

Markus Krajewski and Rhea Tamara Hoffmann

# The European Commission's Proposal for Investment Protection in TTIP

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# FOREWORD

Since summer 2013 Brussels and Washington have been negotiating the Transatlantic Trade and Investment Partnership (TTIP). Special arrangements for investment protection and dispute settlement between private investors and states represent a central aspect of the planned agreement, alongside a sweeping abolition of tariff and non-tariff trade barriers. As the most far-reaching and comprehensive regional trade and investment agreement to date, TTIP is intended not only to promote transatlantic trade and investment activity but also to set the course for future globalisation.

Ever since the talks began, the planned agreement has been the subject of great public controversy. While supporters point to positive growth, employment and prosperity effects, critics fear significant erosion of workers' rights, deterioration of social, environmental, health and consumer protection standards, and consequently significant reductions in standard of living for broad sections of the population on both sides of the Atlantic. The provisions concerning investment protection have turned out to be a particularly contested sphere. Above all, the initially proposed investor-state dispute settlement (ISDS) with private ad-hoc tribunals drew heavy criticism from all sides. It was feared that this model would present considerable dangers to rule of law, public finances and democracy by establishing a two-class or parallel legal system involving potentially very large claims for damages and legal costs, and by weakening the state's right to regulate.

In response to persistent heavy criticism of the investment protection rules planned for TTIP, the European Commission suspended the talks on the investment chapter at the beginning of 2014 and conducted a public consultation on investment protection from March to July 2014. In autumn 2015, on the basis of the results of the consultation and other initiatives of the member-states, the Commission presented a new proposal on investment protection, which included a number of changes to the original approach. It now favours a new international Investment Court System with a permanent bilateral investment court and rules improving the transparency of the dispute settlement process and strengthening the independence and qualifications of the judges. This new model is to form the basis of further

negotiations with the United States on the investment chapter in TTIP.

It was against that background that Friedrich-Ebert-Stiftung joined with the Deutsche Gewerkschaftsbund to commission a piece of research by Prof. Dr. Markus Krajewski of the University of Erlangen-Nuremberg, analysing how the European Commission's new proposal for the investment chapter in TTIP should be assessed from the legal perspective. What improvements does the new approach bring? Does it overcome the central weaknesses of the "old" investor-state dispute settlement mechanism and the private ad-hoc tribunals? Or do major problems and deficits persist in this model too?

By answering these questions, we hope that this report will contribute to the process of making the extremely heated public debate over TTIP more objective and transparent. At the same time it will help to place the decision about whether to accept or reject the outcome of the TTIP negotiations – which will have to be taken by national and European parliamentarians following the conclusion of the talks – on a clearer and more neutral footing. We wish all our readers an insightful read.

## MARKUS SCHREYER

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## SUMMARY

Proposals concerning protections for investors and investments are among the most controversial topics in the talks between the United States and the European Union on a Transatlantic Trade and Investment Partnership (TTIP), which have been under way since July 2013. Exceptionally intense criticism of the arrangements for investment protection, especially investor-state dispute settlement, led the European Commission to hold a public consultation on investment protection in TTIP from March to July 2014. Against this backdrop and member-state initiatives, as well as ongoing political and media criticism of traditional investment protection agreements, in autumn 2015 the European Commission published a proposal for an investment chapter in TTIP.

In summary, the Commission's proposal does not essentially represent any fundamental rejection of the existing investment protection regime. The proposed bilateral Investment Court System eliminates certain procedural deficits in the existing investment arbitration tribunal system, such as improving transparency and establishing of a permanent panel of judges, but without institutional guarantees of complete judicial independence. With respect to substantive protections the Commission's proposal is based largely on the already finalised text of CETA. The clause on the right to regulate remains vague. The Commission has intentionally refrained from more radical steps, such as restricting substantive protection to the level of national treatment. Consequently, the Commission's proposal cannot exclude the possibility of regulatory measures adopted in the public interest (for example labour, social and environmental legislation) leading to compensation liability.

Ultimately, like all investment protection agreements, the Commission's proposal is based on the fundamental premise that foreign investors require special protections in the state hosting the investment, and that simply referring foreign investors to extant domestic protections for business activities, including legal recourse to domestic courts, is not sufficient. This approach establishes a legal regime that grants additional rights to foreign investors and thus always goes further than the legal protections for domestic investors. The Commission's proposal seeks to reform the current system of investor protection, but continues to offer foreign investors

procedural and substantive privileges without subjecting them to concrete obligations.

