BUSINESSEUROPE

NOTE

23 October 2015

SUBJECT : BUSINESSEUROPE's assessment of the European Commission's proposal on a new Investment Court System

The Commission proposal on a new Investment Court System

Following a Public Consultation on Investor-State Dispute Settlement (ISDS) in TTIP and a Concept Paper that further assessed the results of the Public Consultation, the Commission published on 16 September 2015 a proposal, setting up ***a new Investment Court System***.

The Commission proposal is comprised of two parts, the substantive investment protection provisions and the functioning of the system that settles disputes between investors and States. There is also an initial section that provides definitions specific to investment protection.

The main elements of the new Investment Court System are the following:

- ***On the substantive clauses****:*

- More detailed definitions are provided on the 'Right to Regulate', 'Indirect Expropriation' and 'Fair and Equitable Treatment'. These are the conditions that need to be met in order for an investor to be able to launch a dispute settlement procedure against a State.

- Provisions to avoid frivolous claims are included.

- The "Loser Pays Principle" is established and will apply in all cases, except if the Tribunal decides otherwise under certain conditions.

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- ***On the dispute settlement**:*

- A 'Tribunal' is established to judge the claims that an investor raises against a State. In this system, arbitrators are replaced by judges, who will be appointed to cases on a rotation basis and who will have to follow a strict Code of Conduct.

- An 'Appeal Tribunal' is also set up to judge the Tribunal's awards.

BUSINESSEUROPE's assessment of the proposal

BUSINESSEUROPE supports the modernisation of the current system and recognises the efforts of the European Commission to take on board much of the legitimate criticism around ISDS, for instance by increasing transparency, or by taking measures to eliminate frivolous claims. However, on some instances, the new Commission proposal goes beyond the provisions already included in the text of the EU-Canada Comprehensive Economic and Trade Agreement (CETA), not only by replacing the ISDS system with an Investment Court System but also in strengthening the 'Right to Regulate' in the substantive investment protection provisions. *(see analysis of most important aspects below)*

Furthermore, the Commission announced that the new mechanism will replace the ISDS system not only in TTIP but in all on-going and future EU negotiations. This means that the Commission has the intention to present this proposal not only to the US but also to Japan (negotiations on a FTA), China (negotiations on a Bilateral Investment Agreement) or Myanmar (negotiations on a Bilateral Investment Agreement).

This is a critical point, as we believe that a proper assessment needs to be done on the possible impact of this proposal on investment flows to and from the EU. Furthermore, we have to make sure that EU investors are adequately and properly protected abroad. While the debate on ISDS was centred on the negotiations with the US, the proposal now on the table covers a number of countries with very different political, economic and business realities. Rule of Law is not respected equally in countries around the world. Bilateral Investment Agreements are designed to protect investors from the abuse of States' regulatory powers that may prevent investors from their legitimate rights. **We therefore call on the European Commission to conduct a proper impact assessment evaluating the consequences of this proposal both on inflows as well as outflows of investment between the EU and its trading partners before presenting this proposal to them.** We should not forget that the purpose of having an EU investment policy is to ensure a system that has the highest level of protection across all the EU Member States.
More specifically,

- *On the definitions specific to investment protection:*

- The definition of investment should include a reference to services contracts. Even though services will be regulated under the Market Access chapter, it is important that the Investment Chapter encompasses the protection of both goods and services.

- *On the substantive clauses (section 2 of the Commission proposal):*

- Article 2 reaffirms the **'Right to Regulate'**. The inclusion of this article comes as a response to concerns raised by Member States and other stakeholders and is a political commitment not to allow investment protection provisions to curtail the right of States to regulate. The areas of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity are specifically mentioned. Moreover, the Article clarifies that States are not prevented from enforcing state-aid laws. This specific clarification was added following the launch of intra-EU BIT cases.

  It is our understanding that the 'Right to Regulate' informs the investment protection standards. In the exercise of their sovereignty, States conclude International Investment Agreements (IIAs) purposefully accepting to grant foreign investors certain protections. The 'Right to Regulate', even if specifically mentioned in an article, cannot be a 'carte blanche' to justify all government actions, but it can only be seen and applied in context with the investment protection standards, such as 'indirect expropriation' or 'fair and equitable treatment' (FET). A government action in pursuance of legitimate public policy goals could nevertheless violate the FET standard for example. This interpretation can de deduced from the word 'necessary' used in paragraph 1 of Article 2. Also, paragraph 2 of Article 2 can only be read in context with protection standards. If a State commits itself to grant a certain measure (e.g. a subsidy) for a given time, the cessation of the measure introduced in a new legislation before the time period of the old legislation has lapsed might be a violation of the FET standard. Paragraph 2 only states that an investor cannot expect that a state never changes the law but if the State has made a commitment it is bound by it. The relationship between Article 2 and the investment protection standards should therefore be seen *mutatis mutandis*, in the same way the WTO Appellate Body has interpreted the relationship between Article XX and Articles I and III of the GATT: the articles inform each other; one article cannot be read *so expansively as seriously to subvert the purpose and object of the other article*[1]. Given the broad language of Article 2, it is not clear where the limits of the 'Right to Regulate' are, for instance to protect investors from disguised protectionism.

