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**WHI - PAPER 01/2015**

**INTERNATIONAL INVESTMENT PROTECTION  
AGREEMENTS AND EU LAW\***

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\* This study was requested by the European Parliament's Committee on International Trade.

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STUDY

**INTERNATIONAL INVESTMENT PROTECTION  
AGREEMENTS AND EU LAW**

**Abstract**

Investment Protection Agreements with investor-state dispute settlement arrangements concluded by the European Union with third states present special characteristics compared to traditional bilateral investment treaties concluded between states. Beside controversial issues in the current debate, like the preservation of the right to regulate, tensions with regard to the functioning of the EU state aid regime, the principle of non-discrimination in the internal market and, in particular, the autonomy of the EU legal order need to be addressed. The present study suggests considering a more EU model-like solution to the problems and, if this is politically not available, to choose for a differentiated system including safeguards for the prerogatives of the ECJ regarding the interpretation of Union law, but also a number of institutional and procedural provisions such as the establishment of a standing court as well as the possibility for a „Special Committee“ to give guidance on the application of the agreement and harmonised policies. Transparency, public participation and openness in the negotiation of the agreement as well as for the proceedings at the court should be provided for, as well as transparent and democratic procedures for the choice of judges or arbitrators. A new negotiation culture in international relations as part of global governance should be developed in accordance with the principles set out in Article 21 TEU.

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The author expresses his gratitude to his colleagues Professor Dr Pieter Jan Kuijper and Professor Dr Steffen Hindelang for their cooperation, and to his research assistant Michael Schwarz for valuable comments and assistance.

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## Executive Summary

Given the multilevel structure of the European Union and its legal system the relationship between EU law and international investment protection agreements concluded by the EU with third countries has certain characteristics and poses a number of special problems. One is the question of competence for the negotiation and conclusion of such agreements. The present study accepts that the competences of the EU fully cover the contents of the investment protection agreements (IPAs), as far as known, and that this competence is exclusive. Another is to clarify, in each given case, who – the EU or a Member State – is responsible for any alleged violation of a standard established by the IPA.

As an integral part of Union law, the provisions of these agreements, under the conditions laid down by the ECJ and unless otherwise provided, may be accorded direct effect by the ECJ and enjoy primacy over the law of the Member States. Reciprocity should be ensured insofar. Provisions need to be included to avoid, to the greatest possible extent, any “regulatory chill” for the European and for the national legislators following from the threat that democratically decided policies are found to be violating standards set by the IPA under ISDS rules. In particular, with a view to ensuring reciprocity in the relationship with the third countries involved, express provisions should be included in IPAs providing for – or excluding – their direct effect in the legal system of the contracting parties.

Investor-state-dispute-settlement (ISDS) clauses in IPAs provide for foreign investors special procedural rights and a remedy with regard to the respect of the standards established by the IPA that could result in a competitive privilege vis-à-vis domestic investors, disrupt the functioning of the EU state aid regime and be in tension with the autonomy of the EU legal order. The present study discusses several solutions. Given the very different development of the legal systems around the globe, a “one-size-fits-all” solution does not seem to be a choice. With countries meeting highly developed standards and values comparable to the EU, establishing a “EU-model” system based upon non-discrimination, direct effect of the market freedoms and equal protection for all investors throughout the (common) market, some provision for common decision-making on standards and for judicial review would probably solve most of the problems. If this is unrealistic, and for other countries, a local remedies rule or – at least – a local remedies privilege should be considered as necessary part of the ISDS. This would not only help clarifying who, the EU or a Member State, is responsible for any measure at stake. It would also give the ECJ an opportunity to decide upon the validity and interpretation of any EU law provision at stake before an arbitration tribunal may base its award on its own understanding. Neither this solution nor a “prior involvement procedure”, though, would exclude that a tribunal bases its decisions on substantive EU law or on the conditions for the liability of the EU or Member States on an interpretation that could be in tension with the interpretation of the ECJ and, thus, with the autonomy of EU law.

An ISDS-clause in an IPA should preferably establish a standing court the judges of which are to be selected under rule-based democratic and transparent systems and subject to a strong ethical code. This court would develop a reliable case-law in public and participatory proceedings, so to ensure an open discourse on the interpretation of the underlying legal provisions, legal certainty and an environment of trust in the law and the institutions established by the agreements. A joint or “special committee” composed by representatives of the contracting parties and the president of the court could help, with a view to develop a spirit of trust and cooperation, to come to amicable settlements even before legal proceedings are initiated, assess any threat by such proceedings to the regulatory autonomy of the contracting parties and give guidance on the “authentic” interpretation of any relevant clauses of the IPA and, as appropriate, suggest harmonised approaches for legislative measure in all relevant policy areas.

## 1. INTRODUCTION

### 1.1 General remarks

International Investment Protection Agreements (IPAs) must be recognized as an important step forward in international law to give international law more bite. Allowing for arbitration under an Investor State Dispute Settlement (ISDS) provisions with final awards to be enforced at whatever place in the world means **taking law seriously**. It provides investors with legal certainty and, thus, establishes a reliable foundation for some legal certainty and trust, which is a crucial condition for prosperous foreign investment.

It is also a step towards developing a global legal order **taking people seriously** as foreign nationals would not depend entirely on the will of the sovereign in the host country; instead, they are recognized as holding individual and enforceable (procedural) rights independently of the respective national system of judicial review, eventually even against what the actual government or legislator considers to be opportune. This is an important development, since – in contrast to international law in general – enforcement of rights against the host state under the IPA is not left only to the government of the country of origin and to diplomatic consultations between the two governments involved, but the individual concerned has legal standing in her own right.<sup>1</sup>

Yet, there are tensions between IPAs and **national sovereignty**. While it is true that concluding international treaties is an expression of national sovereignty, rather than limiting it, this assumption is questionable if external bodies are given the power to assess and effectively sanction acts of the “sovereign”.<sup>2</sup> A state party to IPAs may therefore be limited by such chilling effects in the democratic choice of its policies; the more foreign investment it has accepted, the more costly and difficult certain political choices may become with a view to the damages or compensation expected to be awarded by arbitral tribunals. Such financial risks may even reach prohibitive levels.<sup>3</sup> On the other hand, national policies have an impact on people in and of other states, “external effects” which cannot be neglected. Foreign investment and the legitimate interests of the investor and its state of origin for protection is but one example. Within a deeply interconnected global system these effects need to be taken into account also in terms of democratic legitimation.<sup>4</sup>

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<sup>1</sup> Divergent views on the question whether the rights in substance are those of the home country and only exercised by the investor, or the investor defends her own rights established by the IPA, will not be dealt with here. The general position seems to be that the questions are of an international law nature and, therefore, issues among states (see Ian Brownlie, *Principles of Public International Law*, 7th ed. (2008), pp. 519-551, where the key reference seems to be diplomatic protection, *ibid.* p. 519). The issues at stake, however – such as national treatment, international minimum standards, denial of justice, expropriation – relate to individuals, and it is difficult to deny that individual (procedural) rights are involved, at least when, by ISDS-clauses, the individual investor concerned is given legal standing for defending her property, legitimate expectations, access to justice etc.

<sup>2</sup> See also Santiago Montt, *State Liability in Investment Treaty Arbitration. Global Constitutional and Administrative Law in the BIT Generation*, Hart Publishing 2009, p. 125, who talks about „Trading Off Sovereignty for Credibility“.

<sup>3</sup> See on this Brownlie (note 1), p. 537, on nationalization which is possible if prompt and adequate compensation is paid: „In reality this renders any major economic or social programme impossible, since few states can produce the capital value of a large proportion of their economies promptly“.

<sup>4</sup> See for further developments with more references Ingolf Pernice, Domestic courts, constitutional constraints and European democracy: What solution for the crisis?, in: Maurice Adams, Federico Fabbrini & Pierre Larouche (eds.), *The Constitutionalization of European Budgetary Constraints* (Hart Publishing 2014), p. 297, 301-303.

As a result, IPAs with ISDS-clauses must be drafted so as to ensure the legitimate rights of foreign investors and establish the level of trust necessary for economically meaningful investment, but at the same time strike a balance with the protection of the democratic and legal autonomy of each state party, so as to leave enough leeway to articulate and implement policies pursuing in the name of national public interest. Such a balance seems to require that:

- as a general rule there is no discrimination of, nor privilege for foreign investors as compared to nationals or residents;
- legitimate expectations and rights of foreign investors regarding the conditions for operating in the host country are honoured;
- state parties to the IPAs are not discouraged to articulate and implement democratically decided policies of public interest;
- as fundamental public interests and/or individual rights are at stake, dispute settlement must be public, transparent and organized through legitimate bodies.

## 1.2 Investment Protection Agreements of the EU

The abovementioned principles apply to states and to the EU accordingly. To a certain extent they are reflected in what is described as “the Brussels consensus”.<sup>5</sup> It is important to note that specific reference is made to the objectives of EU external action laid down in Article 21 TEU. Not only the promotion of democracy, human rights and sustainable development<sup>6</sup> are among these objectives, but also to strive for “an international system based on stronger multilateral cooperation and good global governance (Article 21 (2) (h) TEU). New model IPAs negotiated by the EU worldwide could be a way forward. In developing this new model, nevertheless, account has to be taken of the fact that the situation of the EU as a party to IPAs is of a specific nature. The EU is not a (federal) state and whatever investment is made within the EU takes necessarily place on the territory and, therefore, within the jurisdiction of at least one of its Member States. Two interrelated sets of norms are applicable, the internal law of that Member State and Union law. These peculiarities of the EU are important when discussing general issues of IPAs and, in particular, their ISDS-clauses.

Questions arise in particular with regard to the competence and the responsibilities of the EU and the Member States (infra 1.), the scope of IPAs and their impact on national policies and freedom of action (infra 2.), and the direct effect of these agreements and their status in the national legal systems (infra 3.).

### 1.2.1 EU competence to conclude direct investment treaties

There is the question of who is competent to conclude IPAs with third countries and who is responsible for their proper implementation, at the legislative and at the administrative level. The answer seems to be clear regarding foreign *direct* investment involving a longer lasting effective participation in the

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<sup>5</sup> Frank Hoffmeister and Gabriela Alexandru, A First Glimpse of Light on the Emerging EU Model BIT, in: The Journal of World Investment & Trade Vol. 15 (2014), forthcoming, para. II.4., summarise this compromise with five points:

- (1) provide a high level of protection for EU investors through standard clauses;
- (2) respect the right to regulate in order to meet legitimate public policy objectives;
- (3) increase legal certainty for both investors and host states;
- (4) be consistent with broader principles and objectives of the Union’s external action; and
- (5) include a state-of-the-art dispute settlement chapter with investor-to-state procedures.

<sup>6</sup> For modalities of the integration of this objective into European IPAs in particular see Hoffmeister and Alexandru (note 5), para. III.8.

management or control of the company concerned.<sup>7</sup> Articles 3 (1) (e) and 207 (1) TFEU confer an exclusive competence upon the EU. Unless expressly empowered by the EU or regarding the administrative implementation of EU acts, Member States may not take action in this field, e.g. negotiate bilateral agreements with third states. The situation is less clear, however, regarding *portfolio*-investments. The specific provisions of Articles 63-66 TFEU on free movement of capital within the EU and with third countries are applicable here, though there seems to be little room left for national action or agreements with third countries.<sup>8</sup> What follows is that the EU has competence to conclude IPAs including ISDS-clauses with all possible implications on policy choices and, therefore, the exercise of democratic sovereignty at the national level.<sup>9</sup>

IPAs include provisions on direct or indirect expropriation. With regard to the guaranty in Article 345 TFEU read together with Article 207 (6) TFEU for the rules in Member States governing the system of property ownership it could be argued that insofar the EU has no competence and IPAs would, therefore, have to be concluded in the form of mixed agreements and, thus, with the participation of the Member States and ratification in accordance with their respective constitutional provisions. This would be true, however, only if the agreements were about to affect the national systems of property ownership. This notion has got a restrictive interpretation, however, and would not exclude the application of the general provisions of the Treaties on non-discrimination, the freedom of establishment or the free movement of capital.<sup>10</sup>

Within the limits imposed by the autonomy of Union law and the functions of the ECJ (to be dealt with below) this competence of the EU includes the power to confer jurisdiction for the interpretation and application of IPAs to dispute settlement bodies at the international level.

### 1.2.2 Scope of EU investment protection treaties and national competences

The binding effect upon national policies is of a general nature, as IPAs do not distinguish among policy areas but just set criteria like non-discrimination, fair and equitable treatment, access to justice, etc.; these criteria may be applied, in a given case, equally to policy areas where the EU is competent to legislate (e.g. agriculture, environmental protection, consumer protection) and where Member States

<sup>7</sup> For a definition see ECJ Case C-446/04, *Test Claimants in the FII Litigation* [2006] ECR I-11814, paras. 177-182, with reference to the definitions in Annex I of Directive 88/361/EEC; this definition is broadly applied also for interpreting Article 307 (1) TFEU, see Marc Bungenberg, § 13 Europäischer Internationaler Investitionsschutz, in: Andreas von Arnould (ed.), *Europäische Außenbeziehungen. Enzyklopädie Europarecht*, vol 10 (2014), p. 743, 748-749. See also Frank Hoffmeister and Günes Ünüvar, "From BITS and Pieces towards European Investment Agreements", in: Marc Bungenberg, August Reinisch and Christian Tietje (eds.), *EU and Investment Agreements: Open Questions and Remaining Challenges* (Nomos 2013), p. 57, 65.

<sup>8</sup> See the Explanatory Memorandum of the Commission on the Proposal for a regulation establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party, [COM\(2012\) 335 final](#), para. 1.2.

<sup>9</sup> See also Hindelang, "Der primärrechtliche Rahmen einer EU-Investitionsschutzpolitik: Zulässigkeit und Grenzen von Investor-Staat-Schiedsverfahren aufgrund künftiger Abkommen", in: Marc Bungenberg & Christoph Herrmann (eds.), *Die gemeinsame Handelspolitik der Europäischen Union nach Lissabon* (Nomos 2011), pp. 159-164. Hoffmeister and Ünüvar (note 7), p. 66.