## 1

# INTRODUCTION AND BACKGROUND

Proposals concerning protections for investors and investments are among the most controversial topics in the talks between the United States and the European Union on a Transatlantic Trade and Investment Partnership (TTIP), which have been under way since July 2013. The originally proposed chapters on investment protection were largely based on the already finalised text of the Comprehensive Economic and Trade Agreement (CETA) between the European Union and Canada and received exceptionally intense criticism, especially concerning the arrangements on investor-state dispute settlement (see Krajewski 2014). This led the European Commission to hold a public consultation from March to July 2014 on investment protection in TTIP. Although the Commission hailed this as a new and innovative approach, it was in fact based for the most part on recent Canadian practice (supplemented by comprehensive transparency requirements for investor-state dispute settlement (ISDS)). The findings of the consultation, when they were finally published in January 2015, included a lack of trust among the European public in the independence and impartiality of the traditional system of investor-state dispute settlement. As the outcome of the consultation the Commission identified four areas in which there was a need for reform: protecting the state's right to regulate, creating a dispute settlement process compatible with rule of law, clarifying the relationship between domestic legal protections and investor-state dispute settlement, and introducing a second instance to review the decisions of the investor-state dispute settlement mechanism (European Commission 2015b, 2015c).

In the first half of 2015 a number of EU member-states (including Germany and France) took the initiative and disseminated proposals for reforming investment protection in TTIP and in other future European investment protection agreements. These proposals seek on the one hand an institutional reform of ISDS, and on the other to clarify and restrict the substantive protections. In institutional and processual terms, an international court was proposed (BMWi 2015). This aspect was generally prioritised in the political and media reception, while proposals designed to curtail substantive protections and strengthen the state's regulatory autonomy often tended to be ignored, even though this dimension of

the reform of investment protections is at least as significant as the finer details of the dispute settlement system.

In response to member-state initiatives and ongoing political and media criticism of traditional investment protection agreements, the European Commission in autumn 2015 published a proposal for an investment chapter in TTIP (in the following, "the Commission's proposal"), which is the subject of the present analysis. The first draft of the European Commission's proposal for an investment chapter in TTIP was released on 16 September 2015 (European Commission 2015d). A slightly revised text was presented to the United States in the 11th round of TTIP negotiations and published on 12 November 2015 (European Commission 2015e). That version, which has now been officially introduced into the TTIP talks, forms the basis for the following discussion. The Commission's proposal represents Section 2 ("Investment Protection") of Chapter II ("Investment") in the title on "Trade in Services, Investment and E-Commerce" in TTIP. The Commission's proposal on investment protection must therefore also be read in connection with the other chapters of that title, which were already published at the end of July 2015 (European Commission 2015a). In particular the proposals on investment liberalisation, which are found in the text already published in July 2015, are closely connected with the proposal on investment protection analysed here.

The European Commission's new trade strategy "Trade for All" published in October 2015 must also be regarded as relevant context (European Commission 2015f). In it, the Commission announces its intention to pursue a new path on investment protection, placing an initially bilateral, later multilateral permanent investment court at the heart of its reform initiatives. Clearly, the TTIP proposal should be regarded as anticipating this new strategy. Indeed, the free trade agreement between the European Union and Vietnam published in January 2016 contains an investment protection chapter similar to the TTIP proposal. To the surprise of most observers, the European Union also succeeded in anchoring an essentially comparable mechanism in the revised version of CETA published in March 2016.

The Commission's proposal for investment protection in TTIP is thus one part of a broader-based reform strategy

through which it wishes to shape future agreements. In this connection the question arises whether and how this new strategy can and should be implemented in the agreement with Singapore, which has already been finalised and still contains an “old” dispute settlement mechanism.<sup>1</sup>

The Commission’s proposals do not represent a fundamental rejection of the existing investment protection regime. Like all investment protection agreements, the Commission’s proposal is based on the fundamental premise that foreign investors require special protections in the state hosting the investment, and that simply referring foreign investors to extant domestic protections for business activities, including legal recourse to domestic courts is not sufficient. This approach establishes a legal regime that grants additional rights to foreign investors and thus always goes further than the legal protections for domestic investors. Here the Commission’s proposal diverges fundamentally from the demands raised by academics and critical political voices, to do without special procedural rights for foreign investors altogether and instead to rely on domestic legal protection in the host states or to resort to diplomatic protection.

