chile.

Scope

The provisions of the DSM apply to any dispute concerning the interpretation and application of the provisions of the EU-Ukraine DCFTA, except when otherwise expressly provided (Art. 304). According to Article 52 of the EU-Ukraine AA, the following sections of the EU-Ukraine DCFTA have been excluded from the jurisdiction of the DSM:

— Trade Remedies: global safeguard measures, safeguard measures on passenger cars, anti-dumping and countervailing measures (Art. 52);

— Anti-trust and mergers (Art. 261);

— Trade and Sustainable Development (Art. 300 (7));

The EU-Ukraine AA also provides specific DSM provisions relating to regulatory approximation (Art. 322). As mentioned above, under the EU-Ukraine AA, Ukraine has undertaken to apply, implement or incorporate in its domestic legislation a pre-determined set of EU laws. In case when a dispute would arise concerning the interpretation and application of the provisions relating to regulatory approximation, the arbitration panel shall not decide the question, but request the Court

of Justice of the EU to give a ruling on the question. This concerns the following Chapters of the Agreement: Chapter 1 (Technical Barriers to Trade), Chapter 4 (Sanitary and phytosanitary Measures), Chapter 5 (Customs and Trade Facilitation), Chapter 6 (Establishment, Trade and Services and Electronic Commerce), Chapter 8 (public Procurement) and Chapter 10 (Competition). The ruling of the Court of Justice of the EU will be binging on the arbitration panel. This mechanism whereby the questions of the legal interpretation of the EU *acquis* incorporated into the EU-Ukraine AA are directed to the EU Court via the preliminary ruling procedure is crucial for ensuring homogeneous interpretation of the incorporated EU *acquis.*

Finally, it should be noted that the rulings of the arbitration panels do not have direct effect since it is provided that the *«[the arbitration panel rulings] shall not create any rights or obligations for natural or legal persons»* (Art. 321 EU-Ukraine AA).

Consultations

When there is a dispute regarding the interpretation and application of DCFTA, the DSM provides that the Parties shall first enter into consultations in good faith with the aim of reaching a mutually agreed solution. A Party may seek consultations by means of a written request to the other Party identifying the measure at issue and the provisions of the Agreement that it considers applicable. Consultations shall be held within 30 days (Art. 321 EU-Ukraine AA) of the date of receipt of the request and shall take place, unless the Parties agree otherwise, in the territory of the Party complaint against. The Parties may continue consultations at the latest stages of dispute settlement and may reach a mutually agreed solution to a dispute at any time. They should notify the Trade Committee and the chairperson of the arbitration panel of any such solution.

A consultation stage is important because it gives the Parties an opportunity to have a focused discussion about a specific issue (often it is about market access barriers or new legislation and its compatibility with the commitments under FTA). The consultations allow for a cost

effective platform for the parties to settle their dispute with high level of control over the outcome by negotiation.

Consultations are also important because they provide a good opportunity to clarify the facts and to gather all the relevant data in order to carefully evaluate the strength of the case before determining a Party's further litigation strategy. For the responding Party, consultations may also offer a good opportunity to avoid litigation (and reduce dispute settlement costs) by trying to convince the other Party that some or all of the claims are not worth bringing to further litigation stage.

Establishment of the arbitration panel

If the parties have failed to resolve the dispute by recourse to consultations, the complaining party may request establishment of an arbitration panel. The EU-Ukraine AA provides the standard terms of reference of the arbitration panel: «*to examine the matter referred to in the request for establishment of the arbitration panel, to rule on the compatibility of the measure in question with the provisions of this Agreement […] and to make a ruling in accordance with Article 310 of this Agreement*».

Both Parties have the right to establish an arbitration panel, which is composed of three arbitrators. A permanent list of 15 arbitrators is envisaged under the EU-Ukraine AA (five from each of the Parties and five who are nationals of either Party) with specialized knowledge or experience of law and international trade. All arbitrators appointed to serve on an arbitration panel shall be independent, serve in their individual capacity and not take instructions from any organization or government, or be affiliated with the government of any of the Parties, and shall comply with the Code of conduct set out in Annex XXV to this Agreement.