<sup>10</sup> ECJ Case C-92/92 and C- 326/92, *Phil Collins* [1993] ECR I-5171, para. 22; ECJ Case C-30/90, *Commission/United Kingdom* [1992] ECR I-858, para. 18: "...the provisions of the Treaty, and in particular Article 222 according to which the Treaty in no way prejudices the rules in Member States governing the system of property ownership, cannot be interpreted as reserving to the national legislature, in relation to industrial and commercial property, the power to adopt measures which would adversely affect the principle of free movement of goods within the common market as provided for and regulated by the Treaty." See also Hoffmeister and Ünüvar (note 7), p. 68-69, and Bungenberg (note 7), p. 749. For the debate regarding property and the question whether an IPA concluded in conformity with Articles 207, 208 and 218 TFEU may "prejudice" these national rules, unless the Member States participate, as contracting parties, to the agreement see: Hindelang, *ibid.*, p. 163; see further the Explanatory Memorandum (note 8), para. 1.2., and 3.



have kept their legislative autonomy (e.g. economic, fiscal, social, culture, education, health policies, property ownership). Limiting effects of IPAs concluded by the EU on sovereign policies including the national level, therefore, may well touch upon policy areas that remain within the scope of national competence. The EU draft proposal on trade in services, investment and e-commerce for the TTIP negotiations of 2nd July 2013, for instance, excludes the audio-visual from the liberalisation of investments and, thus, indirectly also from the provisions on investment protection.<sup>11</sup> Other areas like arms industries could be excluded accordingly, though problems may arise in cases of overlapping, e.g. if business activities relate to more than one policy field. But this is a question of political preferences and would not have implications on the question of EU competence. As long as trade in goods or services are at stake the exclusive competence of the EU under Article 207 (1) TFEU leaves no room, in any event, for claiming that effects of IPAs on areas of national competence require the agreements to be concluded as mixed agreements.<sup>12</sup>

### 1.2.3 Primacy and direct effect of EU direct investment treaties

Under Article 216 (2) TFEU agreements concluded by the Union are binding upon the institutions and its Member States. According to the established case-law of the European Court of Justice (ECJ) they become an integral part of the Union legal order.<sup>13</sup> Their provisions could, if the special conditions<sup>14</sup> are met, be invoked against acts of secondary EU law to the extent that these acts are in conflict with them.<sup>15</sup> The ECJ has recognised direct effect to provisions of association and free trade agreements, even if the same is not recognized by the other contracting party.<sup>16</sup> The contracting parties, the ECJ affirms, are free to determine in the agreement what legal effect its provisions shall have in their respective internal legal systems. More importantly, the provisions of international agreements – including decisions by legal bodies established through the treaty – would take part in the principles of primacy and direct effect of Union law.<sup>17</sup> It is well established that primacy is to be accorded by national or Union judges even with regard to national constitutional law.<sup>18</sup> Where investors can invoke a violation of an IPA concluded by the

<sup>11</sup> For the English draft text see: <http://www.bilaterals.org/IMG/pdf/eu-kommission-position-in-den.pdf>: Chapter II Investment Section 1 Liberalisation of Investments Article 3: Scope, Abs. 2: “The provisions of the Section shall not apply to audio-visual services”. The CETA-Agreement, as published by the Commission within the Consultation procedure launched in March 2014 ([http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc\\_152280.pdf#Question1](http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf#Question1)) provides in Article X: Reservations and Exceptions following § 5: “Audiovisual: For the EU, the Section on Establishment and Section on Non-Discriminatory Treatment do not apply to measure with respect to Audiovisual services”.

<sup>12</sup> For the aspect of Article 345 TFEU see, however, *supra* note 9. That Art. 207 TFEU further contains the competence to include ISDS mechanisms in future EU IPAs is uncontested, Stephan W. Schill, “Luxembourg Limits: Conditions for Investor-State Dispute Settlement under Future EU Investment Agreements, in: Marc Bungenberg, August Reinisch and Christian Tietje (eds.), *EU and Investment Agreements: Open Questions and Remaining Challenges* (Nomos 2013), p. 40.

<sup>13</sup> Established case law since ECJ Case 181/73 *Haegeman* [1974] ECR 449, para. 5; see more recently ECJ Case C-211/01 *Commission v Council* [2003] I-8913, para. 57.

<sup>14</sup> ECJ Case 12/86 *Demirel* [1997] ECR 3719, para. 14: “A provision in an agreement concluded by the Community with non-Member countries must be regarded as being directly applicable when, regard being had to its wording and the purpose and nature of the agreement itself, the provision contains a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of subsequent measure”. See also Francesca Martinez, “Direct effect of International Agreements of the European Union”, in: *European Journal of International Law* 25 (2014), 129.

<sup>15</sup> ECJ Case C-366/10 *Air Transport Association of America*, nyr, paras. 50 et seq.

<sup>16</sup> ECJ Case 104/81 *Kupferberg*, [1982] ECR 3641, paras 18, 26. See also Koen Lenaerts and Piet Van Nuffel, *European Union Law*, 3rd ed. (Sweet & Maxwell 2011), para. 22-045.

<sup>17</sup> See Wolfgang Weiß, “Human Rights in the EU: Rethinking the Role of the European Convention on Human Rights after Lisbon”, in: *European Constitutional Law Review* 7 (2011), 64, 72 & 91.

<sup>18</sup> ECJ Case 11/70 *Internationale Handelsgesellschaft* [1970] ECR 1125, para. 3. For the pivotal role EU law befits the legal concept of primacy regarding external influences see Christina Eckes, “Protecting Supremacy from External Influences: A Precondition for a European Constitutional Order?”, *European Law Journal* 18 (2012), pp. 230-50.

EU with their country of origin or establishment, it follows from these principles that not only secondary EU legislation but also the national measure at stake, be it administrative, adjudicative or legislative – even on the constitutional level, would be inapplicable – and not only give a right to compensation – simply because it amounts to an infringement of the IPA that forms part of the Union’s legal order and thus takes part in the primacy of Union law.<sup>19</sup>

By virtue of taking part in the primacy of EU law, IPAs concluded by the EU, thus, seem to pose greater difficulties regarding national sovereignty and regulatory autonomy than state-to-state bilateral investment treaties (BITs). And their general scope reaches policy areas beyond what is covered by the substantive powers of the EU. Third state investors would be provided with rights within the jurisdiction of the Member States, which they would not benefit from in national BITs, and be bestowed with rights that EU investors in a third country party to an EU-agreement would not enjoy.

This “overdrive”-effect brought about by the incorporation of international agreements into EU law at the national level, of course, only applies if a direct effect is accorded to the substantial provisions of the IPAs or to decisions of arbitral tribunals. As long as the ECJ, as is its rationale in WTO matters, was to refuse doing so,<sup>20</sup> there would be no problem. But the situation may not be comparable to the WTO system, so that it is most likely that ISDS-clauses would be recognised to have direct effect.<sup>21</sup>

To apply the principles of direct effect and primacy unilaterally within the EU with no reciprocity, however, would not be a satisfying result. A solution could be to expressly exclude any direct effect of the provisions of the IPAs and, in particular, of decisions taken under ISDS clauses. Another, and perhaps more efficient solution could be to expressly provide for the direct effect of the agreement to both parties. While, at least with the United States, this latter solution does not seem to be a realistic option, the former may not necessarily be effective, as questions of primacy and direct effect are of a constitutional nature and secondary law cannot set aside what the ECJ could find necessary to conclude

<sup>19</sup> If, however, the IPA represents a mixed agreement by both the EU and the Member States, a qualification is needed: in the case of mixed agreements, the primacy of the IPA as forming an integral part of the EU legal order pursuant to Art. 216(2) TFEU is, of course, restricted to the EU’s competences as the federal order of competences between the Union and the Member States may not be altered through the conclusion of international agreements and thereby bypassing procedural rules for Treaty amendments. Therefore, within the ambit of the Member States’ exclusive competences the rank of an IPA relative to national law is not ruled by EU law; insofar national law must determine the rank of the IPA provisions within the Member States’ legal orders. Here, the situation is still what it was in the past in the IP sector, see ECJ Case C-431/05 *Merck Genéricos* [2007] ECR I-7026, paras. 34, 47,

<sup>20</sup> The ECJ refuses to accord direct effect in WTO matters (including the decisions of the WTO Panels and Appellate Body) because of the specificity of the obligations and the enforcement mechanism as well as for a lack of reciprocity. Indirectly already ECJ Joined Cases 21-24/72 *Internationale Fruit*, [1972] ECR 1219, paras. 19 et seq.; more expressly Case C-377/02 *Van Parys* [2005] ECR I-1465, paras. 51-54. See, for an assessment of the ECJ’s jurisprudence, Nikos Lavranos, “The CJEU’s Relationship with Other International Courts and Tribunals”, in: Karsten Hagel-Sorensen et al. (eds.), *Europe: The New Legal Realism – Essays in Honour of Hjalte Rasmussen* (Djof Publ. 2010), pp. 395 et seq.

<sup>21</sup> For the positive tendency of the ECJ to recognise the direct effect of provisions of international agreements of the EU see: Francis G. Jacobs, *The Internal Legal Effects of the EU’s International Agreements and the Protection of Individual Rights*, in: Anthony Arnull et al. (eds.), *A Constitutional Order of States? Essays in EU Law in Honour of Alan Dashwood*, (Hart 2011), p. 529, 532-539. To incorporate a provision into the IPA excluding such primacy and direct effect derived from the mere fact that the EU concluded the agreement does not seem to be a solution. Contrary to what is suggested, Article 1 (4) of the Draft revised agreement on the accession of the European Union to the Convention for the Protection of Human Rights and Fundamental Freedoms (Council of Europe Doc 47+1(2013)008rev2, available at [http://www.coe.int/t/dghl/standardsetting/hrpolicy/Accession/Meeting\\_reports/47\\_1%282013%29008rev2\\_EN.pdf](http://www.coe.int/t/dghl/standardsetting/hrpolicy/Accession/Meeting_reports/47_1%282013%29008rev2_EN.pdf)), does not seem to have this purpose; on this see most recently, Paul Gragl, “A giant leap for European Human Rights? The Final Agreement on the European Union’s accession to the European Convention on Human Rights”, 51 *Common Market Law Review* (2014), pp. 13-58). A simple provision of an international agreement is not sufficient to exclude the application of principles having of a constitutional nature at the level of primary law.

in accordance with the general principles of EU law. Nevertheless, as the Court stated with regard to the extension of the EU emissions trading system to the air transport industry in the case of the Air Transport Association of America and Others in its judgment of 21 December 2011, the contracting parties to an international agreement have a say on the direct effect of its provisions:

“In conformity with the principles of international law, European Union institutions which have power to negotiate and conclude an international agreement are free to agree with the third States concerned what effect the provisions of the agreement are to have in the internal legal order of the contracting parties. Only if that question has not been settled by the agreement does it fall to be decided by the courts having jurisdiction in the matter, and in particular by the Court of Justice, in the same manner as any question of interpretation relating to the application of the agreement in the European Union”.<sup>22</sup>

### 1.3 Tensions between EU law and IPAs in general

The relationship and possible tensions between European Union law and international IPAs concluded by the EU have been assessed in literature to some extent.<sup>23</sup> *George Bermann* deals with tensions between international arbitration treaties and EU law in general, and shows how direct conflicts between these two legal regimes have been settled by “accommodation” in a number of cases.<sup>24</sup> In situations of confrontation of the two regimes, however, for the simple fact that “the international arbitral tribunals from which awards emanate are themselves the product of that regime”, he shows that these tribunals are

“likely to favour the mandates of the international arbitral regime when conflicts with EU law cannot be avoided. Every indication from the recent jurisdictional rulings of investment arbitration tribunals supports this prediction”.<sup>25</sup>

EU law, thus, does not seem to be given the regard it would deserve. On the other hand, with a view of the ECJ case law defending the autonomy of the EU legal order, he rightly notices that there is “no reason to assume that the ECJ will prove more deferential in principle to the international arbitral system than it has been to these other national and international legal orders”.<sup>26</sup>

What may hold true for Member State’s BITs concluded prior to the entry into force of the Lisbon Treaty<sup>27</sup> does not necessarily pertain to IPAs concluded with third countries by the EU since it has

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<sup>22</sup> ECJ Case C-366/10, *Air Transport Association of America* [2011] ECR I-13833, summary § 1 (only in the html document: <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62010CJ0366&rid=2>).

<sup>23</sup> Prominently George A. Bermann, “Navigating EU Law and the Law of International Arbitration”, in: 28 *Arbitration International* (2012), pp. 397-445, on conflicts of obligations from BITs with EU law, in particular, *ibid.* p. 420-440, dealing however mainly with questions arising from Member State’s BITs. See also Ramses A. Wessel, “Between the Authority of International Law and the Autonomy of EU Law”, in: J. Diez-Hochleitner et al. (Eds.), *Últimas tendencias en la jurisprudencia del Tribunal de Justicia de la Unión Europea* (Wolters Kluwer 2012), pp. 759-65; August Reinisch, “The EU on the Investment Path – Quo Vadis Europe? The Future of EU BITs and other Investment Agreements”, in: 12 *Santa Clara Journal of International Law* (2014), p. 111; Marc Bungenberg, August Reinisch, Christian Tietje (eds.), *EU and Investment Agreements: Open Questions and Remaining Challenges* (Nomos 2013); Hindelang (note 9), p. 157.

<sup>24</sup> Bermann (note 23), pp. 425-431. The cases, however, generally concern intra-EU BITs where national courts were considering appeals against arbitral awards for public policy issues.

<sup>25</sup> Bermann (note 23), p. 435.

<sup>26</sup> Bermann (note 23), p. 436, inviting however the ECJ to „seriously consider doing just that“.

<sup>27</sup> Art. 351 TFEU entails a *prima facie* exception to the general fidelity of Member States to EU law. However, it also states that: “To the extent that such agreements are not compatible with the Treaties, the Member States or States concerned shall take all appropriate steps to eliminate the incompatibilities established.” To this end, “Member States shall, where necessary, assist each other”, and “where appropriate, adopt a common attitude.” See as an example the ATEL case, ECJ, C-264/09

exclusive competence in this field. The EU and its courts will arguably not be able to rely upon any claim of primacy for its own law over legal commitments it has taken in an international agreement. In other words: While legal conflicts of measures by Member States undertaken in accordance with their bilateral investment treaties on the one hand, but in breach of their duties under EU law on the other hand (e.g. state aids, consumer protection etc.), may well need a solution giving precedence to EU law over international obligations, no such argument can be accepted *a priori* regarding the international obligations the EU has agreed to.<sup>28</sup>

Hence, where tensions may arise between general EU law and obligations under IPAs concluded by the EU,<sup>29</sup> it is of highest interest for the EU to ensure that appropriate instruments to resolve such conflicts are found prior to the entry into force of such agreements in order to ensure that both EU and national public policies are not compromised by the risk of foreign investors questioning the measures deemed necessary, or claiming compensation. Though most of the thousands of bilateral investment agreements worldwide seem to function smoothly, regarding some recent experience with existing agreements of the Member States the following problem areas can be identified:

### 1.3.1 The “regulatory chill”

One of the most prominent cases illustrating the risks involved in investment protection is that of *Vattenfall* on the construction of a new power plant at Moorburg near Hamburg. To avoid damages said to be of some 1.4 billion Euros Germany has issued, as part of the amicable settlement, “a modified water use permit”.<sup>30</sup> A much more difficult example is the *Vattenfall* claim for damages argued to be caused by the German nuclear energy phase out which was unpredictable for the claimant.<sup>31</sup> Based upon the provisions of the European Energy Charter Treaty *Vattenfall* filed a claim for some 3.7 billion Euros at an arbitration tribunal established under the ICSID convention.<sup>32</sup> Article 10 (1) of the Energy Charter Treaty gives investors the guarantee of “fair and equitable treatment” and of “most constant protection and security”. It states that “no Contracting Party shall in any way impair by unreasonable or discriminatory

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*European Commission v Slovak Republic* [2011] ECR I-8065, where the Court ruled on the legality of Slovakia granting priority transmission rights to a Swiss investor (ATEL) under a BIT between Slovakia and Switzerland, which had adverse effects on the functioning of the internal market, particularly the Directive 2003/54/EC on the Internal Market in Electricity. For a perceptive view on how the duty under Art. 351 TFEU to “take all necessary steps to eliminate the incompatibilities” see Jan Kleinheisterkamp, “Financial Responsibility in the European International Investment Policy”, ICLQ 63:2 (2014), forthcoming.