The Commission’s proposal concentrates on responding to the problems identified through the public consultation of 2014. At its heart stands a reform of the dispute settlement process. The Commission’s proposed introduction of an Investment Court System represents an innovative and significant departure from the existing dispute settlement mechanisms. But in substantive terms the proposal principally develops and refines pre-existing standards that have already been applied in the agreements with Canada and Singapore, and exhibits no comparable innovative character.

The following brief analysis unfolds in three steps. Firstly, the draft is analysed in terms of the definitions used, its scope and its exceptions. The so-called “right to regulate” clause is also discussed (section 2). An investigation of the main substantive investment protections forms the next step (principle of fair and equitable treatment, principle of non-discrimination, protection against expropriation without compensation) (section 3). Finally, the procedural reforms and the creation of an Investment Court System are analysed (section 4).

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<sup>1</sup> The Commission explicitly refers to previous practice in investor-state arbitration mechanisms as “old style” (European Commission 2015g).

## 2

## SCOPE AND DEFINITION OF TERMS

### 2.1 PROTECTED INVESTMENTS AND INVESTORS

The Commission's proposal is based on a broad definition of "investment" that encompasses a broad range of assets. The list used to define investment in the draft is open-ended, producing a broader scope than would be expected of a closed list. The list used in the Commission's proposal also includes interests arising out of concessions even where these remain without commercial use.<sup>2</sup> This could also include mineral prospecting concessions, which would be problematic in the context of regulating or banning fracking. The investments covered by the Commission's proposal ("covered investments") also include all investments that are directly or indirectly held or merely (directly or indirectly) controlled, regardless whether the investments were made before or after the agreement comes into force.

An "investor" is defined as any natural or legal person of a party to the agreement that has made, makes or intends to make an investment in the territory of another party. Like the CETA text, the Commission's proposal narrows the definition of legal persons to those with "substantial business operations" in the territory of their home state (Chapter I, General Provisions, Article 1-1). As in CETA, this excludes so-called "letter-box companies". However, it remains unclear what specifically is to be understood under "substantial business operations".

Beyond this, in Article 9 the proposal contains a so-called "denial of benefits" clause that permits the parties to deny investment protection if an investor from a non-party "owns or controls the enterprise". This permits the protections of the investment chapter to be denied to particular companies, even if they are for example incorporated under US law, if third-state investors hold a majority of shares or have the power to legally direct its actions. However, the Commission's proposal lacks precise definitions of what is to be understood under ownership and control.

The broad definitions of investor and investment permit companies with complex transnational ownership structures to secure protection under the agreement for both direct and indirect holdings. Thus if a parent company structures its investments in the host state through one or more intermediate holding companies in different countries, any of them (even with minority ownership) may theoretically pursue a complaint, as long as the country in question has an investment protection agreement with the host state (UNCTAD 2011, 12–13). This arrangement offers no possibility to prevent so-called "treaty shopping" and permits parallel complaints by subsidiaries and parent companies. However, the possibility of denying access to the dispute settlement process if ownership is restructured after the dispute arose or when it was already foreseeable should also be mentioned (Article 15, Anti-Circumvention). This permits the tribunal to decline jurisdiction where a restructuring has been conducted exclusively for the purpose of gaining access to dispute settlement under TTIP.

### 2.2 PROTECTING THE STATE'S RIGHT TO REGULATE

State sovereignty includes the state's right to govern its own internal affairs. As international treaties, investment protection agreements restrict sovereignty by placing international obligations upon the state. One important debate in investment protection law relates to the question of the extent to which investment protection obligations constrain the right to regulate. One option for strengthening the state's right to regulate vis-à-vis investment protection that has been discussed and used in recent agreements is clauses explicitly underlining that right. Rather than excluding particular policy areas altogether from the scope of the agreement or using an exception clause to reconcile potential conflicts between investment protection and regulatory autonomy, such provisions generally serve only as interpretive guidance and possess no normative force of their own (Krajewski 2014, 14–15).