The procedure is different from the WTO DSU which relies on *ad hoc* selection of the arbitrators (panelists) from an open roster. Chairperson of the arbitration panel will be appointed from the nationals of either Party. In case the Parties cannot agree on the composition of the panel, it is provided that the panelists will be drawn by lot from the list of the arbitrators. At the time of writing the present article, the selection

procedure of appointing five independent arbitrators from Ukraine was expected to be formally completed soon in accordance with the Decree of the Cabinet of Ministers of Ukraine dated 2 December 2015 No 995 and the Order of the Ministry of Justice of Ukraine dated 25 May 2016 No149/5 «On selection of the candidates to be appointed as arbitrators on behalf of Ukraine for the arbitration panels in the framework of the dispute settlement mechanism, provided in Articles 306 and 307 of the EU-Ukraine AA». The arbitrators should comply with the Code of Conduct which is provided as Annex XXV of the EU-Ukraine AA.

Importantly, the Parties cannot block the initiation of the arbitration procedures by refusing to appoint an arbitrator. This important characteristic feature distinguishes the present DSM from the previous, predominantly diplomatic DSM in the framework of the Partnership and Cooperation Agreement (PCA). Indeed, according to diplomatic sources, under the PCA DSM, the EU intended to initiate an arbitration procedure over the Ukrainian legislation promoting automobile production, but failed to do so due to the alleged refusal of Ukraine to appoint its own arbitrator to adjudicate this dispute.

Interim Panel Report

The arbitration panel must issue to the Parties its interim report setting out the findings of the facts, the applicability of the relevant provisions and the basic rationale behind any findings and recommendations within 90 days of the date of establishment of the arbitration panel (in certain cases when it is no possible to respect the 90 days deadline due specific reasons, an extension is possible but in no circumstances should an interim report be issued later than 120 days of the date of establishment of the arbitration panel). Any Party may submit a written request for the arbitration panel to review precise aspects of the interim report within 14 days of its issuance. As it is the case with the consultation stage, shorter deadlines are set for issuance of the Interim Report and questions from the Parties on certain aspects of the Report: half the standard time for the disputes involving seasonal or perishable goods and 20 days and 5 days respectively for the disputes concerning trade in energy matters (Art 308(2) and 308 (3)).

Arbitration Panel Ruling

The arbitration panel must notify its ruling to the Parties and to the Trade Committee within 120 days of the date of establishment of the arbitration panel (with possibility of extension but under no circumstances should the ruling be notified later than 150 days from the date of establishment of the arbitration panel. Disputes involving seasonal or perishable goods again are subject to a shorter deadline for the arbitration panel ruling, i.e. 60 days with the maximum extension to 75 days from the date of establishment of the panel. Even a shorter deadline has been set for issuance of the arbitration panel ruling for the trade in energy related disputes, i.e. 40 days from the date of establishment of the arbitration panel with no possibility of an extension (Art. 310 (2) and 310(3)).

The above-described arbitration procedure under the EU-Ukraine AA is significantly more expedite (i.e. 150 days) than that under the WTO DSU which sets a nine months deadline from the panel establishment to adoption of the panel report by the Dispute Settlement Body.

It should also be noted that the EU-Ukraine AA does not provide for an appellate procedure which is another distinctive feature when compared to the WTO DSU where the Appellate Body can uphold, modify or reverse the legal findings and conclusions of a panel.

Compliance and remedies

Each Party is obliged to take measures necessary in order to comply in good faith with arbitration panel ruling, and the Parties will endeavor to agree on the period of time to comply with the ruling. The complying Party has 30 days after the notification of the arbitration panel to notify the other Party and the Trade Committee about the reasonable period of time it considers necessary for compliance. The complying Party is then obliged to notify the complaining Party and the Trade Committee before the end of the reasonable time of any measure it has taken to comply with the arbitration ruling.

In case of disagreement concerning the existence or consistency of the notified measure, the complaining Party may request the original

arbitration panel to rule on the matter. The arbitration panel must notify its ruling within 45 days of the date of submission of the request.

If no agreement on compensation is reached, the complaining Party is entitled to suspend obligations arising from any provision contained in the EU-Ukraine DCFTA at a level equivalent to the nullification or impairment caused by the violation. In suspending obligations, the complaining Party may choose to increase its tariff rates to the level applied to other WTO Members on a volume of trade to be determined in such a way that the volume of trade multiplied by the increase of the tariff rates equals to the value of the nullification or impairment caused by the violation (Art. 315(3)).