<sup>28</sup> See also Bermann (note 23), p. 438, with a different argument, however: “As the European Union increasingly constitutes itself a participant in binding international legal regimes – as if it were a nation-state, even though it most certainly is not – it will find itself correspondingly less comfortable asserting a privilege not to be bound by the authoritative rulings of the judicial bodies of those regimes”.

<sup>29</sup> Without denying tensions see: Hoffmeister and Alexandru (note 5), para. IV regarding enforcement by ISDS-clauses: „There is also no legal impediment to include such clauses at EU level”, referring to the case law of the ECJ showing that „the EU's competence to conclude international agreements necessarily entails the power to submit itself to the decisions of a court which is created or designated by such agreements as regards the interpretation and application of their provisions”.

<sup>30</sup> See ICSID Award Case No- ARB/09/6 of March 11, 2011, [http://www.encharter.org/fileadmin/user\\_upload/Investor-State\\_Disputes/Vattenfall-Germany\\_Award.pdf](http://www.encharter.org/fileadmin/user_upload/Investor-State_Disputes/Vattenfall-Germany_Award.pdf). On the issue see also Sebastian Knauer, *Vattenfall vs. Deutschland. Machtkampf um Moorburg*, in: *Spiegel Online* available at <http://www.spiegel.de/wirtschaft/vattenfall-vs-deutschland-machtkampf-um-moorburg-a-635520-2.html>.

<sup>31</sup> See Knauer (note 31), part 1. See also *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12, not public. For the procedure so far see the summary given by the World Bank, available under: <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&reqFrom=ListCases&caselId=C2220&actionVal=viewCase>.

<sup>32</sup> See comments by Jakob Schlandt, 15 Juristen gegen die Demokratie, *Frankfurter Rundschau* of 13 May 2013, available at: <http://www.fr-online.de/wirtschaft/vattenfall-15-juristen-gegen-die-demokratie,1472780,22189216.html>. See also Kerstin Kohlenberg, Petra Pinzler and Wolfgang Uchatius, Im Namen des Geldes, *Die Zeit* No. 10, Dossier, 27 February 2014, p. 15, talking of more than four billion Euros.

measures their management, maintenance, use, enjoyment or disposal”; nor shall such investments “be accorded treatment less favourable than that required by international law, including treaty obligations”. Other relevant provisions are Article 13 on expropriation and Article 14 on free transfers related to investments. Article 13 of the Energy Charter Treaty seems to be of particular interest:

“Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation...”<sup>33</sup>

With these very general terms it is difficult to determine whether certain policies are or are not impairing “by unreasonable” measures the enjoyment of an investment. What exactly are measures having equivalent effect to a legal expropriation? We know from the ECJ case law on Article 34 TFEU how broadly such terms may be construed.<sup>34</sup> The EU Draft for the CETA provisions on investment protection strive to draw a limit in an annex to Article 14 on expropriation:

„For greater certainty, except in the rare circumstance where the impact of the measure of series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation”.<sup>35</sup>

These explanations resemble the proportionality criteria applied by courts in disputes over the fundamental right to private property when reviewing measures that do adversely affect the right to property but do not constitute a case of expropriation.<sup>36</sup> Handing this task over to international arbitral tribunals could be a big and risky step, unless there are strong precautions against an uncontrolled use.<sup>37</sup> International investor arbitration, as some fear, seems to involve what is called a “regulatory chill”

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<sup>33</sup> See also the terms of Article 14 of the TTIP Draft on Investment Protection, *supra* note 11. An Annex to this provision (as it is not yet included in the Energy Charter Treaty) distinguishes between direct and indirect expropriation, the latter occurring “where a measure of series of measures by a Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer or title or outright seizure.” The Commissions consultation documents (*supra* note 11) contain the full text of Article X of the CETA-Draft Agreement on expropriation with similar texts.

<sup>34</sup> See particularly ECJ Case 8/74 *Dassonville* [1974] ECR 837; even though the ECJ has progressively narrowed the definition established here (see ECJ Case C-120/78 *Cassis de Dijon* [1979] ECR 649, Joined Cases C-267/91 and 268/91 *Keck and Mithouard* [1993], ECR I-6097, it remains open finally to the ECJ in each case to determine whether or not a case is covered by Article 34 TFEU.

<sup>35</sup> Annex on Expropriation to Article X of the Draft CETA Investment Text published for the public consultation on ISDS in the TTIP launched in March 2014 (*supra*, note 11). The Consultation further includes in Question 4 on expropriation a reference to more detailed clarifications on direct and indirect expropriations in Article X of the CETA, pointing to “an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure”, and indicates specific factors to be considered ([http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc\\_152280.pdf](http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf)). For another to clarifying the terms see the Commission’s Factsheet on Investment Protection and Investor-to-State Dispute Settlement in EU agreements, see: [http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc\\_151916.pdf](http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf), p. 7-8.

<sup>36</sup> See for Article 17 of the Charter of Fundamental Rights: Wolfgang Durner, “Wirtschaftliche Grundrechte”, in: Detlef Merten / Hans-Jürgen Papier (eds.), *Handbuch der Grundrechte in Deutschland und Europa VI/1* (C.F. Müller 2010) § 162 paras. 49-56; for Article 14 of the German Basic Law see: BVerfGE 58, 300.

<sup>37</sup> For an attempt to give some clarity on the notion of indirect expropriation on a comparative law basis see Montt (note 2) p. 231 et seq., 288-289, concluding, however, that regarding the expropriation clause there is a „considerable degree of deference towards the regulatory state”. The problem is in his eyes rather „the ad hoc characterisation of its application” (*ibid.*, p. 290) – „which makes the adjudication process highly uncertain, unpredictable, and overly dependent upon the personal biases of individual arbitrators” (*ibid.*, p. 236).

detering national legislators to adopt policies that are democratically felt desirable, and it is open whether general provisions on the regulatory autonomy of the contracting parties could be a way out.<sup>38</sup>

The impression that in cases such as *Moorburg* the final settlement sacrificed environmental policies is alarming; the more so as Article 19 of the Energy Charter Treaty expressly obliges the Contracting Parties to “strive to minimize in an economically efficient manner harmful environmental impacts occurring either within or outside its Area... taking proper account of safety”. Was this provision taken into account and given serious thought? Why was the settlement not published fully, including the modified water use permit mentioned above? In the other *Vattenfall*-case on the German withdrawal from the civilian use of nuclear power, a reaction to the Fukushima disaster, it remains to be seen if not only environmental requirements but also the exception granted under Article 24 (1) (b) (i) of the Energy Charter for any measure “necessary to protect human, animal or plant life or health” will play a pivotal role in the balancing act against the investors’ pecuniary interests.

The reference to the ICSID system or other procedures for dispute settlement in Article 26 of the Energy Charter Treaty hands over matters of such high political salience to arbitral tribunals, the decisions of which are in principle final and can be enforced worldwide.

Even if it is only for a small number of cases, it would be difficult to accept that democratically enacted environmental policies or measures taken on consumer protection and public health decided at the European or national level within the EU are scrutinized and, if the three lawyers of an international arbitration tribunal taking a different view on the legitimate interests at stake, deem it appropriate, to order compensation for the foreign investors who feel that their investment or profit expectations are adversely affected by them. Such risk for the legislative authorities could amount to be prohibitive for policies regarded necessary for the public good. In the Australian tobacco-case, *Philipp Morris* is claiming billions of dollars in compensation for losses due to strict measures regarding advertising and packing of tobacco-products,<sup>39</sup> but also the pending NAFTA law suit of *Lone Pine* against Canada for a moratorium on fracking in the province of Quebec<sup>40</sup> should be taken as alarming examples for the potential legal risks taken by the EU if it decided to conclude IPAs modelled after the European Energy Charter Treaty or NAFTA with third states. Moreover, depending on the interpretation to be given by the arbitral tribunals – often still in strictly confidential proceedings! – of provisions like fair and equitable treatment, etc., social policies like the introduction of minimum wages and the reform of the EU data protection regime<sup>41</sup> may be jeopardized by proceedings initiated by foreign investors on the basis of the IPAs. Compared to the protection foreign investors benefit from in their home state, the practice of the arbitration tribunals in some cases risks to develop towards a “super-protection” in foreign countries, with adverse effects upon the host countries’ legislative autonomy.<sup>42</sup>

<sup>38</sup> With more references see Reinisch (note 23), pp. 146-148.

<sup>39</sup> See Kohlenberg & others (note 32), p. 16.

<sup>40</sup> See Ilana Solomon, “No Fracking Way: How Companies Sue Canada to Get More Resources”, *Huffington Post* available at: [http://www.huffingtonpost.ca/ilana-solomon/lone-pine-sues-canada-over-fracking\\_b\\_4032696.html](http://www.huffingtonpost.ca/ilana-solomon/lone-pine-sues-canada-over-fracking_b_4032696.html). See also the Council of Canadians for Social Justice: Fracking is not a right. Tell Lone Pine to drop its NAFTA lawsuit against Quebec’s moratorium on fracking!, available at: <http://www.canadians.org/action/petition/index.php>.

<sup>41</sup> Privacy seems to be an area for which Article X: General exceptions, of the Draft CETA Investment text of 21 November 2013 refers to in para. 1 (a) (iii).

<sup>42</sup> Based upon an analysis of the US practice see Lise Johnson & Oleksandr Volkov, “Investor-state contracts, host-state ‘commitments’ and the myth of stability in international law”, in: 24 *The American Review of International Arbitration* (2013), p. 365: “...this paper’s finding that investment treaty arbitration has developed principles of ‘super-protection’ that jump beyond domestic legal principles is notable in that it suggests foreign investors are not merely able to maintain and rely on developed home country safeguards when investing in foreign territories, but are also able to draw from a set of stronger

What might have been very much in the interest of capital exporting countries like the US, the UK or Germany in their relationship to third world countries needing investment during the last decades now turns back on EU Member States with unexpected legal risks against their own policies. This should further demand to re-evaluate the function of ISDS-clauses in future IPAs between the EU and third countries altogether: as historically the “logic of dispensing foreign investors from exhausting national remedies emerged as a solution to the low effectiveness of the rule of law in many developing countries and at a time where investment streams were unidirectional”<sup>43</sup>, the conditions in this respect have changed drastically in cases like the EU-Canada Comprehensive Economic and Trade Agreement (CETA) or the Agreement on Transatlantic Trade and Investment Partnership (TTIP). It should follow that in order to justify the incorporation of ISDS-clauses at all, a comparative evaluation of the decisive aspects of the legal regimes involved and the effectiveness of judicial protection for foreign operators must take place prior to the conclusion of any IPA, which very well may arrive at the result that the exhaustion of local remedies on both sides is deemed perfectly bearable and that there is no need for additional ISDS mechanisms. Could a combination of express provisions on the direct applicability of IPA standards with ISDS-clauses to be built into free trade agreements as a device of last resort encourage national courts to becoming more respectful of individual rights and the rule of law equally for foreign and local investors?

The approach chosen by the Commission is to emphasise progressively the right to regulate. Since 2006 the Commission underlined the need to avoid the lowering of domestic environmental, labour or occupational health and safety legislation and standards as a means to attract foreign investment, and the EU-Korea Free Trade Agreement provisionally in force since 2011 provides for each party the “right to regulate and to introduce new regulations to meet legitimate policy objectives”.<sup>44</sup> More extensively, the same goal is pursued by the provisions in the Preamble and several provisions of the Draft CETA agreement made public by the Commission within the framework of its new consultation procedure opened in March 2014, where – apart from a commitment to sustainable development –

“the right of the Parties to take measures to achieve legitimate public policy objectives on the basis of the level of protection they deem appropriate”

is not only recognised but also more concretely defined. Such provisions will certainly counterbalance the interests of investors for protection of their business and property. They do not give assurance, however, to the host state that in each case their legitimate and democratically decided policies are not impaired by the decision of an arbitration tribunal under ISDS.

### 1.3.2 The EU state aid regime

The EU state aid regime is another useful example when it comes to the pitfalls in the design of future IPAs between the EU and third countries like Canada, the US or China. Under Article 108 (3) TFEU Member States must notify the Commission of any state aid measure to be undertaken, and such measures shall not be put into effect until the Commission has reached a positive final decision. When a

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protections newly created by ad hoc arbitral tribunals. In this way, the scope of investor’s rights becomes untethered from domestic systems, enabling firms with global operations to benefit from heightened standards and rights offered by private arbitrators’ interpretations of treaty provisions, while bypassing the balances struck through domestic lawmaking processes.” For details see *ibid.*, pp. 406 et seq., p. 414: “...investor-state arbitrations largely shift the risk of regulatory change from investors to states (and taxpayers), putting greater pressure on governments to refrain from taking action to refine and upgrade their laws and regulations.” For the risks see also Montt (note 2), p. 370: “danger that international investment law jurisprudence could crystallise conservative rules that overprotect the status quo”.

<sup>43</sup> Kleinheisterkamp (note 27), p. 12.

<sup>44</sup> Article 7.1 (4) of the EU-Korea FTA; see for this approach taken by the Commission Hoffmeister and Ünüvar (note 7), p. 62-63.

Member State or a regional government grants an aid to a foreign investor with a view to give an incentive for creating jobs in the region or otherwise contributing to the general economic welfare, or even just promises to do so in an official statement, without this measure being duly reported to the Commission, this aid is unlawful and, if actually granted, will have to be recovered according to the ECJ case-law and the provisions of Regulation 1999/659.<sup>45</sup> But even in other cases, such as the German arrangements for renewable energy with its exceptions for energy-intensive industries like aluminium, state aid rules may simply not have been understood to be applicable and, thus, not been taken care of.<sup>46</sup>

The investor may not be satisfied with the recovery of the aid and argue that she had rightfully trusted the government having promised or granted the aid or the otherwise beneficial policy exception later qualified as an aid. If the protest proves to be unsuccessful, the investor may invoke fair and equitable treatment or other rights granted under the IPA and be accorded the amount equal to that of the state aid in compensation. How can it be made sure that Articles 107 and 108 TFEU are effectively applied, in such a situation, and that the distortions of competition in the internal market stated by the Commission to result from the unlawful aid are excluded nonetheless?<sup>47</sup> Some experience with intra-EU investment protection agreements shows that arbitration tribunals are willing to take account of opinions given by the Commission as an *amicus curiae* and recognised the argument that compliance of a Member State with EU law would not breach the Energy Charter Law,<sup>48</sup> but there is little assurance that similar recognition is given to EU law at the international level.