In Article 2 (1) the Commission's proposal contains a provision under which the rules on investment protection shall

<sup>2</sup> BMWi (2015) takes a different line: "For greater certainty, interests arising from a concession in the absence of any substantial economic activity based on the concession, do not constitute an 'investment'."



not affect the state's right to regulate, including state measures necessary to protect legitimate political objectives such as environmental and consumer protection. The list of legitimate policy objective is not conclusive, meaning that labour protections may also be considered. However, for reasons of legal clarity it would certainly be recommendable to include a formulation that explicitly mentions workers' rights (for example "labour protection including collective agreements") alongside the reference to "social protection" which could be interpreted more narrowly.

However, the legal content of Article 2 (1) is absolutely unclear. The formulation "shall not affect the right of the Parties to regulate" corresponds neither to the standard formulations in general justification clauses such as GATS Article XIV or NAFTA Article 1101 (4) (for example "nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures"<sup>3</sup>) nor to the formulations used for sectoral exceptions ("This agreement does not apply to"). While "shall not affect" does contain a command ("shall not"), it has however no clear legal implications and remains a mere observation ("affect"). As far as can be seen, this formulation has not hitherto been used in any other investment protection agreement.

Moreover, the formulation also contains a necessity test and protects only "legitimate" state objectives. The use of these terms opens up a margin of discretion in dispute settlement and takes out of the hands of the state the question of which measures truly respond to a necessity and which are regarded as disproportionate because of their scope. In fact, the necessity of state measures has in the past sometimes been interpreted very restrictively (Van Harten 2015, 4; Marwedel 2015).

Article 2 (2) of the Commission's proposal states that the provisions of the investment chapter cannot be interpreted to mean that any party had agreed never to alter its legal or regulatory framework. Certain investment tribunals had come to this far-reaching conclusion on the basis of so-called umbrella clauses. That is what Article 2 (2) is intended to exclude.

Umbrella clauses oblige the states parties to keep all promises they make in relation to investments within their territory by investors from the other states parties. This is designed to prevent state institutions influencing the extent and object of their direct treaty obligations to investors by altering the legal framework.

The umbrella clause contained in the Commission's proposal (Article 7) is restricted to written commitments to investors, and as such liable to be relevant principally to so-called investor-state contracts. The umbrella clause protects the investor against breach of written commitments by state action. However, if the action ensues from a regulatory measure (such as the withdrawal of a concession), the umbrella clause may indeed constrain the state's right to regulate. This would greatly curtail the force of Article 2 (2) in the Commission's proposal, if the investor is entitled to take action over written commitments.

Essentially, the right to regulate should be safeguarded by constraining the substantive protections (principle of fair and equitable treatment, most-favoured-nation principle, protection against expropriation without compensation etc.), in order to ensure equivalence between the "right to regulate" clause and the protections and effectively avoid conflicts between regulatory autonomy and investment protection.

As the discussion above demonstrates, the formulation selected by the Commission certainly raises numerous legal questions that can potentially be clarified in dispute settlement. It is thus also clear that the state's right to regulate is not so strongly protected as to be fundamentally exempt from becoming the subject of investment protection cases (see also Van Harten 2015, 5).

## 2.3 SECTORAL EXCEPTIONS

Despite its fundamentally broad approach, the Commission's proposal provides for a number of restrictions on the scope of the investment chapter. For example, where there is no concrete legal obligation to grant a subsidy, its refusal or termination cannot be regarded as a violation of the agreement (Article 2 (3) of the Commission's proposal).

Further provisions elsewhere in the draft (Section 2, Annex II: Public debt) exclude application of the protections and the dispute settlement process in cases relating to the restructuring of public debt. This adds measures relating to debt relief and bank restructuring and dissolution to the exclusions and removes this crucial sphere of financial and economic crisis management from investment protection.

It must also be critically noted that the Commission's proposal includes no exception for public procurement. While public procurement is exempt from the investment liberalisation obligations (Section 1, Article 2-1, see European Commission 2015a), there is no corresponding exception from the provisions on investment protection.

<sup>3</sup> The same formulation is also used in Article 2 (4) in the Commission's proposal, but this relates only to the termination of a subsidy found to be in contravention of EU law or the demand for its reimbursement at the request of the European Commission or a responsible court.

# 3

## SUBSTANTIVE INVESTMENT PROTECTION

### 3.1 NON-DISCRIMINATION

The principle of non-discrimination (Article 2-3(2)) and the most-favoured-nation principle (Article 2-4(2)) are found in Chapter 2 (Section 1, Liberalisation of Investment, see European Commission 2015a). The formulations of both corresponds to those in the CETA text. It should be noted that the most important restriction on the most-favoured-nation principle – under which other investment protection agreements must be ignored – is also included in the TTIP draft.