The above-described compliance procedure under the EU-Ukraine AA DSM is largely similar to that under the WTO DSU where the compliance begins with setting a deadline for compliance through negotiations with a 15-month benchmark for the compliance deadline. During the period before the deadline, the complying party must report on its actions and in case compliance has not taken place before the deadline, the Dispute Settlement Body may authorize the complainant to suspend concessions or other obligations under the WTO, in an amount equivalent to the nullification (or impairment). In case there is a dispute concerning compliance, it must be settled under the WTO DSU with recourse to the original panel (whenever possible).

Mediation mechanism

A separate mediation mechanism is provided that allows the Parties to seek mutually agreed solutions through a comprehensive and expeditious procedure concerning market access issues concerning non-tariff measures (Art. 324 EU-Ukraine AA). The purpose of the mediation procedure is not to review the legality of a measure, but rather to find a prompt and effective solution to a particular market access issue without recourse to litigation (the mediation mechanism does not exclude the possibility to have recourse to dispute settlement) (Art. 324 EU-Ukraine AA). This mechanism functions through an appointment of a mediator who can advise and propose a non-binding solution within 60 days (Art. 324 EU-Ukraine AA).

As for the WTO practice in this regard, Article 5 of the WTO DSU provides for the possibility of good offices, mediation or conciliation, if agreed to by «*the parties to a dispute*», which implies that a dispute exists. However, Article 5 has never been used *during* an on-going dispute since the only known resort to mediation under the said Article under the WTO DSU took place *prior* to the dispute, i.e. in 2002 concerning the European Community tariff preferences for canned tuna instead of initiating formal dispute settlement proceedings.

Relationship with the WTO DSU and the WTO jurisprudence

There are normally three options for dealing with forum shopping in dispute settlement: give precedence for the FTA DSM, give precedence to the WTO or other proceedings; or allow the parties to choose but prohibit re-litigation.

Given a choice between brining a dispute under the WTO or under a FTA, most complainants choose the WTO, which is one of the reasons why there are so few FTAs disputes. It is generally perceived that complainants prefer the WTO for a number of reasons: significant number of cases, greater level of predictability about the likely outcome of the dispute, strong compliance obligations and enforcement mechanisms, appellate procedures and the possibility to mobilize third-party support.

The EU-Ukraine AA DSM excludes the possibility of parallel, concomitant or repetitive dispute settlement procedures under the WTO Agreement and under the EU-Ukraine AA DSM. Indeed, where a Party has, with regard to a particular measure, instituted a dispute settlement proceeding, either under the EU-Ukraine AA DSM or under the WTO Agreement, it may not institute a dispute settlement proceeding regarding the same measure in the other forum until the first proceeding has been concluded. In addition, a Party shall not seek redress of an obligation which is identical under the EU-Ukraine AA and under the WTO Agreement in the two forums. Once a dispute settlement procedure has been initiated, the Party shall not bring a claim seeking redress of the identical obligation under the other Agreement to the other forum, unless the forum selected

fails for procedural or jurisdictional reasons to make findings on the claim seeking redress of that obligation.

It should be noted the difference of the initiation procedures under AA and WTO. For the dispute settlement proceedings under the WTO Agreement, the proceedings are deemed to be initiated by a Party's request for the establishment of a panel under Article 6 of the WTO DSU. For the dispute settlement proceedings under the EU-Ukraine AA, the proceedings are deemed to be initiated by a Party's request for establishment of an arbitration panel under Article 306(1) of the Agreement.

At the moment of writing of the present article, no dispute has been initiated under the WTO Dispute Settlement Understanding between the EU and Ukraine it is therefore remains to be seen how the issue of jurisdictional choice of a dispute will be addressed by the Parties.

With regard to the existing WTO jurisprudence, it must be mentioned that in cases where an obligation under the EU-Ukraine AA is identical to an obligation under the WTO Agreement, the arbitration panel shall adopt an interpretation which is consistent with any relevant interpretation established in rulings of the WTO Dispute Settlement Body.

Concluding remarks

With the expected entry into force of the EU-Ukraine AA later this year, only time will tell whether its new DSM will be resorted to in order to resolve trade disputes between the EU and Ukraine. However, already at this early stage it is important to mention that the DSM provided in the EU-Ukraine AA sets out a new and advanced system of dispute settlement which could be used to effectively avoid and resolve trade disputes.