### 1.3.3 The principle of non-discrimination

IPAs frequently contain clauses granting national treatment and non-discrimination, they also contain most favoured nation clauses. Such clauses can be found in the draft Articles X.1 and X.2 of the draft CETA text on investment,<sup>49</sup> national treatment will probably also be granted in the TTIP. But what does “national” treatment exactly mean in an IPA concluded by the EU, which is not a state and thus has no “nationals”?

With regard to an IPA concluded by the EU three groups of investors can be distinguished:

- National investors: those who are investing in the Member State where they are established; equal treatment of all national investors is granted by national (constitutional) law.
- European investors: those who are established within a EU Member State but investing across borders in other Member States; all EU investors benefit from Article 18 TFEU, market freedoms and secondary Union law, even if national law would allow for discriminations.
- Third country (foreign) investors: those who are established outside the EU but making investments in one or more of the Member States; there is protection under Article 63 (1) TFEU<sup>50</sup> and under international law (customary minimal legal standards for the treatment of aliens or BITs).

<sup>45</sup> See, in particular, Articles 3, 11 and 14 of Regulation 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, as amended by 734/2013.

<sup>46</sup> See *infra*, 4.c. For an attempt to settle the conflict see the Commission’s Energy and Environmental State aid guidelines of 9.4.2014, C(2014) 2322, [http://ec.europa.eu/competition/sectors/energy/eeag\\_en.pdf](http://ec.europa.eu/competition/sectors/energy/eeag_en.pdf).

<sup>47</sup> See also Hindelang (note 23), pp. 177-178.

<sup>48</sup> With more details and references see: Hoffmeister and Ünüvar (note 7), p. 59-60.

<sup>49</sup> For a public version of the relevant CETA text see the annex to the Public consultation on modalities for investment protection and ISDS in TTIP, European Commission, [http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc\\_152280.pdf](http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf).

<sup>50</sup> See Steffen Hindelang, *The Free Movement of Capital and Foreign Direct Investment* (OUP 2009), pp. 204-7.



If foreign investors are granted “national treatment” so that they are aligned with national investors in each Member State, they would have to comply with all national legislation regarding corporate law, tax law, labour law, environmental and consumer protection law, etc. in the host country. If incorporated under the national law of a chosen Member State, such a company, however, is treated “automatically”, in accordance with Article 54 TFEU, as a European investor regarding its investments in other Member States and therefore benefits from the principle of mutual recognition and from secondary EU legislation facilitating intra-EU transactions. According to Article 62 TFEU this assimilation applies to the freedom of establishment as well as to services. National treatment granted in an IPA between the EU and a third country extends this guarantee to third country nationals established in one of the EU Member States. There is no reason to refuse non-discrimination or national treatment-clauses in IPAs and the recognition of direct effect, as the ECJ has done in numerous EU-agreements.<sup>51</sup> It follows that third country nationals would enjoy the same rights as Member States nationals regarding establishment, providing services as well as for participation in the capital of companies in other Member States under Article 55 TFEU.<sup>52</sup>

The guarantee of national or most favoured nation treatment in IPAs does not imply, however, that foreign investors would be given the status of, or be assimilated to Union citizens pursuant to Article 20 TFEU. This status reaches far beyond what is needed for the exercise of economic rights including free and secure foreign investment and, in particular, involves political and social rights.<sup>53</sup>

In case one EU Member State unlawfully impinges on the investment of a foreign investor established in another Member State, national treatment would mean that the investor would dispose of the same legal remedies as other companies established in this Member State. The case would be brought to a national court that may, if the case falls within the scope of Union law, submit any questions of interpretation or validity of relevant EU law to the ECJ. This ultimately begs the question: Would ISDS-clauses provide foreign investors the right to choose the dispute settlement procedure to reach a judgment more quickly? Moreover: Could that judgment even differ in substance from that of the national court based upon a preliminary ruling of the ECJ?

As a result, foreign investors using ISDS as a “fast track” procedure would be privileged compared to EU investors both in procedure as well as in substance. Such privileges would result in what we already know in the internal market context as “reverse discrimination”. This time, however, “reverse discrimination” would not simply affect the national citizens due to the limited scope of EU law in cases lacking any cross-border element, but it would put all EU investors to a disadvantage due to the procedural and substantive benefits granted to foreign investors under the IPAs. Equally important, granting arbitral tribunals the authority to independently adjudicate in cases involving said tensions between IPA provisions and EU law in cases involving not only states but individuals could exclude the ECJ from giving its interpretation to the relevant Union law and, therefore, pose a threat to the autonomy of the EU legal order.

#### 1.3.4 ISDS clauses and the autonomy of the Union’s legal order

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<sup>51</sup> ECJ Case 104/81 *Kupferberg* [1982] ECR 3641, para. 26. See also Case C-12/86 *Demirel* [1987] ECR 3719, para. 14; Case C-171/01 *Wählergruppe Gemeinsam* [2003] ECR I-4301, para. 54. For an overview see Jacqueline Dutheil de la Rochère, “L’effet direct des accords internationaux”, in: Allan Rosas, Egils Levits and Yves Bot (eds.), *The Role of the Court of Justice, in: The Court of Justice and the Construction of Europe: Analyses and Perspectives on Sixty Years of Case Law* (Asser Press Springer 2013), pp. 637, 643-644.

<sup>52</sup> For a possibility for exceptions to the “treatment”-provisions of Article 10 (2) and (3) to Regional Economic Integration Organisations see, however, Article 10 (g) of the European Energy Charter. See also Article 24 (4) (a) of this Charter regarding free trade areas and customs unions, as well as Article 25 of the Energy Charter granting a general exception from the most favoured nation clause for Economic Integration Areas.

<sup>53</sup> See Articles 21-24 TFEU and, for non-discrimination regarding social rights ECJ Case C-456/02 *Trojani* [2004] ECR I-7573.

ISDS-clauses in an IPA concluded by the EU can raise problems for the autonomy of Union law and its interpretation. Similarly cases regarding clashes between European or national rules on the one side, and provisions protecting more or less legitimate expectations of foreign investors, etc. on the other side, may involve questions of Union law with regard to its interpretation and at times even its validity.

ISDS clauses establishing the competence of arbitral tribunals in these cases could be understood as posing a threat to the autonomy of the EU legal order and, in particular, to exclude the ECJ from its competence under Article 267 TFEU,<sup>54</sup> and its duty to ensure that in the interpretation and application of the Treaties the law is observed (Art. 19 TEU). This could be contrary to Article 344 TFEU which states that:

“Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein”.

Contrary to the case of intra-EU BITs, however, the IPAs concluded by the EU would not be covered by this prohibition<sup>55</sup>: Not the Member States, at least *prima facie*, but the EU would be the contracting party. The mere participation of the Member States would not imply that disputes among Member States are within the focus of the agreements – and this is what Article 344 TFEU strives to reserve to the ECJ – but the IPA would only cover disputes between the EU or the Member State responsible and a third country party to the IPA.

Could ISDS-clauses, nevertheless, be a threat to the autonomy of the Union’s legal order? Thus far, there is no case-law on this issue.

On the one hand, it is true that the ECJ in Opinion 1/91 on the European Economic Area acknowledges that the Union may generally conclude international agreements including a binding dispute settlement procedure with decisions that legally bind the European Union and its institutions, and that the Court would itself feel bound by judgments of such judicial organs or arbitral courts.<sup>56</sup> There are examples for this in the case of WTO where the ECJ has accepted rulings of the Appellate Body to which the Court refers approvingly.<sup>57</sup> Also with the ratification of the Treaty on the accession of the EU to the European Convention of Human Rights (ECHR)<sup>58</sup> the EU and its institutions will be bound by judgments of another Court, the European Court of Human Rights (ECtHR), and there is little doubt that the ECJ in its upcoming Opinion on this treaty<sup>59</sup> will accept this binding effect and not find autonomy at risk.<sup>60</sup> In these cases the EU plays a role similar to that of a state party to an international agreement, and as far as a judicial or arbitral institution is established to judge upon compliance of the contracting parties with the provisions of the agreement or the interpretation thereof, it is difficult to see how the autonomy of the Union’s legal order should be affected or could be opposed to such an arrangement.

<sup>54</sup> On this question see also Reinisch (note 23), pp. 152-156, with more references. See also Hindelang (note 23), pp. 168-183; Ingolf Pernice, “The Autonomy of the EU Legal Order - Fifty Years After Van Gend”, *50ème anniversaire de l’arrêt Van Gend en Loos : 1963-2013 : actes du colloque, Luxembourg, 13 mai 2013* (Ed. Office des publications de l’Union européenne – Luxembourg 2013) p. 55, pp. 75-79.

<sup>55</sup> Schill (note 12), p. 44.

<sup>56</sup> See ECJ [Opinion 1/91](#), *EEA* [1991] ECR I-6079, para. 39.

<sup>57</sup> ECJ Case C-245/02, *Anheuser Busch* [2004] ECR I-10989, para. 55; Case C-638/11 P *Gul Ahmed Textile Mills*, nyr, para. 32. See on this also Pieter Jan Kuijper, “It Shall Contribute to ... the Strict Observance and Development of International Law”, in: Allan Rosas, Egils Levitz and Yves Bot (eds.), *The Role of the Court of Justice, in: The Court of Justice and the Construction of Europe: Analyses and Perspectives on Sixty Years of Case Law* (Asser Press Springer 2013), pp. 589, 609 note 86.

<sup>58</sup> Draft of 24 June 2011, [Council of Europe](#) CDDH-UE(2011)16.

<sup>59</sup> ECJ Opinion 1/14, ECHR, forthcoming.

<sup>60</sup> For more details see Pernice, (note 54), pp. 70-74.

In the case of an ISDS as part of an IPA between the EU and a third country, however, the situation may be different. Though the arbitration tribunal would only assess whether or not the guarantees given to investors in that agreement are violated and, if so, declare the EU or a Member State liable for damages or compensation, the legal effect of such an award could well reach beyond what is accepted under the WTO or ECHR systems. The WTO system does not know individual rights and is a flexible system based ultimately upon negotiations between states. The judgments of the ECHR, even if ordering for compensation, cannot be enforced. By contrast, ISDS are made to give the investor final awards on compensation or damages that can be directly enforced, often worldwide.<sup>61</sup> Even if the tribunal would not give a binding ruling on the interpretation or applicability of Union law, its decisions could well impact the functioning of the EU legal order and so considerably affect its autonomy. In this perspective the following examples may be considered:

- With a view to comply with new standards laid down in a EU directive on water or air quality, a Member State has revised the environmental conditions of the authorization for an industrial activity in which an American firm has invested and the profitable operation of which is now in question. Threatened to be held liable under the ISDS for damages because of an indirect expropriation, the Member State would grant an exception for this case and not apply the directive. Would the ECJ in an infringement procedure under Article 258 TFEU accept that the directive is not applied in the case, because of the IPA, or should it condemn the Member State for its violation of EU law? – Or, what is the situation if the Member State complied with the directive and was held liable for compensation by the arbitral tribunal established under the IPA, while the EU competitors have to bear the additional costs without any compensation? This would amount to a case of “reverse discrimination” for it certainly creates distortions of competition similar to those created by a state aid in favour of a third state undertaking. The EU would have to change its law to avoid such tensions.
- As explained, national treatment granted in an EU-third state IPA may be invoked by a third state investor established in a Member States for enjoying the same rights as a national investor under EU law for a secondary investment or for providing services in another Member State. In case of an arguably unjustified restriction on the exercise of these freedoms, it could, like European investors, appeal to the competent national court, which might make a reference to the ECJ, in order to enforce its freedom.<sup>62</sup> The “fast track”, however, would be to file a complaint directly with the arbitral tribunal, claiming unjust discrimination or unfair treatment. The tribunal’s binding and enforceable decision would not only set a sort of precedent for future assessments of similar cases, including European investors asking for equal treatment, but would also undermine the balance drawn by the ECJ or by the Union legislator between the market freedoms and the mandatory requirements of public interest of Member States justifying restrictions of trade, on the freedom to provide services or of establishment. With this respect, the bypassing of national courts and the ECJ can by no means be considered a fast track to justice *stricto sensu*. As the arbitral tribunal may only grant damages to the injured party on the grounds of the IPA but has no authority to annul the administrative decision or the underlying legislative act, the ISDS mechanism partly defeats the purpose of judicial review and promotes

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<sup>61</sup> Even if it is argued that individual undertakings must be considered, in terms of international law, enforcing rights of their state of origin against the other contracting party, the purpose and the result are that the individual gets protection and, in a given case, compensation or damages, as if it would enforce its own rights.

<sup>62</sup> If the agreements contains a clause excluding from national treatment the special rights accorded within a Regional Economic Integration Organisation, this would not be possible. Enforcement worldwide is provided for under ICSID, see Articles 53-55 of the Convention on the Settlement of Investment Disputes between States and Nationals of other States.

an “endure and cash in” attitude. This is contrary to both EU standards and the common principles on state liability in most Member States,<sup>63</sup> where first the annulment of the measure is to be sought in order to require “the competent Community institutions to take the necessary measures to remedy that illegality”.<sup>64</sup>

- The German policy of encouraging the use of renewable energies is based upon a system under which the additional costs for the producers of renewable energy are financed by a levy on the price of traditional energy paid by industries and consumers, the *EEG-Gesetz* (Federal Statute on Regenerative Energy). The Commission takes the view that certain exceptions from this levy conceded to energy-intensive industries amount to a violation of EU state aid rules. If so, Germany would be requested by the Commission to recover the “state aid” equivalent to the savings of these industries under the exception-rule. While there is no escape from this for Europeans, foreign investors – not aware of such extensions of state aid law and assuming that Germany has checked the conformity with the applicable legislation – could in such a case file a claim for damages or compensation under the ISDS. Even though they are free to hear the EU Commissions’ views and take account of EU law concerns,<sup>65</sup> the arbiters would not need to consider details of EU state aid law, procedural issues and the application of the Union principle of legitimate expectations. While European investors are deemed to know the law and could not rely on their expectations, the expectations of foreign investors would be honoured, as arbiters may treat the case as a question of fair and equitable treatment,<sup>66</sup> or find it a case of indirect expropriation and declare Germany – or the EU? – liable for compensation; the result would be that Germany is in (forced) infringement to Article 107 TFEU.<sup>67</sup> In particular, the prohibition of Article 108 (3) TFEU cannot be implemented, while the foreign investor would enjoy the competitive privilege the state aid rules are about to prevent. Though it is difficult to say that the ISDS involved interpretations of Union law binding upon the ECJ or other institutions, such an outcome would be felt discriminatory by the German competitors, distort competition and put at risk the proper functioning of the Union’s state aid system.
- The EU is a special contracting party to IPAs, as legal competence as well as responsibility and liability for the acts at issue in an ISDS may rest with the EU, with one or more of the Member States or even shared. This is the reason why the Commission has proposed a regulation establishing the method and procedures of attribution of responsibilities.<sup>68</sup> As this regulation can only be for internal use within the EU, special provision has to be made in an IPA for the right of the EU and its Member States to determine who will be the respondent, and to determine if an award is given ordering payment of damages or compensation, whether the EU or a Member

<sup>63</sup> Kleinheisterkamp (note 27), pp. 11-2.