It should also be noted that the non-discrimination principle is largely directed towards preventing discrimination against foreign investors. The upshot of restricting investor protections to national treatment would give foreign investors the same protections against state measures as their domestic counterparts. And that would hardly place any greater constraints on state action than those that already ensue from national law, in particular constitutional law (BMW 2015; see also Marwedel 2015).

### 3.2 FAIR AND EQUITABLE TREATMENT

Article 3 states the principle of “fair and equitable treatment” in a slightly different form than in classical investment protection agreements. Rather than restricting itself to demanding fair and equitable treatment, it goes on to define criteria defining violations. The six measures listed in item 2 – including “denial of justice” by the host state, “manifest arbitrariness” and “fundamental breach of due process” – are largely those that arbitration has subsumed under violation of the principle of “fair and equitable treatment”. The proposal largely corresponds to the same clause in CETA.

Article 3 (4) stipulates that a commitment made by a host state that creates a legitimate expectation on the part of the investor may be taken into account when considering whether a violation of the agreement has occurred. As an interpretation of the principle of fair and equitable treatment, this protection of “legitimate expectation” has in the past been criticised as too far-reaching. The background to the criticism is a body of sometimes very expansive rulings

that have interpreted every (legislative) change that an investor failed to anticipate as a violation of the principle or made standards for dealings with foreign investors so strict that they cannot be satisfied even in highly developed legal cultures.

Here the draft proposes recognising as legitimate only those expectations that are based on a specific promise by the host state. But how that is to be interpreted remains unclear. In particular it does not specify that only written promises can justify protection of legitimate expectation. The formulation of the principle of fair and equitable treatment is therefore still too broad.

Closer examination of the construction of Article 3 reveals that while the principle of fair and equitable treatment is initially defined more narrowly than in earlier drafts – and than is the case in certain classical investment protection agreements – that restriction is then relativised by reference to the investor’s legitimate expectations.

### 3.3 PROTECTION AGAINST EXPROPRIATION WITHOUT COMPENSATION

The protection against expropriation without compensation formulated in Article 5 is comparable to the corresponding article in CETA, comprising the traditional formulation of the requirements for legal expropriation with compensation and a reference to Annex I, which is to be consulted for interpretation. Annex I serves as guidance in interpreting whether a case involves expropriation requiring compensation or state regulatory action not requiring compensation. Here the draft proposes that non-discriminatory measures in furtherance of legitimate political goals such as health, environmental and consumer protection do not represent indirect expropriation and are therefore not subject to any obligation of compensation. That does not, however, apply if the measure is so serious as to be obviously disproportionate. Although a test of proportionality always involves the option of weighing investor protection against state regulatory interest, the transfer of that discretion to an arbitration tribunal or court must be viewed critically.

The level of compensation is orientated on the fair market value of the expropriated investment immediately before the state intervention. While this yardstick is widely applied in investment protection law, it is not defined any more closely. The EU's Charter of Fundamental Rights, for example, simply demands "fair" compensation, and following the rulings of the European Court of Human Rights compensation for a lawful expropriation must be "reasonably related" to the value of the investment. Here, however, consideration of legitimate public interests can lead to compensation at less than full market value.<sup>4</sup> With respect to compensation for expropriations carried out under German law, one particular difference is that under German law no compensation is granted for lost future profits. Investment arbitration tribunals, on the other hand, regularly include future profits in their calculations of the value of investments.

Another financial factor is interest on the claim, which the Commission's proposal proposes calculating at a "normal commercial rate". This represents a rather vague basis for calculation where much more precise alternatives would be available (such as the London Interbank Offered Rate, LIBOR).

The European Union has no harmonised property protections that could be compared to the Commission's proposal. Instead, property law is largely defined by the member-states and thus exhibits variation. In the European Union the right to property is protected under Article 17 of the Charter of Fundamental Rights, but its application is restricted to acts of the organs and institutions of the European Union and the implementation of EU law by the member-states. Article 6 (3) of the Treaty on European Union incorporates the rights guaranteed in the European Convention on Human Rights in EU law as general principles of law. Article 1 (2) of Protocol 1 to the European Convention on Human Rights protects the right to property, and most member-states possess their own constitutional iterations of the right to property (for example in Germany Article 14 of the Basic Law). All EU member-states also possess numerous laws codifying the social function of property.<sup>5</sup> Both in the case of the protections of Article 14 of the German Basic Law and the right to property in the Charter of Fundamental Rights, these involve protections created by the legislator. This means that the substance of the property right is not preordained, but is shaped by decisions of the legislator. This is where the distinction lies between the property protections of investment protection and that of the EU member-states. The process of testing national and European property rights always involves a proportionality test, whereas this is not stipulated in the Commission's proposal.