[1] WTO Appellate Body Report, US – Gasoline, p.18

Our understanding is that the burden of proof of the 'Right to Regulate' lies with the States, which have to follow a strict necessity test according to WTO rules. However, this needs to be clearly mentioned in the Commission's proposal, including the criteria for the necessity test. The parties of the Agreement must always respect the principles of **proportionality** and **legality**.

European business is concerned about the lack of clarity on the limits of the 'Right to Regulate' that, combined with the limitations that stem from the definitions of Fair and Equitable Treatment or Indirect Expropriation (including IPR), can substantially limit the scope of legitimate investment protection. According to the proposal, a State measure must be "manifestly excessive" to qualify as indirect expropriation. Such a wording is too restrictive and can become problematic for investors. If judges interpret this phrase too narrowly, any claims that plead indirect expropriation could be dismissed.

- More specifically, Article 3 is dealing with the treatment of investors and covered investments. BUSINESSEUROPE has concerns with respect to the language used to describe the principle of fair and equitable treatment. As written, the definition might lead to a significant narrowing of the protection of investors. In order to avoid legal uncertainty and the lowering of investment protection, the following words in the text (in bold hereafter) "**fundamental** breach", "**manifest** arbitrariness" and "**targeted** discrimination" should be eliminated (a similar remark applies to Annex I paragraph 3 on expropriation, where the word "manifestly" is also found). Besides, in paragraph 4, legitimate expectations of investors should be better guaranteed by replacing "**may**" by "**shall**". The text should read as follows: *"When applying the above fair and equitable treatment obligation, a tribunal **shall** take into account whether a Party made a specific representation to an investor…"*.

- Article 5, paragraph 3, describes how **compensation** in cases of expropriation would be calculated. It shall amount to the fair market value of the investment at the time immediately before the expropriation (or the implementing expropriation became public knowledge, whichever is earlier), plus the interest at a normal commercial rate, from the date of the expropriation until the date of payment. However, the loss of profits is not covered. We must not forget that investment decisions are taken with a long term perspective that includes expected profits. If this is not taken into account to calculate compensation the investment risk increases significantly and this might have a negative impact on investment flows. Thus, compensation should include loss of profits.

- Annex II on **Public Debt** aims at clarifying that claims on the restructuring of public debt issued by States do not constitute breaches of the States' obligations and should not be submitted or considered. As this is a new element in the Investment Protection

section, questions are raised on how these provisions will be used in practice and what the impact on investments will be. We are aware this is a sensitive issue but we need to take into account that public debt restructuring in certain cases can generate situations of discrimination vis-à-vis foreign investors particularly in countries with less stable political and economic regimes. Such a restriction should be better defined and limited to emergency situations of the State.

- *On the new Investment Court System (section 3 of the Commission proposal):*

- Article 1 offers the scope and definitions for the new Investment Court System. In the definition of "locally established company", the criteria included in the footnote n°4. point *"i)": "A juridical person is: (i) owned by natural or juridical persons of the other Party if more than 50 per cent of the equity interest in it is beneficially owned by natural or juridical persons of that Party [...]"* are too restrictive. The threshold of 50% is not reflecting all business realities. Accordingly, the text should include clear language on "effective control".

- Article 9 establishes a **Tribunal of First Instance** to hear claims submitted by investors against States. In principle, BUSINESSEUROPE is open to discuss this idea as we need to assess how this system will work in practice. Our concerns are concentrated in the following areas:

  Judges: According to the Commission proposal, 15 judges will be appointed – 5 nationals of an EU Member State, 5 US nationals, 5 nationals of third countries. The number of judges can be increased. The judges shall have the qualifications required in their respective countries for the appointment to judicial office, or be competent jurists, with demonstrated expertise in public international law and also, *desirably*, in international investment law, international trade law and the resolution of disputes. The judges will be appointed for a six-year term, renewable once. The Tribunal will hear the cases in divisions of three judges – one EU national, one US national, one national of a third country. The division will be chaired by the judge who is a national of a third country. A President and a Vice-President will be appointed for a two-year term and will be nationals of third countries. The President of the Tribunal shall decide on the composition of each division, making sure that the judges are appointed randomly and have equal opportunity to serve.

  The fact that the investor is not given an opportunity to choose one of the three judges raises major concerns about the impartiality of the Tribunal of First Instance in favour of the State. The proposed process by which judges will be appointed does not guarantee sufficient transparency and impartiality. Furthermore, on the question of qualifications, it is the view of the European business that the judges should not only have a demonstrated expertise in public international law but also in the areas of investment law and dispute resolution. We understand that the aim of the new system is to attract a broader basis of experts, however, we risk losing valuable experience

if the qualifications criteria are too general. Finally the fact that third country judges are presiding raises political questions on the functioning of the Tribunal, in particular if they will have the leverage and ability to take a decision based on an agreement their country is not part of.