<sup>64</sup> ECJ, Order of November 8, 2007 in Case C-421/06 *Fratelli Martini and Cargill* [2007] ECR I-152, para. 52.

<sup>65</sup> See, with references to Case AES v. Hungary, *Hoffmeister and Ünüvar* (note 7), p. 60. Also in the Case *Electrabel v. Hungary* the submissions made by the EU Commission under Article 26 ECT were broadly discussed, see ICSID Case No. ARB/07/19, available at: <http://www.italaw.com/sites/default/files/case-documents/italaw1071clean.pdf>, paras. 4.89 et seq., with the result that EU law is treated like national law as a “fact” only (para. 4.127), and particularly on the claim for the need of “harmonious interpretation”, the autonomy of the ECJ and how to deal with possible conflicts between ECT and EU law, *ibid.*, para. 4.144-4.189.

<sup>66</sup> Considering that even the German Government was surprised by the critical position of the European Commission qualifying the measure as a state aid.

<sup>67</sup> The system could, in addition, be considered contrary to the WTO Subsidies Agreement.

<sup>68</sup> Commission Proposal for a regulation establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party, [COM\(2012\) 335 final](#).

State will pay the bill.<sup>69</sup> The EU draft for the TTIP, e.g., so provides in its chapter on Negotiation on Investor-State Dispute Settlement that “before submitting a claim against the EU, or a Member State, the investor must request a determination as to whether the EU or the Member State will act as respondent in any particular case”.<sup>70</sup> Provisions to this effect can also be found in the Article X-20 (“determination of the respondent”) of the CETA Draft of April 2014. Even if a note to this provision states that “the tribunal shall be bound by the determination made pursuant to article x-...”, absent such determination in a given case it may be the arbitration tribunal who decides who is liable for damages and, thus, judges upon the question of responsibility of the EU or a Member State for a specific act or omission. While paragraph 4 of the aforementioned provision sets out criteria for adjudicating the responsibility, based upon the origin of the measure, exclusively of a Member State or including EU measures, it will still be for the tribunal to interpret and apply them in a given case. Yet, such questions pertain to the internal structure and the federal distribution of competences between the levels of government in the EU. Deciding upon them is reserved exclusively to the ECJ.

- In addition to grasping a say over what entity (EU or Member State) will be held responsible and therefore liable for an act or omission causing damage to a foreign investor under the IPA, the arbitral tribunal by awarding damages further may carry out a task specifically attributed to the ECJ, namely to determine the compensation for Union legislative acts which are in full conformity with the Treaties. Clearly, a distinction is to be drawn between internal EU liability and liability established under international law. Yet, under international law, responsibility of states is a settled issue among states. The case of liability to individuals is not established, except for ISDS. This is new, and, therefore, the distinction referred to is not a compelling argument if, under an international treaty like CETA or TTIP, it is the EU itself to create a system for liability of the EU for individual claims in addition to what the Treaties already provide for. Article 340 (2) TFEU states that “In the case of non-contractual liability, the Union shall, in accordance with the general principles common to the laws of the Member States, make good any damage caused by its institutions or by its servants in the performance of their duties.” Hence, the ECJ is to derive the standards and legal boundaries of the Union’s “objective liability”, i.e. liability for legislative acts in conformity with EU law and regardless of any degree of culpability, from a comparative analysis of the Member States law on state liability.<sup>71</sup> The current restrictive approach to EU liability for legislative acts in conformity with EU law would not only be widened significantly in substantive terms through EU-third state IPAs, but ISDS-clauses would hand over to arbitral tribunals the task of determining the scope and extent of compensation for objective legislative liability, which – as a legal responsibility not only to adjudicate existing standards but also to actively develop such standards – is expressly assigned to the ECJ under Art. 340 (2) TFEU. It is doubtful whether the competence of the ECJ under Articles 268 in combination with Article 340 (2) TFEU allows conferring power to decide upon the liability of the EU to other courts or

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<sup>69</sup> For a discussion of the distribution of financial responsibility and state liability see Kleinheisterkamp (note 27), pp. 9-17.

<sup>70</sup> See para. 8) of the chapter, *supra* note 11.

<sup>71</sup> See Kleinheisterkamp (note 27), pp. 13-5. The Court generally takes a restrictive approach to non-contractual liability, see joined cases C-120/06 and 121/06 *FIAMM and Fedon* [2008] ECR para. 174: “The Court has, moreover, stated that the strict approach taken towards the liability of the Community in the exercise of its legislative activities is attributable to two considerations. First, even where the legality of measures is subject to judicial review, exercise of the legislative function must not be hindered by the prospect of actions for damages whenever the general interest of the Community requires legislative measures to be adopted which may adversely affect individual interests. Second, in a legislative context characterised by the exercise of a wide discretion, which is essential for implementing a Community policy, the Community cannot incur liability unless the institution concerned has manifestly and gravely disregarded the limits on the exercise of its powers.”

tribunals even by international agreements at all.<sup>72</sup> Proper consideration of why the ECJ is so restrictive in according damages in cases of legislative acts even more so seems to apply to what has been said, above, about the “regulatory chill” of arbitration under ISDS-clauses.

These examples are far from being clear cases where the autonomy of the EU legal order can be said are violated. The ECJ, however, is rather strict on this question. The relevant series of cases starts with the Opinion 1/91 of the ECJ on the Treaty relating to the establishment of the European Economic Area. The Court found this Treaty impinging on the autonomy of the EU legal order for “the machinery of courts provided for in the agreement” conflicted with the EU provisions regarding the prerogatives of the ECJ namely under ex-Article 164 EC, now Article 19 TEU.<sup>73</sup> In the context of mixed agreements, the preservation of the autonomy of the EU legal order requires that the international dispute settlement mechanism may not decide upon matters concerning the distribution of competences between the EU and the Member States.<sup>74</sup> As in the present examples nothing allows to conclude that the arbitration tribunals could give interpretations of EU law binding the ECJ, the criteria established in the Opinion 1/91 do not seem to pose problems for ISDS.

The ECJ has taken a more restrictive view in its Opinion 1/09 on the draft agreement on the European and Community Patents Court. Though it rejected the argument that Article 344 TFEU was violated, for the jurisdiction of the Patent Court to be established related “only to disputes between individuals in the field of patent”,<sup>75</sup> it nevertheless found the Agreement in conflict with the Treaty. The reason was that a substantial part of the responsibilities of the ECJ in the EU judicial system was to be conferred to a body outside of its ultimate control. The Court, therefore, concluded that:

“the envisaged agreement, by conferring on an international court which is outside the institutional and judicial framework of the European Union an exclusive jurisdiction to hear a significant number of actions brought by individuals in the field of the Community patent and to interpret and apply European Union law in that field, would deprive courts of Member States of their powers in relation to the interpretation and application of European Union law and the Court of its powers to reply, by preliminary ruling, to questions referred by those courts and, consequently, would alter the essential character of the powers which the Treaties confer on the institutions of the European Union and on the Member States and which are indispensable to the preservation of the very nature of European Union law.”<sup>76</sup>

ISDS clauses providing for international arbitral tribunals to settle investor-state disputes, including those of the ICSID system, would give these tribunals a final and binding say as to the relevant interpretation of EU law at stake, even if understood as “facts” only, without the ECJ necessarily being involved. Though this competence may not be exclusive, like in the case of the European Patent Court, arbitration tribunals would nonetheless *de facto* be the forum where questions of EU law are adjudicated with binding effect upon the EU institutions and the Member States.

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<sup>72</sup> The situation is different from that of the WTO with a dispute settlement system that involves states and the EU only, not private parties, where in case the EU is found violating WTO law retaliatory tariffs may be allowed by the Appellate Body against EU imports to the third state concerned or compensation among contracting parties concerned.

<sup>73</sup> ECJ [Opinion 1/91 EEA](#) [1991] ECR I-6079, para 46.

<sup>74</sup> *Ibid.*, paras. 39-40. From this it follows that ISDS clauses in future IPAs must not determine what contracting party, the EU or a Member State, is to be considered the proper respondent in an arbitration but must leave this question for the EU and the Member States to decide, see Schill (note 12), p. 49.

<sup>75</sup> ECJ [Opinion 1/09 Patent Court](#), [2011] ECR I-1137, para. 63.

<sup>76</sup> *Ibid.*, para. 89.

Preservation of the EU legal order, the Court has stated in its Opinion on the European Common Aviation Area,

“requires that the procedures for ensuring uniform interpretation of the rules of the ECAA Agreement and for resolving disputes will not have the effect of binding the Community and its institutions, in the exercise of their internal powers, to a particular interpretation of the rules of Community law referred to in that agreement.”<sup>77</sup>

Hence, the Court takes a firm stand when it comes to questions of EU law that fall within the exclusive competence of the ECJ, such as the interpretation of EU law and the judicial dialogue between the ECJ and the national courts,<sup>78</sup> and is not willing to cede ground. It is difficult to see how an award given by an arbitration tribunal would not frequently involve the interpretation of EU law, at least as preliminary questions. Though this may, basically, be understood as a question of fact within the framework of assessing, under the ISDS, the conformity of EU or Member States’ measures with the provisions or standards set up in the IPA, comparable to the functioning of the WTO dispute settlement mechanism, the legal implications are different. The ISDS-system produces binding rulings for the benefit of private actors and not decisions applicable between states only. There is no room for negotiations between the governments involved once the ruling is given; the investor can directly enforce it, mostly worldwide.

If these rulings are not directly binding, as the ECJ states in the ECAA case, the Union and its institutions, in the exercise of their internal powers, to a particular interpretation of the relevant rules of Union law,<sup>79</sup> the mechanism is comparable, nevertheless, to that the ECJ has given its Opinion 1/09 on the Patent Agreement; what was quoted above from the Courts’ Opinion<sup>80</sup> can easily be applied to ISDS: In the conferring on an international court which is outside the institutional and judicial framework of the European Union an exclusive jurisdiction to hear a significant number of actions brought by individuals in the field of *foreign investment* and to interpret and apply European Union law in that field, would deprive courts of Member States of their powers in relation to the interpretation and application of European Union law and the Court of its powers to reply, by preliminary ruling, to questions referred by those courts. The autonomy of Union law, therefore, is at stake; and the fact that EU judges are not necessarily included in the international tribunal, as in some of the cases on autonomy judged by the ECJ,<sup>81</sup> would not make it easier but even more difficult to accept the arrangement.

Thus, as far as ISDS bodies’ decisions produce binding interpretations on EU law, it is concluded that, at least, a preliminary ruling procedure analogous to Art. 267 TFEU has to be implemented whenever questions of EU law arise in arbitration.<sup>82</sup> And in order to preserve the autonomy of the EU legal order and its *effet utile* the preliminary ruling would indeed have to be binding for the tribunal.<sup>83</sup>

It is very doubtful however, whether any third country would accept such a role of the ECJ; and the interpretation given to Union law by an arbitration tribunal is not necessarily binding for the ECJ. Nevertheless, as established in the examples given, awards issued under ISDS could bring Member States in conflict with obligations under EU law, lead to discriminations of European investors, distort competition and endanger the functioning of the Union legal order. This could be all the more relevant for the ECJ with a view to the autonomy of Union law, as questions regarding the delimitation of

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<sup>77</sup> ECJ [Opinion 1/00 ECAA](#) [2002] ECR I-3493, para. 13.

<sup>78</sup> *Ibid.*, paras. 12-13; ECJ [Opinion 1/09 Patent Court](#), [2011] ECR I-1137, para. 89.

<sup>79</sup> See the previous quote, at note 77.

<sup>80</sup> See quote *supra* note 76.

<sup>81</sup> E.g. ECJ [Opinion 1/91 EEA](#) [1991] ECR I-6079, para 46, referred to *supra*, note 73.

<sup>82</sup> See Schill (note 12), pp. 51-52. For an extensive discussion of such a system of referral see von Papp (note 103), pp. 1065-81.

<sup>83</sup> ECJ [Opinion 1/91 European Common Aviation Area](#) [1991] ECR I-6097, paras. 61-65.

responsibilities between the EU and the Member States may also play a role in such cases. The ECJ has made clear already in Opinion 1/91 that such questions are not to be adjudicated by courts other than the ECJ.<sup>84</sup>

## 2. DESIGNING INVESTMENT PROTECTION IN CONFORMITY WITH EU LAW

Given the commonly accepted benefits of investment protection in international trade it is of highest interest how provisions safeguarding investments and, in particular, provisions on investor-state dispute settlement should be configured in IPAs between the EU and third countries so to comply with primary EU law (*infra* I.). A particular question in this context is whether it is possible to envisage a model, which is generally applicable or if tailor-made solutions are needed, depending on the level of development of the partner country in question (*infra* II.). If tailor-made solutions are deemed preferable, it will have to be determined if these differentiated solutions could involve delays or limitations for some investors' access to ISDS (*infra* III.).

### 2.1 Configuring IPAs in compliance with EU law

With regard to the abovementioned problems of IPAs concluded by the EU with third countries the following solutions may be considered for ensuring compliance with the law of the European Union.

#### 2.1.1 Regulatory autonomy - overcoming the "regulatory chill"

Given the legitimate criticism against the "regulatory chill" by IPA commentators, the European Parliament and the Commission agree that the regulatory autonomy of all contracting parties must be guaranteed by an express provision in the agreement. The key problem with ISDS in this context seems to be the vagueness of the protection clauses (*infra* a.). Given all the adverse implications of ISDS, the best solution, therefore, would seem to opt for a more integrative solution, one that would be designed according to what may be called the "European model" (*infra* b.). As far as this proves politically undesirable or impossible, detailed provisions may be envisaged for the IPA aiming at more legal certainty regarding the preservation of the regulatory autonomy of the contracting parties (*infra* c.).