provisions concerning balance of payments difficulties, tax measures and security exceptions will be inserted in the general part of the agreement and will then also apply to investment protection. It is therefore impossible to say with certainty how TTIP investment protection would affect the introduction of a financial transaction tax or control on capital movement.

Unlike the CETA text, the TTIP draft – as mentioned – contains an umbrella clause, although it is restricted to written agreements between state and investor. That caveat defuses the negative effects of broader umbrella clauses, which have often produced strong restrictions on state regulatory autonomy. At the same time, it should be critically noted that the inclusion of any kind of umbrella clause at all represents a retrograde step compared to CETA.

### 3.4 OTHER PROTECTIONS

Article 6 of the Commission's proposal contains a general proposal on free transfer of capital and payments associated with investments. Article 6 (3) defines exceptions, including for so-called "prudential measures". The text also states that

<sup>4</sup> ECHR, *Pincová and Pinc v. the Czech Republic*, Application No. 36548/97, Judgment of 5 November 2002, para. 53.

<sup>5</sup> ECJ Case 44/79 *Hauer* [1979] ECR 3727, para. 20–22.

# 4

## DISPUTE SETTLEMENT

The Investment Court System proposed by the Commission is the aspect of the draft that has drawn the greatest attention. After the public consultation revealed deep criticisms of the existing system, partly on the grounds that it represented an arbitration process, after proposals from Germany and France proposing the establishment of a bilateral court, the Commission has also come down for a fundamentally new system and thus confirmed the criticism of the old system of investor-state arbitration.

### 4.1 INVESTMENT COURT SYSTEM

In order to replace the investor-state arbitration system with a process more in keeping with democratic rule of law, the Commission proposes an Investment Court System comprising a Tribunal of First Instance with fifteen publicly appointed judges and an Appeal Tribunal (with six judges). In order to ensure its neutrality, the fifteen-member Tribunal of First Instance will be composed of five American judges, five from the European Union and five who are citizens of neither the United States nor the European Union.

The Tribunal of First Instance will hear investment cases in divisions of three judges. In a contradiction left unresolved in the proposal, the composition of divisions is to rotate yet remain random. Each division of the tribunals is to be composed of one US judge, one EU judge, and one "neutral" judge as chair. The Appeal Tribunal will hear cases as a standing panel of six judges: two American, two EU citizens and two neutral.

The Commission's proposal also lends institutions involved in the current investor-state arbitration system (such as the International Centre for Settlement of Investment Disputes (ICSID) and/or the Permanent Court of Arbitration) an administrative role in the new Investment Court System. One of these two institutions is to form the administrative secretariat of the court system. In Section 3, Article 6 (2), the Commission also proposes the possibility to submit a claim to the tribunal under ICSID or UNCITRAL rules. Given that the European Union is not a signatory of the ICSID Convention, the relationship

between the Commission's proposal and ICSID is unclear. In particular the question arises whether as a non-signatory the European Union is entitled to determine the validity of ICSID rules and the tasks of the ICSID secretariat in relation to a different international treaty (in this case TTIP). The role of existing procedural rules for investor-state arbitration raises a number of thus far unresolved questions and problems, upon which the Commission has yet to comment.

One positive aspect is that third-party funding is explicitly mentioned and must always be declared.

### 4.2 QUALIFICATION AND INDEPENDENCE OF JUDGES

The Commission's proposal bases the transformation from the classical system of investor-state arbitration to an Investment Court System largely on limiting the number of individuals involved in resolving disputes and compensating their effort with allowances.