Claims heard by one judge: There is a possibility for the disputing parties to agree that the case is heard by one judge only. This could be a positive step to ensure that SMEs have access to the system by reducing costs and time. We just need to make sure that impartiality and respect of the investors' rights will be safeguarded, including in the selection of the judge.

Administration and costs: The Tribunal will set up its own working procedures and will be assisted by a Secretariat, which can be either the ICSID Secretariat or the Secretariat of the Permanent Court of Arbitration. A monthly retainer fee (to be fixed in the future) will be offered to the judges. The President and Vice-President of the Tribunal will also receive a fee for each day they worked fulfilling their functions. These fees will be equally shared by both parties of the Agreement. These fees may in the future be permanently transformed into regular salaries.

It is not clear how the rules of procedure of the Tribunal will coexist with the rules of ICSID or the Permanent Court of Arbitration. Another question is where the Tribunal is going to be physically located. Provisions in the Commission proposal allow for the Tribunal to become permanent in the future, but it is not clarified where, until that moment, the Tribunal will seat to hear claims.

- An **Appeal Tribunal** is set up by Article 10, to hear appeals from the awards issued by the Tribunal. In principle BUSINESSEUROPE is open to discuss this idea. Nevertheless, we need to assess how this system will work in practice, especially in the following areas:

  Members: The Appeal Tribunal will have 6 members - 2 EU nationals, 2 US nationals 2 nationals of third countries. The number of Members can be increased. The Members will be appointed for a six-year term, renewable once. A President and a Vice-President will be appointed for a two-year term. They will be nationals of third countries. The Members shall have the qualifications required in their respective countries for the appointment to judicial office, or be competent jurists, with demonstrated expertise in public international law. The Appeal Tribunal shall hear appeals in divisions of three Members. The division will be chaired by the Member national of a third country. The President of the Appeal Tribunal shall decide on the composition of each division. BUSINESSEUROPE has the same concerns as those expressed for the Tribunal of First Instance. In order for the Appeal Tribunal to be perceived as impartial and independent, it needs to allow the investors to choose at least one judge.

Administration and costs: A monthly retainer fee will be offered to the Members, which will be equally covered by the parties of the Agreement. The fees may be permanently transformed into salaries. The Appeal Tribunal will be assisted by a Secretariat, which can be the ICSID Secretariat or the Secretariat of the Permanent Court of Arbitration.

Our concerns are similar to those raised in the section above, regarding the Tribunal, for instance in the selection of the Members of the Appeal Tribunal and the administration of the mechanism.

Moreover, the Appeal Tribunal will hear appeals from the awards issued by the Tribunal, which means that the Appeal Tribunal will be able to look at how the Tribunal treated the claim, and not only at the procedural aspects. We are therefore concerned that an increased number of claims will arrive at the level of Appeal Tribunal. This may elevate the costs that the disputing parties will have to cover as well as increase the overall time of the dispute settlement procedure, which could particularly impact SMEs.

- **Transparency** provisions are described under Article 18. The Commission proposes that the UNCITRAL rules on transparency apply to disputes. It is crucial that sensitive and confidential information is safeguarded throughout the dispute resolution procedure, including in the publication of documents and the participation of experts and third parties in the Hearings. This is essential, for instance to protect intellectual property rights or commercially sensitive information.

- The process of **consolidation** is provided under article 27. We understand that the Commission would like to encourage the consolidation of similar claims and this could potentially benefit SMEs. However, we have to make sure that the criteria under which consolidation can take place should be clearly stated. For instance, lacking clear consolidation criteria, the fact that a claimant who drops out of the consolidation process after an order for consolidation is given cannot resubmit its claim to the Tribunal, but only to the domestic courts may be particularly problematic.

- The **'Loser Pays"** is established as principle under Article 28. The Tribunal might decide against the implementation of the 'Loser Pays Principle' under certain conditions. In practice the implementation of the 'Loser Pays Principle' may prevent a company from using the system, in particular if this company is an SME. It is our view that the 'Loser Pays' should only apply in cases of abuse of the system and not as a principle. The proposal already foresees provisions to address frivolous claims (Articles 16 and 17 of the Commission proposal) making the 'Loser Pays Principle' unnecessary.

- Article 30 is dealing with the **enforcement of awards**. It is provisioned that States will recognise final awards issued by the Tribunal or the Appeal Tribunal, as if they were final judgements of their domestic courts and that the execution of the award shall be governed by the relative laws. However, it is not clear how the awards will be recognised and executed by the domestic courts and what is the connection / relationship with the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards or the relevant ICSID rules. This should be made clear as investors are confronted already in the current system with enforcement problems.

- For BUSINESSEUROPE it is critical to ensure that investors will not be denied access to justice and to a fair and equitable treatment regardless of their nationality or size. We understand that this proposal of the European Commission aims at reducing the timeframe and costs of disputes. Therefore, **we should ensure that in practice the system does not become too complex and costly in particular for SMEs.**

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