##### 2.1.1.1 The problem of vagueness and intended privileges

The European Parliament vehemently expressed its concerns in 2011 as follows:<sup>85</sup> It

"23. Stresses that future investment agreements concluded by the EU must respect the capacity for public intervention;

24. Expresses its deep concern regarding the level of discretion of international arbitrators to make a broad interpretation of investor protection clauses, thereby leading to the ruling out of legitimate public regulations; calls on the Commission to produce clear definitions of investor protection standards in order to avoid such problems in the new investment agreements;

<sup>84</sup> ECJ [Opinion 1/91](#) EEA [1991] ECR I-6079, para. 2: "...Contracting Parties". As far as the Community is concerned, that expression covers the Community and the Member States, or the Community, or the Member States. Consequently, that court will have to rule on the respective competences of the Community and the Member States as regards the matters governed by the provisions of the agreement. To confer that jurisdiction on that court is incompatible with Community law, since it is likely adversely to affect the allocation of responsibilities defined in the Treaties and the autonomy of the Community legal order, respect for which must be assured exclusively by the Court of Justice". On this point see also Reinisch (note 23), p. 155.

<sup>85</sup> European Parliament resolution of 6 April 2011 on Future European international Investment Policy ([2010/2203\(INI\)](#)).



25. Calls on the Commission to include in all future agreements specific clauses laying down the right of parties to the agreement to regulate, inter alia, in the areas of protection of national security, the environment, public health, workers' and consumers' rights, industrial policy and cultural diversity;"

As far as can be seen, considerable efforts have been made by the Commission for the CETA Agreement<sup>86</sup> and are promised to be made also for the TTIP on Trade in Services, Investment and E-Commerce, regarding definitions and clarification so as to make sure that the national and European authority to regulate is effectively protected. Also the EU Commissions' spokesman for trade, *John Clancy*, announced in a Memorandum of 20 December 2013 that under the treaty actually negotiated:

"Legitimate policy measures taken by public authorities to protect the environment or public health and which apply to all firms in the same way – foreign or national – cannot be successfully challenged under these provisions under the guise of investment protection..."

...we will leave no room for doubt. TTIP should explicitly state that legitimate government public policy decisions cannot be over-ridden. It will be made crystal clear that this agreement will not limit the scope for governments to take decisions on, for example, the balance between public provision of healthcare and private services. A company will not receive compensation merely because its profits drop due to health or environmental regulation."<sup>87</sup>

Accordingly, the Annex to the Article on Expropriation in the draft CETA Investment Text specifies that

"3. For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations".<sup>88</sup>

But is it possible to achieve this degree of clarity through the general terms of an agreement?<sup>89</sup> What is the meaning of "legitimate" policy measure? And where's the tipping point, where a measure cannot be considered "legitimate" any longer? Is it not exactly for this legal grey area that the ISDS is established, with "neutral" arbiters instead of arguably biased national judges of the host state?

Ensuring that no discrimination of foreign investors may take place, is a most legitimate concern, and ISDS seems to be a legitimate and effective procedural safeguard to this effect. But is there, in turn, any safeguard against foreign investors to be privileged? The Commission aims at excluding any differentiated treatment: National and foreign investors are to be treated alike. The question, however, is whether and under which conditions privileging foreign investors could even become a purpose of the IPA. Take the case of a direct or indirect expropriation decided for a specific sector of the national economy, and little compensation only, if any, is accorded to the investors concerned because of a real public need; is it not precisely the purpose of IPAs in such a case to better protect foreign investors than national firms? Foreign investors have no representation in the political process of their host state; they are dependent upon what may come up with in a democratic process. They have, as *Albert Hirschman* would have expressed it, no voice and may therefore only vote with their feet by choosing the exit

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<sup>86</sup> See supra, note 49.

<sup>87</sup> European Commission Directorate-General for Trade, Memorandum United States Brussels, 20 December 2013, Investment protection does not give multinationals unlimited rights to challenge any legislation. A statement by EU Trade Spokesman John Clancy about the investment protection provisions in Free Trade Agreements like TTIP (Transatlantic Trade and Investment Partnership), available at: <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1008>.

<sup>88</sup> Supra, note 49.

<sup>89</sup> For an attempt to clarify of definitions and standards see Hoffmeister and Alexandru (note 5), para. III.

option<sup>90</sup> which frequently would mean to suffer significant losses. In this situation, foreign investors' protection exists for making investments safe and attractive. In this vein, the IPA could even be understood to make visible the external effects of "sovereign" national policies and, in particular, to internalize their external costs – nothing strange in a world of interdependent economies.

#### 2.1.1.2 The "European model" as an alternative?

If neither the desired clarity can be achieved nor a strict concept of equal treatment, thus, can serve the specific purpose of an IPA, could the drafters of the EU IPAs with third countries, such as the TTIP, possibly draw from the EU's own experience? Article 21 TEU invites us to think in this direction. The EU, in some way, deals with the democratic deficits of its Member States which result from the external effects of national policies; in accordance with the principle of subsidiarity it establishes a system of common decision-making to deal with issues one state cannot manage at all, or not without interfering with the interests of people in, or investors of other countries.<sup>91</sup>

Within the EU there is neither need nor place for investment protection agreements, for there are other – and sufficient – safeguards for the protection of investors from one Member State in other Member States. First of all, the general principle of non-discrimination on grounds of nationality (Article 18 TFEU), gives a fundamental assurance to intra-EU investors. A set of guarantees, secondly, for the freedoms of establishment and to provide services of free movement of capital and free payments, construed by the ECJ as individual rights of the investor exclude any unjustified restrictions. And there is common legislation for setting common standards for the preservation or promotion of common public goods. All this is based upon the common foundation of basic values including the rule of law and access to justice (Articles 2 and 19 (1) TEU, Article 47 of the Charter of Fundamental Rights).

As this system works fairly well,<sup>92</sup> it would seem appropriate to build upon the "European model" granting all investors equal rights and legal certainty, instead of relying upon the traditional investment protection clauses, the effect and purpose of which are to give foreign investors a special legal status. Clearly, neither primacy nor direct applicability as accepted among Member States for Union law can easily be expected to be accepted by third countries for similar provisions established by an IPA under international law. ISDS provisions in IPAs are an attempt to achieve a similar effectiveness for the investor, if awards are final, binding and directly enforceable. As shown above, however, they remain a foreign and, sometimes, disruptive element for the internal legal system, while under the "European model" the legal system encompasses the foreign investor's rights. To make the "European model" effective, a joint commission or a court to settle disputes will be needed as well as a mechanism ensuring proper implementation of the decisions made by such institutions. Drawing from the EU experience with the European Economic Area and earlier free trade arrangements, and with some innovative thinking it nevertheless seems to be possible to find an adequate formula for ensuring effective application of the agreements to come on the basis of mutual recognition and common institutions.<sup>93</sup>

<sup>90</sup> Albert O. Hirschmann, *Exit, Voice and Loyalty: Responses to Decline in Firms and Organizations and States* (Harvard University Press 1970).

<sup>91</sup> See Jürgen Neyer, *The Justification of Europe. A Political Theory of Supranational Integration* (OUP 2012), pp. 4, 57, 68-70. Instead of replacing democracy at the European level by a "right to justification" (*ibid.*, pp. 15, 85-111), but with similar premises see Ingolf Pernice, *Solidarität in Europa. Eine Ortsbestimmung im Verhältnis zwischen Bürger, Staat und Europäischer Union*, in: Christian Calliess (ed.), *Europäische Solidarität und nationale Identität* (Mohr Siebeck 2013), pp. 44-56.

<sup>92</sup> Exceptions must be conceded with regard to certain difficulties regarding the efficiency of the judicial system in a number of EU Member States, see: [http://ec.europa.eu/justice/effective-justice/scoreboard/index\\_en.htm](http://ec.europa.eu/justice/effective-justice/scoreboard/index_en.htm).

<sup>93</sup> See, for instance, Kleinheisterkamp (note 27), pp. 23-5, 27, who argues that since, for once, the EU is a very particular actor in the field of international arbitration, which has yet to establish legal standards for IPAs with third countries and is not

Contrary to IPAs including ISDS-clauses, the “EU model” would not involve special threats to the regulatory autonomy of the EU or its Member States, as there are no special rights and remedies for foreign investors. On the other hand, European investors in the US would not benefit from special protection either: US and EU investors would be treated equally, including their access to justice. As the EU trade spokesman *John Clancy* has explained:

“the reason ISDS is needed in TTIP is that the US system does not allow companies to use international agreements like TTIP as a legal basis in national courts. So European companies – and especially SMEs – will only be able to enforce the agreement through an international arbitration system like ISDS”.<sup>94</sup>

Against the evidence put forward by the Commission suggesting that ISDS clauses in international agreements are needed to ensure effective investment protection in litigation before U.S. courts, Jan Kleinheisterkamp in a detailed analysis states that such claims are unfounded and the underlying problems will not successfully be dealt with through ISDS but reveal a general weakness of investor state arbitration.<sup>95</sup> This is not about the direct application of the obligations under an international investment treaty. The question is whether there is valid reason to stir doubts about full respect for the rule of law on both sides and non-discrimination regarding access to justice. If both sides of the TTIP are proud of the respect of the rule of law and common values within their respective jurisdiction, arrangements more sophisticated than ISDS may be appropriate to meet the respective interests.

Clearly, an “EU-model” arrangement would be a novelty in this regard, and to introduce it would be beyond traditional international law and imply new thinking based upon new concepts both for the US system and for the EU. But the benefits compared to according special rights to foreign investors, as well as to the ISDS, with regard to the preservation of regulatory autonomy and the principle of equal treatment might be a proper argument for both sides to think about such a substantial change.

### 2.1.1.3 Preserving regulatory autonomy through clear definitions and a joint committee

If it is impossible to reach agreement with third countries upon such a system the alternative would be to spell out what regulatory autonomy entails in legal terms. Given the vagueness of many provisions of Union law regarding the internal market and objectives of complementary policies, IPAs should, thus, include a provision, perhaps in the form of an exception clause, stating clearly that neither environmental, consumer and health protection, social and welfare policies, nor policies regarding national security and cultural diversity of the contracting parties shall be jeopardised.<sup>96</sup> On the basis of the existing experience with investor arbitration, it should be made clear what kind of instances may not be taken as cases of direct or indirect expropriation or breaches of legitimate expectations. Such a

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bound to either the standards entailed in Member state BITs or other IPAs the present negotiations with Canada or the U.S. mark a decisive and precedent-setting period; hence, what is needed is a more “mature solution” that relies largely on a comparative approach that examines and outlines in more detail the “exact rights to protection that both European investors abroad as well as foreign investors in the EU should be entitled to” in the IPAs.

<sup>94</sup> See *supra* note 87.

<sup>95</sup> See Jan Kleinheisterkamp, “[Is there a Need for Investor-State Arbitration in the Transatlantic Trade and Investment Partnership \(TTIP\)?](#)”, draft available on SSRN <[www.ssrn.com](http://www.ssrn.com)>.

<sup>96</sup> In a similar vein, Kleinheisterkamp (note 27), p. 17, looking at the EU’s regulatory autonomy in the Internal Market, holds that “The core problem for the Internal Market is the high degree of legal uncertainty resulting from the vagueness of the investor protection standards and the large spectrum of possible interpretations which might be given to them in the decentralized system of investment arbitration. This uncertainty – both for states and investors – is what ultimately puts the effectiveness of EU regulation of the Internal Market into question.” (internal footnotes omitted).

negative list could certainly not be exhaustive, but it would give guidance to the arbiters on the limits of investors' protection.

On the procedural side, there should be provisions for a joint committee of the contracting parties or a similar body competent to give, by consensus, guiding interpretation to the provisions of the agreement after it becomes clear, in a tribunal's award that what the arbitration came up with is not what was intended by the contracting parties. Such a political body may not have competence to review an individual award, but its authentic interpretation will be of great value for the subsequent case law.

### 2.1.2 Repercussions of the "EU model" on the state aid regime

Absent special protection for foreign investors on the basis of equal treatment tensions with the EU state aid regime, as explained above, can be avoided. Investors from third countries would be subject to the same obligations regarding aids granted by Member States as investors from any EU Member State. There would be no room for claims related to commitments of national authorities of the host country with regard to a state aid, which might be found binding by an arbitral tribunal at a later stage<sup>97</sup> and be opposed to the order for recovery in application of the EU state aid law.

In the interest of legal certainty an IPA with ISDS-clauses shall contain express references to the obligations under the EU state aid regime and to the procedures applicable, making clear that legitimate expectations may not be based upon commitments made by a national authority regarding the compatibility of a measure with state aid law.

### 2.1.3 Securing respect for the principle of non-discrimination

Foreign investors should neither be disadvantaged nor privileged when investing abroad. Both would be cases of illegitimate discrimination. As established above, particularly ISDS-clauses could be contrary not only to the principle of non-discrimination but also to the autonomy of Union law.

Giving the foreign investors a special remedy, however, is exactly what the agreements with ISDS-clauses are about. This would not only discriminate against EU investors inside the EU but equally become an incentive for investors generally to invest abroad instead of within their respective countries. To ensure equal treatment effectively would need establishing a common legal system including directly applicable guarantees in substance and procedure, along the lines given by the model of the European internal market.

### 2.1.4 Preserving the autonomy of the Union's legal order

To have no ISDS clause in an IPA would avoid any problem with regard to the autonomy of the EU legal order. The IPA would, however, lose one of the elements deemed most important and effective. To overcome any possible reluctance of US courts to apply directly the provisions of an IPA, a clear and express provision could, however, be included. With regard to the EU, the ECJ has clearly accepted that such provisions would be binding for the EU and its Member States in case on the conformity with international law of the extension of the European emissions-trading system to the air transport sector:

"In conformity with the principles of international law, European Union institutions which have power to negotiate and conclude an international agreement are free to agree with the third States

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<sup>97</sup> For a general appraisal of how commitments or contractual arrangements granting stability for the investor are judged by arbitral tribunals in practice see Johnson & Volkov (note 87), pp. 372, 374 et seq.

concerned what effect the provisions of the agreement are to have in the internal legal order of the contracting parties".<sup>98</sup>

On the assumption that American or Canadian courts as well as European courts do apply the standards set in the IPA directly in a foreign investors case, ISDS clauses would not be needed or, at least, be established as a remedy of last resort only. If, however, neither the "EU model" suggested above nor such clauses of direct applicability are politically not available, it is necessary to design ISDS arrangements so to avoid at best all implications giving reasons for concern that the autonomy of the Union's legal order be negatively affected. Not only for this purpose, but also to preserve reciprocity in this case, there should be, instead, an express clause excluding that provisions of the IPA are given direct effect.