In order to ensure the availability of judges, Section 3, Article 9 (12), proposes a so-called "retainer fee" of approximately €2,000 per month. All other fees are to be governed by Regulation 14 (1) of the Administrative and Financial Regulations of the ICSID Convention. The level is set by the Secretary-General and is currently \$3,000 per working day.<sup>6</sup> Because cases will be heard by three judges serving in rotation, there is always the possibility that a judge will receive "only" the "retainer fee" of €2,000 in any given month, and no additional work-related compensation. Here one of the weaknesses of the Commission's proposal is already apparent. Firstly, judicial independence is not adequately ensured if the only regular payment is the proposed €2,000. In particular in relation to the day rates of \$3,000 that are usual in the branch, this would appear not to be generous enough to ensure judicial independence. Although Section 3, Article 11

<sup>6</sup> See schedule of fees (ICSID, as of January 2013, <https://icsid.worldbank.org/apps/ICSIDWEB/ICSID%2520Document%2520Library/ICSID%2520Schedule%2520of%2520Fees%2520January%25201,%25202013%2520English.pdf+&cd=3&hl=de&ct=clnk&gl=de> (accessed 7 December 2015).



("Ethics"), prescribes that judges "shall refrain from acting as counsel or as party-appointed expert or witness in any pending or new investment protection dispute under this or any other agreement or domestic law", the use of the word "counsel" does not exclude them also operating as arbitrators in the classical investor-state arbitration system (see also Marwedel 2015). Thus concerns regarding judicial independence cannot be completely dismissed. Considerations of cost also show that it would probably make a great deal more sense to simply pay the judges € 10,000 to 15,000 per month rather than a € 2,000 "retainer fee" plus \$3,000 per working day.

Appointed judges must be formally qualified in their home country or "jurists of recognised competence". They should possess demonstrable competence in international law, and competence in international economic law is also regarded as desirable. Competence in domestic law is not required (unlike BMWi 2015). Members of the Appeal Tribunal require no additional qualifications beyond these.

Although Article 5 of Annex 2 (in Chapter 2, Section 3) stipulates pro forma that the members of the investment court must be "independent and impartial", simply stating these principles does not ensure that they are realised. Instead independence and impartiality demand firm institutional, financial and qualification requirements. The Code of Conduct in Annex 2 makes no reference to existing rulebooks.<sup>7</sup> Under Article 11 (2) of Section 3, a notice of challenge may be lodged against any member of the Tribunal or the Appeal Tribunal if there is evidence of a conflict of interests as defined in the Code of Conduct. No other sanction mechanisms are provided.

### 4.3 TRANSPARENCY AND THIRD-PARTY PARTICIPATION

Clear progress is visible in the field of transparency. In Article 18 the Commission's proposal refers to the most progressive agreement to date, the UNCITRAL Transparency Rules,<sup>8</sup> which provide for publication of the most important documents in arbitration cases. But this does not cover settlements reached between the parties. The proceedings of the investment court should be public as a rule. The Commission's proposal is thus based on the same level of transparency as the investment protection in CETA, which can be regarded as very progressive in international comparison.

Article 23 provides for a right of third parties to intervene in cases. Any natural or legal person who can demonstrate a direct interest in the outcome of a case may apply within 90 days of submission of the complaint to the Tribunal to be admitted as an intervener. The Tribunal may decide to grant or refuse. The intervener receives access to most of the documents exchanged between the parties and may participate (also actively) in the hearings. This grants the intervener the

position of supporting one of the two parties. The role of intervener is distinct from the function of the *amicus curiae* ("friend of the court"), who may also fulfil a more neutral advisory role. Alongside intervention, Article 23 explicitly permits this possibility in accordance with the transparency rules of Article 18.

### 4.4 CONTENT OF RULINGS

The tribunal's ruling obliges the state to compensate the investor for harm incurred through a violation of the agreement. Under the Commission's proposal the tribunal can only oblige the state – and never the investor – to pay compensation, as there is no provision for counter-claim and the state has no possibility to lodge a claim itself. The Commission's proposal differentiates between damages under Article 28 (1) (a) and restitution of property under Article 28 (1) (b) in the case of expropriation. In the latter case "monetary damages representing the fair market value" are prescribed. The tribunal may not order the repeal of a state measure (Article 28 (1), end). In that respect the agreement departs radically from the consequences of national law.

Under German constitutional law a claimant cannot simply tolerate a violation of the right to property (under Article 14 of the German Basic Law), and demand only compensation. Instead he or she must have the state measure reviewed by the responsible courts. If the Federal Constitutional Court rules that the claimant is entitled to compensation, it will require the legislator to provide this. Under German constitutional law the legislator determines the content and limits of property rights, and compensation can only be demanded where this is provided by law. For reasons of separation of powers the legislator alone decides the level of compensation. In investment protection law, by contrast, a tribunal can directly order a state to pay compensation. The legislator is not involved in this process.