Clearly, trade frictions between the EU and Ukraine could arise (as recently evidenced by the EU criticism of the two measures Ukraine adopted to regulate export of unprocessed timber and steel scrap) and in such circumstances the EU-Ukraine AA DSM provides for an orderly manner for the Parties to settle their disputes. Only time will tell whether the Parties would actually resort to the new DSM mechanism under the EU-Ukraine AA or would rather prefer the WTO which is already familiar, credible and legitimate mechanism with available institutional

framework of the Secretariat and possibility of an appeal. In addition, the costs of the WTO DSM are already paid by the Parties' respective WTO contributions whereas the costs for the DSM under the EU-Ukraine AA are to be borne by the Parties.

Exclusion of some of the Chapters from the EU-Ukraine AA DSM such as safeguard and anti-dumping measures directs settlement of the disputes on such matters exclusively to the WTO. Also, importantly, the EU-Ukraine AA DSM will have no jurisdiction over interpretation of the EU *acquis* in regulatory approximation matters since in such cases a reference for a preliminary ruling by the Court of Justice would be required.

At the same time, a number of issues could exclusively be dealt through the EU-Ukraine AA DSM. Among them is denial of rights that are only provided for and created by the EU-Ukraine such as, for instance, preferential market access or preferential rules of origin.

Finally, it must be pointed out that the EU-Ukraine AA DSM is also needed in order to ensure that the promises and commitments set out in the EU-Ukraine AA are maintained. Indeed, economic projections of the gains from any Free Trade Agreement are based on the assumption of full compliance with the Agreement's obligations. Ensuring compliance through enforcement and efficient dispute settlement mechanism is crucial for the EU-Ukraine AA gains to materialize.

BIBLIOGRAPHY

1. *Remarks* by President of the European Council Herman Van Rompuy at the press conference of the Eastern Partnership summit in Vilnius. European Council. The President. Vilnius, 29 November 2013. EUCO 254/13. URL: http://data.consilium.europa.eu/doc/document/ST-254-2013-INIT/en/pdf
2. *Association Agreement* between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Ukraine, of the other part. Official Journal of the EU, (OJ, 2014, L161).
3. *Statement* by Jean-Claude Juncker, President of the European Commission, on the vote in the Dutch Senate on the ratification of the Association Agreement between the European Union and Ukraine. Brussels, 30 May 2017. European Commission. STATEMENT/17/1461. URL: http://europa.eu/rapid/press-release_STATEMENT-17-1461_en.htm

4. *Understanding* on Rules and procedures Governing the Settlement of Disputes. Annex 2 of the WTO Agreement. URL: https://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm
5. *Broude, T.* From Pax Mercatoria to Pax Europea: How Trade Dispute Procedures Serve the EC's Regional Hegemony. In Economics of European Union Law, ed. Paul B. Stephan. Cheltenham, U.K.: Edward Elgar. 2007. P. 319—34.
6. *Bilateral* and Regional Trade Agreements: Commentary and Analysis, ed. Simon Lester and Brian Mercurio. Cambridge, U.K.: Cambridge University Press. 2015. 496 p.
7. *Morgan, D.* Dispute Settlement under PTAs: Political or Legal? In Challenges to Multilateral Trade: The Impact of Bilateral, Preferential and Regional Agreements, ed. Ross Buckley, Vai Io Lai, and Laurence Boulle. Alphen aan den Rijn, Netherlands: Kluwer Law International. 2008.
8. *Preferential* Trade Agreement Policies for Development: A Handbook, Ed. J.-P. Chauffour and J. Ch. Maur. World Bank. 2011.
9. *Szepesi, St.* Comparing EU Free Trade Agreements: Dispute Settlement. In Brief. Donaldson, Victoria, and Simon Lester. 2009.
10. *G. Van der Loo, B. Nijhoff.* The EU-Ukraine Association Agreement and Deep and Comprehensive Free trade Area. 2015.
11. *Xuto, N.* Thailand: Conciliating a Dispute on Tuna Exports to the EC. In Managing the Challenges of WTO Participation: 45 Case Studies, ed. Peter Gallagher, Patrick Low, and Andrew Stoler. Cambridge, U.K.: Cambridge University Press. 2005.