#### 2.1.4.1 Exhaustion of local remedies

Access to ISDS was suggested to be subject to the exhaustion of local remedies. This would give national courts the opportunity to submit preliminary questions on Union law to the ECJ, so that the ECJ could give its ruling as a basis for a final judgment of an EU court. Though it would give strong guidance to an arbitration tribunal dealing with the matter subsequently, such a preliminary ruling cannot be binding upon an international arbitration tribunal while the rulings of the arbitrators are binding upon the institutions of the EU and its Member States and may provide private parties with directly enforceable rights. Yet, the ECJ's Opinion 1/00 on the European Civil Aviation Area excludes that an international court established by an agreement to which the EU is a contracting party is given jurisdiction upon the interpretation of Union law with binding effect for the EU institutions and the Member States.<sup>99</sup> Even if an arbitration tribunal, thus, has full information on the interpretation of the relevant provisions of EU law thanks to the provision for a local remedies clause, therefore, such a clause does not fully resolve the problem of the autonomy of the EU legal order.

#### 2.1.4.2 A standing court with power to make references under Article 267 TFEU

Instead of *ad hoc* arbitration, the IPAs of the EU could contain provisions on the establishment of a permanent court for the settlement of disputes under the IPA. Can such a court be legally bound to refer questions to the ECJ under Article 267 TFEU when the interpretation of the Treaties or the interpretation or validity of EU legal acts adopted according to the Treaties is at stake?<sup>100</sup> The question is whether an arbitration tribunal established by the EU, possibly in a mixed agreement ratified also by the Member States with a third country, can be considered as a "court or tribunal of a Member State" as required by Article 267 TFEU. The ECJ has accepted the BENELUX Court as a court of a Member State,<sup>101</sup> it has refused to accept, however, the complaints board of European Schools as a court allowed to make references to the ECJ, as it is a court not of a Member State but of an international organisation established by the Member States under an international agreement.<sup>102</sup> The wording of Article 267 TFEU would be stretched to its limits if a court established with third states would be accepted to be a court of a Member State. On the other hand, a teleological interpretation recognising the coherence of the Union's legal order and the unity of the application of Union law as the central purpose of Article 267 TFEU and the *effet utile*, could well argue in favour of a broader reading. The ISDS would have to meet the other conditions set by the Court, in particular, it would have to be established by law (though not by a legislative act of a Member State), its jurisdiction would have to be compulsory to the extent that the

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<sup>98</sup> ECJ Case C-366/10 *Air Transport Association of America* [2011] ECR I-13833, summary para. 1.

<sup>99</sup> *Supra* note 77.

<sup>100</sup> See on this question Reinisch (note 23), pp. 155-156.

<sup>101</sup> ECJ Case C-337/95 *Dior* [1997] ECR I-6013, para. 31.

<sup>102</sup> ECJ Case C-196/09 *Miles* [2011] ECR I-5105, paras. 39-41.

respondent cannot evade or circumvent its jurisdiction, the tribunal would have to be independent, awards would have to be given according to rules of law and binding. Only if the ISDS provided for a permanent arbitration court or tribunal, however, this institution could be understood as a court within the meaning of Article 267 TFEU.<sup>103</sup>

The question remains open, nevertheless, whether a third state would be ready to accept that the ECJ's rulings are binding upon the arbitration tribunal. At least it would request a similar assurance for its courts. As the purpose of the arbitration clauses, however, is to have a neutral judge giving a decision independently of what judges of one or the other contracting party would find appropriate, the system of Article 267 TFEU does not seem to be a proper solution to the problem of autonomy.

### 2.1.4.3 Prior involvement procedure

Taking Article 3(6) of the draft treaty on the accession of the EU to the ECHR as an example, a somewhat "softer" solution could be found in the introduction of prior involvement procedure.<sup>104</sup> The idea is to ensure that, where questions of EU law are at stake, the ECJ is given an opportunity to judge upon the validity or the interpretation of the act in question against the standard of EU law taking into account the obligations under the IPA before the arbitration tribunal takes its decision. Such a fully-fledged prior involvement procedure would, moreover, change the nature of investor-state arbitration if it were construed so as to give the ECJ the opportunity and power to annul the act in question. It would follow that investment arbitration would be more than a remedy for compensation and better help serve justice.<sup>105</sup> If the ECJ nullifies the relevant act, this would of course change the legal situation to be assessed by the tribunal. But even if there is only an interpretation given to the relevant Union acts, and even if this ruling if the ECJ is not binding for the tribunal, in the spirit of sincere cooperation underlying each IPA, it would take this interpretation as a given fact and contemplate on that basis upon the claims lodged by the investor.<sup>106</sup>

What remains unanswered, however, is how to construe the adjudicatory competence of the ECJ in such cases. Neither Article 267 TFEU on preliminary rulings nor Article 272 TFEU on the possibility for the ECJ to be conferred upon "jurisdiction to give judgment pursuant to any arbitration clause contained in a contract concluded by or on behalf of the Union" seem to allow for the less invasive construction of prior involvement,<sup>107</sup> for the ECJ would not be the arbiter and judge of last instance but just a "consultant" for the arbitral tribunal. Likewise, Article 273 TFEU stating that the ECJ shall have jurisdiction in any dispute

<sup>103</sup> For the conditions see ECJ Case C- 54/96 *Dorsch* [1997] ECR I-4961, para. 23, confirmed in Case C-96/04 *AG Niebüll*, [2006] ECR I-3561, para. 12. For a comprehensive discussion see Constanze von Papp, "Clash of 'Autonomous Legal Orders': Can EU Member State Courts Bridge the Jurisdictional Divide Between Investment Tribunals and the ECJ? A Plea for Direct Referral From Investment Tribunals to the ECJ", 50 *Common Market Law Review* (2013), pp. 1066-1076, with additional references. See also Pernice (note 54), pp. 78-79.

<sup>104</sup> Art. 3(6) of the Draft Accession Treaty reads: "In proceedings to which the European Union is a co-respondent, if the Court of Justice of the European Union has not yet assessed the compatibility with the rights at issue defined in the Convention or in the protocols to which the European Union has acceded of the provision of European Union law as under paragraph 2 of this article, sufficient time shall be afforded for the Court of Justice of the European Union to make such an assessment, and thereafter for the parties to make observations to the Court. The European Union shall ensure that such assessment is made quickly so that the proceedings before the Court are not unduly delayed. The provisions of this paragraph shall not affect the powers of the Court."

<sup>105</sup> Cf. *supra* III.4.

<sup>106</sup> Some provisions of a similar kind are made in Article 3 of Annex 1 to Article X-27 of the draft CETA Investor-to-State Dispute Settlement Text for „a person or an entity that is not a disputing party (third persons(s))" to file a written submission with the arbitral tribunal regarding a matter within the scope of the dispute".

<sup>107</sup> Unless, however, one would follow the broader approach to Art. 267 TFEU and the parties to the IP would be willing to design the ISDS system in accordance with the criteria set out, see *supra* b.

between Member States which relates to the subject matter of the Treaties if the dispute is submitted to it under a special agreement between the parties, only applies to disputes between Member States, not the EU and third parties.<sup>108</sup> That the ECJ may be asked for its legal opinion, particularly in an international law context, can be seen from Article 218 (11) TFEU. But this provision is very specific and neither susceptible to an extensive application nor open for an application by analogy. The Court in its Opinion 1/92 on the European Economic Area made clear that despite the fact that the powers conferred upon the Court by the Treaties may only be modified pursuant to the procedures established therein and “an international agreement concluded by the Community may confer new powers on the Court, provided that in so doing it does not change the nature of the function of the court as conceived in the EEC Treaty.”<sup>109</sup> In the opinion of the Court, the function-preserving character required for the conferral of new competences invariably implies the binding effect of the Court’s decisions.<sup>110</sup> Prior involvement, conceived as a less invasive instrument, would, therefore, be a new competence of the ECJ and require prior amendment of the TFEU.<sup>111</sup>

## 2.2 One-size-fits-all or tailor-made solutions ?

There seems to be a political preference for adopting one model for IPAs with ISDS-clauses for all economic partners of the EU worldwide. It could allow developing common standards also for the interpretation of the specific criteria to be applied for the protection of foreign investors, and so enhance legal certainty in an – ideally – global market to the benefit of all countries and the people thereof.<sup>112</sup> It could even end up in, at least indirectly, a sort of *global ius commune* insofar as other countries may feel induced to agree on similar terms as laid down in the “model-agreement”. To reach such a solution, a transparent process and some openness for the participation of other countries – as observers – in the negotiation of the first important IPAs of the European Union could be of great help.

The existing system of bilateral investment agreements governed by international law and the Vienna Convention on the Law of Treaties with its rules on the interpretation of international treaties, however, is far from such a “systematic” solution. Also with a view to the diversity of the development both, economically and regarding to good governance, individual rights, the rule of law and judicial protection there are doubts whether a one-size-fits-all solution is at all realistic. It seems, rather, to be appropriate to consider a “European model” solution as suggested *supra* B.I.1.b. in the framework of agreements upon free trade areas such as under the TTIP with the US or the CETA with countries having similarly developed systems of fundamental rights and judicial review. In a medium or long term perspective, this solution, once adopted, could be offered as the standard model to more and more partners in the world as the appropriate means to ensure free trade and investment on the basis of non-discrimination, the rule of law and other shared values.

Cooperation with other countries could be developed upon the basis of agreements containing ISDS clauses of a “new generation” that make sure that national public policies are not jeopardised. Effective protection could be conditioned in such agreements by clauses making sure that the investors fully

<sup>108</sup> ECJ, Case C-370/12 *Pringle*, nyr, para. 175.

<sup>109</sup> ECJ, Opinion 1/92 *EWR II* [1992] ECR I-2821, para. 32.

<sup>110</sup> *Ibid.*, para. 33.

<sup>111</sup> Insofar, preference might be given to system where local remedies need to be exhausted, see *infra* III.1.

<sup>112</sup> In this vein see Montt (note 2) p. 371 et seq., with a comparative law approach, concluding: “...investment treaty jurisprudence is currently following and should follow this general structure. Restricting the scope of expropriations to claims involving total and substantial deprivations – global constitutional law – and assigning the FET clause to claims involving the periphery – global administrative law – serve as a proper and convenient interpretation of investment treaties”.

respect certain internationally agreed rules of behaviour, including the standards of corporate social responsibility (CSR).

### 2.3 Delaying or differentiating investor's access to ISDS

At first sight, it is difficult to find reasons for differentiating among investors with regard to access to ISDS. Such differentiation could easily be understood as discriminatory. There are cases, nevertheless, where a differentiation should be seriously considered. Among those instances, the "local remedies privilege" seems to be most attractive (*infra* 1.). Another approach of differentiation could be to distinguish *ratione materiae*, i.e. with a view to the diverse guarantees given in an IPA (*infra* 2.). A third differentiation could be considered with regard to the urgency of the matter (*infra* 3.).

#### 2.3.1 Local remedies privilege

While no investor may be admitted to pursue her issue at national court and an arbitral tribunal in parallel,<sup>113</sup> if an investor has exhausted local remedies in the host country it may be justified to facilitate its access to the ISDS both, regarding procedure and regarding fees.

The investor choosing first to pass through the proper channels of the national legal system in the host country, including, if applicable, reference to the ECJ under Article 267 TFEU, before availing herself with the rights under ISDS, could not be held as using an unfair privilege in comparison to the national competitors. Understanding the ISDS as a remedy of last resort would indicate that the investor has taken seriously the judicial system, the law and the regulatory autonomy of the host country. Prior involvement of the ECJ in the ISDS proceedings would not be needed. All questions on law and facts relevant in the case would be on the table and this would considerably facilitate the tasks of the arbitration tribunal. This would facilitate and probably also accelerate the arbitration, and so compensate to some extent, for some of the losses in time and fees suffered because of the use of local remedies.

If it is accepted that the effectiveness of ISDS would be in question if the exhaustion of local remedies was made a general condition for the access to ISDS – an assumption that might not be true in all cases and would be wrong if procedures were accelerated at the national level –, providing for a "local remedies privilege", therefore, could have considerable advantages. Furthermore, it would induce investors to accept the domestic judicial system as a first and hopefully effective remedy. The potential "control" by an arbitration tribunal under ISDS-clauses would encourage the national judges to carefully consider the case also with regard to the standards set by the IPA, and it would therefore probably reduce the number of claims in the ISDS and so save costs and time for the investors as well as for the contracting parties.

#### 2.3.2 Differentiation *ratione materiae*

It is appropriate to give investors privileged access to ISDS in cases of violation of the principle of fair and equitable treatment where access to justice in the host country is refused. There are good reasons to allow in such circumstances direct access to ISDS. The question is what provisions may be adopted to allow that the problem be rapidly remedied. The most appropriate seems to be that, after all efforts for amicable settlement have failed, the arbitration tribunal can order the re-examination of the matter by the domestic authorities or courts with penalties to be paid for any undue delay, if it does not directly award adequate compensation to the investor for the failure of the national authorities of the host state to ensure fair and equal treatment.

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<sup>113</sup> See also Hoffmeister and Alexandru (note 5), para. IV.2.



Similar preference could be considered for cases where the transfer of capital related to the investment is restricted. Such cases need rapid remedy, and there seems to be no major difficulty in assessing the legitimacy of a claim or of the measure put to scrutiny. Like in the case where access to justice is refused, there could be an accelerated procedure to come rapidly to a final decision.

Other cases such as compensation for direct or indirect expropriation or violations of the principles of national or most favoured nation treatment may be more difficult to judge, in particular where the regulatory autonomy of the host state is at stake. Such cases could, when all efforts for an amicable settlement have failed, be subject to a two step procedure under which a claim to the arbitration tribunal is admissible only after a "special committee" to be established by the contracting parties has found that the claim under the ISDS is not abusive. Delays caused by this method seem to be justified if the matter touches directly the democratically established policies of a contracting party and the opening of a procedure under ISDS would, therefore, create considerable political problems.

### 2.3.3 Differentiation *ratione tempore* – urgency and interim measures

Special attention should be paid to cases where a rapid decision by the arbitration tribunal or even interim measures can avoid greater damage. There should be an accelerated procedure upon request of the investor for such cases, if the "special committee" finds the request *prima facie* well grounded. However, the arbitration tribunal in charge may decide to deal with the case in normal proceeding if the reasons given for the accelerated procedure prove not to hold in substance.

## 3. INSTITUTIONAL AND PROCEDURAL ISSUES OF ISDS SYSTEMS

The primary purpose of ISDS mechanisms in investor protection agreements of the EU must be the preservation of the rule of law. It can be seen as a first step to take international law seriously. In spite of the contracting parties being states – or the EU – which accord procedural rights to individuals, the fact that private persons or companies can enforce guarantees contained in the IPA benefitting them against the host state, must be understood as a major achievement in international relations.

Against this backdrop several questions need to be addressed with regard to the concrete design of ISDS procedures to form an integral part of the EU legal order in the future. Should there be a permanent court (*infra* I.)? What should the conditions for access to the ISDS be and, in particular, should the exhaustion of local remedies be required (*infra* II.)? How can the autonomy and coherence of the Union's legal order be preserved (*infra* III.)?