### 4.5 RELATIONSHIP TO NATIONAL LEGAL PROTECTION

Unlike legal protection on the basis of other public international law treaties (such as human rights treaties), the Commission's proposal does not require domestic remedies to be exhausted before a claim is lodged with the investment tribunal. As such, one important aspect of the reform-oriented policy agenda for investment protection law is lacking (Marwedel 2015).

The Commission seeks to address the problem that an investor could demand multiple compensation by combining an investment protection case with a domestic case, or seek the annulment of the measure in the national courts while also demanding damages in an investment protection case by instituting a so-called "no U-turn" clause. Under the "no U-turn" clause an investor may begin by taking legal action in domestic courts. If in the course of the process he or she decides to pursue an investment protection case it is then no longer possible to return to domestic remedies afterwards. Instead of facing the investor with a classical "either/or" choice,

<sup>7</sup> One option would be the more comprehensive IBA Guidelines on Conflicts of Interest in International Arbitration of the International Bar Association (IBA).

<sup>8</sup> UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (effective date: 1 April 2014), available at <http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf> (last accessed on 17 May 2016).

the options are kept open for longer. Parallel cases against one and the same state measure are ultimately excluded, but the local remedies and the role of the national courts are not strengthened (also Van Harten 2015, 6). There will still be parallel cases before the national courts and the Investment Court System concerning the same dispute, because the national courts and international investment protection offer different legal opportunities (similar Schill 2015).

Because the definition of investor is drawn so broadly, the Commission's proposal cannot exclude the possibility of a parent company and its subsidiary both pursuing legal action.

# 5

## REPERCUSSIONS ON COLLECTIVE BARGAINING

Like any other investment protection agreement, the Commission's proposal places obligations only on state and supra-state actors and is directed against measures taken by states and by the European Union. The actions of private actors are not captured. An investor therefore cannot use an investment agreement to take action directly against collective agreements between trade unions and employers, because as a rule these are non-state entities. The situation could be different in the case of collective agreements with public-sector bodies. Ultimately a claim would also be conceivable when a collective agreement is declared universally applicable by a government, because that involves action by the state. While in this case the claim would be directed against the declaration of universal applicability, the collective agreement would also indirectly become a subject of the proceeding.

In the field of industrial action certain substantive investment protections could create a right to damages on the grounds of collective bargaining. For example, the Commission's proposal obliges the host state to grant full protection and security to the investments of foreign investors. Under that principle the state must protect the investment and potentially intervene in strikes or labour disputes of longer duration if the investor is able to prove that the security of his or her investment is or was endangered by the dispute (Ceysens and Sekler 2005). In the event of a violation of the principle of "full protection and security" the state could be required to pay damages. It would also appear possible that investors could claim an indirect expropriation to obtain protection from labour and social legislation and thus trigger the state's compensation liability. Furthermore, particular forms of co-determination could be attacked as indirect expropriation, for example where workers are granted a role on the supervisory board of a stock company (see Rittstieg 1991). Under German law the introduction and expansion of co-determination is not an expropriation justifying compensation.<sup>9</sup> On the other hand, it could be argued on the basis of the Commission's proposal that permitting workers' representatives to block company decisions was tantamount

to the withdrawal of the substantial content of property. In this connection it should be noted that the concretisation of the definition of indirect expropriation in Annex I, item 3, makes no mention of collective agreements, labour protections and similar.

<sup>9</sup> BVerfGE 50, 290 – Mitbestimmung.

# 6

## CONCLUSION

The Commission's proposal seeks to reform the existing system of investment protections, but continues to offer foreign investors procedural and substantive privileges without concrete obligations. The proposed Investment Court System also suffers deficits concerning judicial independence and retains aspects of the traditional investor-state dispute settlement system.

Although the Commission's proposal is in many respects groundbreaking (introduction of an International Court System, initiative to rein in existing investor protections), the innovative and progressive potential is far from exhausted. The Commission has deliberately steered away from pioneering steps such as restricting the level of substantive investment protections to that of national treatment.

Moreover the Commission's proposal cannot exclude the possibility of regulatory measures adopted in the public interest (such as labour, social and environmental legislation) leading to compensation liability.

In summary, the Commission's proposal can be regarded as a step in the right direction, but one that still suffers crucial deficits.



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