Other questions regard the confidentiality of the procedures, the exclusion of the public and the composition of the tribunals. In response to the various criticisms against an ISDS to be established with the US as part of the TTIP the European Commission has made clear that it will ensure that the following principles determine the system:

"(3) Third, we will open up investment tribunals to scrutiny. Documents will be public. Hearings will be open and interested parties - including NGOs and civil society groups - will be able to make submissions. Transparency is the principle.

(4) Finally, we will eliminate any risk of conflict of interests. The arbitrators who decide on EU cases must be above suspicion. The defending party will have a right to veto two of the three arbitrators

appointed in any case. All of them will be required to sign up to a strict, enforceable, code of conduct. We will also push for the inclusion of appeal mechanisms in future agreements".<sup>114</sup>

These commitments cover important conditions under which ISDS can only be acceptable: Transparency and access to information (*infra* IV.), public participation in the proceedings (*infra* V.), careful selection of the arbitrators (*infra* VI.) and the introduction of an appeal mechanism (*infra* VII.).

### 3.1 Should there be an ad hoc tribunal or a standing court?

It has been said that only with a standing court the introduction of a preliminary question-procedure involving the ECJ could be considered.<sup>115</sup> Apart from this rather unrealistic option, the criterion for the choice of an *ad hoc* tribunal or a standing court should be the authority and legitimacy of this institution. Given the power of the ISDS tribunals to issue awards which may affect the regulatory autonomy of the contracting parties, legitimacy requirements are of utmost importance. It is the choice and the independence of the tribunal and of the arbitrators, it is the transparency of the proceedings, but it is also the visibility and stability of the institution to be held accountable for its case law what makes up legitimacy. If *ad hoc* tribunals with changing composition appear and disappear, if arbitrators are appointed *ad hoc*, after having worked as lawyers in other cases and before returning to other business when the case is decided, it will be more than difficult for the general public to hold them accountable, to assess the awards and to react to the performance of the system at large. With a permanent court, in contrast, some kind of jurisprudence will be developed within the framework of each agreement that the judges have to stand for and on which basis some legal certainty may emerge progressively.

While *ad hoc* arbitration tribunals seem better to correspond to a diplomatic approach of relations and negotiation among sovereign states, a standing court with carefully selected judges would be an important element in the emerging system of global governance committed to the rule of law. Though the authority and legitimacy will always have its source in the will of the contracting parties, the public will have an interest in its work and the discourse on it has a legitimizing effect, too. This discourse, and with it the accountability of the ISDS to the public is certainly facilitated with a standing court the judges of which are known as well as the case-law developed.

### 3.2 Access to ISDS, the local remedies rule and the role of a "special committee"

Among the Commission's principles for the ISDS reference is made to the amicable settlement, which shall be encouraged.<sup>116</sup> Indeed, the arbitration tribunal should be regarded as a solution of last resort only. As a consequence, access to ISDS should be subject to a compulsory attempt to reach settlement.

Whether or not the exhaustion of local remedies should be made a condition for the access to ISDS is questionable. On the one hand, local courts could rapidly remedy the problems, and they might be more familiar with the exact circumstances of the case and contribute to proper fact-finding. Compulsory exhaustion of local remedies would also, in the case of the EU, offer the opportunity for the ECJ to be

<sup>114</sup> Memorandum of 20 December 2013, *supra* note 87. More details about how these provisions look like can be found in the Draft CETA Agreement (note 11), Article x-33: Transparency of Proceedings.

<sup>115</sup> In this vein Nikolaos Lavranos, *Designing an International Investor-to-State Arbitration System after Opinion 1/09*, in: Marc Bungenberg & Christoph Herrmann (eds.), *European Yearbook of International Economic Law – Special Issue: Common Commercial Policy after Lisbon* (Springer 2013), p. 216, who proposes to assign a "special court in the Member [State] or within the ECJ that would act as an investor-to-state arbitration court."

<sup>116</sup> See the explanations given on ISDS in the consultation document, *supra*, note 49: „The EU will encourage the amicable settlement of disputes, through a required period for consultations, and the possibility of mediation“.

involved and to rule on any question of Union law.<sup>117</sup> On the other hand, they may be suspect of being biased, and the investors' protection could lose much of its effectiveness if the investors had to go through all instances of national courts before being admitted to ISDS. In any event, the local remedies rule could only be admitted as a compulsory condition if a time limit is included giving the investor a right to pass on to the ISDS if within the given time limit the national courts have not come to a satisfactory decision.<sup>118</sup>

The more appropriate solution seems to be, as explained above, to arrange for a "local remedies privilege" by which investors who have tried to pursue their case in the host state would benefit from some advantages regarding the ISDS.

As all ISDS procedures are time consuming and costly for both sides, there should be some filter for rejecting *a limine* claims that are abusive or evidently unfounded. The permanent court should be assisted for this purpose by a "special committee", as already mentioned, which may be composed of one representative of each of the contracting parties and the chair of the arbitration tribunal they may agree upon. This committee could also be in charge of admitting investors for the "accelerated procedure" when good reasons are given for the urgency of the matter.

### 3.3 Preserving the autonomy and coherence of the Union's legal order

In cases where local remedies have not been exhausted – and the ECJ has not been given an opportunity to rule on relevant questions of EU law – it would be of great help, as explained, to provide for a prior involvement of the ECJ as a part of the ISDS. Some discrimination and distortion of competition among investors which may affect the proper functioning of the EU legal system could so be avoided, even if the rulings of the ECJ would not have legally binding effect for the arbitration tribunals.

These tribunals, in turn, should be bound, in applying the provisions of the IPA, to abstain from giving their own interpretation to provisions of national or Union law but endeavour to follow authoritative guidance from the ECJ or hear the European Commission – to be invited as *amicus curiae* – for obtaining information on how relevant Union law should be understood. Provisions to this effect should be included in the agreement on ISDS.

### 3.4 Transparency and access to information

One of the fundamental requirements of legitimacy both for the negotiation process of IPA establishing ISDS and of the functioning of ISDS is transparency. "Information is the currency of democracy", these words, attributed to *Thomas Jefferson*, have got new emphasis in the past decades, namely with the internet. As early as in 1990 the European Union has introduced provisions on open access to information, unknown so far in most of the Member States with its Directive 90/313 on the freedom of access to information regarding the environment.<sup>119</sup> The United States follow this trend, as shown by the „Open-Government-Initiative“ promoted by President Obama striving for a change towards

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<sup>117</sup> See already supra B.III.1. The problem remains, that such preliminary rulings would not be binding upon the arbitration tribunal, see supra B.I.4.a.

<sup>118</sup> On this point see the discussion in the study of Steffen Hindelang, *Investor-State Dispute Settlement (ISDS) and Alternatives of Dispute Resolution in International Investment Law* (2014, part 2 of the present project for the EP), para. 4.3.2.2.2.3.2.2., suggesting also „an ‚elastic‘ local remedies rule“ as a pragmatic solution that takes account of the position of the contracting party in the Rule of Law Index (*ibid.*).

<sup>119</sup> Council Directive [90/313/EEC](#) of 7 June 1990 on the freedom of access to information on the environment. O.J. L 158, 23 June 1990, pp. 56–8.

transparency and public participation guided by the idea of „collaborative governance“.<sup>120</sup> This shows that transparency is a precondition and an essential element of democratic governance.<sup>121</sup>

The time of secret diplomacy in processes of international rule-making seems to be over. As the experience with the ACTA-agreement shows, people in Europe are reluctant to accept secretly negotiated provisions relevant to their daily lives. The drafts and documents related to the CETA, the TTIP and other agreements should, therefore, be made available to the public and open discussion. Accordingly, the proposals of the Commission to provide for public access to information and documents related to ISDS proceedings shall be welcomed. It allows scrutiny and criticism by all interested parties and, thus, contributes to the legitimacy of the tribunals, academic analysis and, finally also to legal certainty for investors and states. In this vein, all arbitral proceedings under ISDS to which a Member State is party must be open to the public and its decisions be published.<sup>122</sup> It is only under the conditions of transparency that parliamentary control can take place effectively. The launch of a public consultation on the EU's investment chapter within the negotiations of the TTIP early 2014 by Commissioner De Gucht was a first important step.<sup>123</sup>

### 3.5 Public participation in the proceedings

The same is true for allowing public participation in the proceedings, namely that, for instance, NGOs and civil society at large have an opportunity to submit their views. The more the discourse is open to the public, the less suspicion will remain regarding the integrity of the process. Organising ISDS as an open and participatory instrument for finding an appropriate balance between sovereign democratic decisions of the host country and the protection of legitimate business interests of the investor would be a great step towards a new culture of openness in global governance.

### 3.6 Choice and deontology of the arbitrators

Arbitrators in ISDS are exercising an enormous power, their choice and deontology must therefore be beyond any doubt. The current practice is opaque and all initiatives for introducing a transparent and rule-based system for the selection of arbitrators and for establishing a code of conduct for their activities must be welcomed. These rules could follow the system for selection of judges for supreme or international courts, if there is a standing court as suggested above; but even if a system of ad-hoc tribunals is envisaged, the list of persons available for participating in an arbitration tribunal should be established in a transparent and rule-based procedure excluding any conflict of interest and doubts about the integrity of the arbitrators.

### 3.7 Appeal mechanism

With a view to give the public interest of the contracting parties a decisive role and to allow some control over the outcome of ISDS in a given case, it seems to be appropriate to provide for an appeal mechanism

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<sup>120</sup> White House: „Transparency and Open Government“, available at: <http://www.whitehouse.gov/open/about>. Critical regarding the practical implementation and acceptance: G. Wewer, Eine Blaupause für Deutschland? Barack Obama und die kollaborative Verwaltung, in: dms 2013, pp. 182 et seq.

<sup>121</sup> For more details see Ingolf Pernice, „Verfassungs- und europarechtliche Aspekte der Transparenz staatlichen Handelns“, in: Alexander Dix et al. (Hrsg.) *Informationsfreiheit und Informationsrecht. Jahrbuch 2013* (Lexikon 2014), pp. 17-34.

<sup>122</sup> For this transparency see also Hoffmeister and Alexandru (note 5), para. IV.3. From a German constitutional law perspective arriving at the same conclusion Johanna Wolff, „Nicht-öffentliche Schiedsverfahren mit Beteiligung der öffentlichen Hand am Maßstab des Verfassungsrechts“, *Neue Zeitschrift für Verwaltungsrecht* 2012, pp. 205-209.

<sup>123</sup> See for this Hoffmeister and Alexandru (note 5), para. V. with reference to European Commission, Press Release of 21 January 2014, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1015>.

allowing a final review by the contracting parties of the awards given by the arbitration tribunal. There is no reason, though, to duplicate the arbitration-model. The review should rather be a matter for a joint committee composed by representatives of both contracting parties. Appeals should be open to be launched both, by the investor or by the respondent. Only if the joint committee comes to an agreement upon the incorrectness of the award, the award may be nullified and sent back to the arbitration tribunal with instruction about the agreed interpretation of the rules in question or, if there is no room for further consideration, be amended so as to comply with the authoritative interpretation given to the IPA by the contracting parties.

Clearly, the appeal procedure should be open and transparent like the proceedings of the ISDS.

#### **4. CONCLUSIONS**

International investment protection agreements are a challenge with regard to European Union law for several reasons. As an important instrument for securing some legal certainty and protection for European investors worldwide, their application among countries that have developed sophisticated systems of judicial remedies and protection of fundamental rights on the basis of the rule of law would, to some extent, imply that these countries do not seriously believe in their own achievements of civilisation. These symptoms of crisis should, first, give rise to revisiting internally, for each party, their internal legal system with a view to ensure effective legal protection without discrimination for all investors: foreign investors, but to ensure equal treatment also for local, national and European investors. The existing problems could, second and in addition, be taken as an incentive for developing, at the international – if not global – level safeguards that provide for investors (and why not for private individuals in general) an effective judicial remedy “of last resort” in case the agreed standards of protection of fundamental rights in general, including protection against direct or indirect expropriation, unfair and inequitable treatment etc. are violated.

A double strategy, thus, is needed that would not only be more consistent with the common values affirmed by the EU-Treaty, in particular as guiding its external action (Articles 2, 3 (5) and 21 (1) TEU) as well as many international instruments, and generally improve the investment climate worldwide, but also contribute to avoiding certain tensions that may only in part be remedied by a specific configuration of international investment agreements including ISDS systems to be concluded by the European Union.

With this perspective, the findings of the present study can be understood also as presenting elements for a strategy of progressively establishing a framework of mutual trust and legal certainty for global trade and investment based upon the rule of law, due process and the respect of fundamental rights common to democratic societies.

1. Given the differences in development of the legal systems worldwide, some differentiation regarding IPAs seems to be unavoidable: ISDS have a special history, special reasons and special purposes: What may be successful for asymmetric relationships in terms of development and good governance may not be the best solution for contracting parties with similarly effective systems for the effective protection of national and foreign investors.
2. IPAs concluded by the EU with third countries would be applicable with no regard to the division of powers and responsibilities within the EU. Due to their general terms and absent any express exceptions, such as envisaged for the audio-visual industry, they apply to any sector of activities within the Member States. The rules on primacy and direct effect of EU law would be applicable within the Member States, including to national constitutional law. Their rules in substance as well as regarding the interpretation, thus, need to be carefully framed.

3. Particular attention should be given to issues like the “regulatory chill” challenging the autonomy of the democratic legislator, and the “super-protection” privilege of foreign investors using the “fast track” for defending their interests at arbitration tribunals instead of national courts where their local competitors have to appeal to. Also tensions with the EU state aid system and – at least indirect – threats to the autonomy of the EU legal order demand differentiated solutions.
4. A more sophisticated, integration-oriented “European model”-solution with common legislative and judicial institutions might be the better way to address questions of discrimination and direct or indirect expropriation, or to ensure fair and equitable treatment within the framework of transatlantic free trade arrangements and agreements with states having similar values and standards. As the European experience shows, real free trade presupposes more than mutual recognition of technical, health, environmental, consumer protection etc. norms and standards, but requires norm-setting mechanisms; and some provision for dispute settlement is needed not only for investments but also more generally with regard to the effective functioning of a free trade area.
5. With the perspective of stretching such an arrangement to other countries that may not yet be considered ready to join such a system, or if it proves to be too audacious to pursue this path, a new generation of IPA’s with ISDS, to be negotiated and concluded in an open and transparent manner should be envisaged. Specific features of such agreements, deemed to ensure to the highest possible degree conformity with the EU law, namely preserving the autonomy with the EU legal order, might be:
  - a. an express provision for the direct effect of the guarantees laid down in the IPA before the courts of each contracting party
  - b. a local remedies privilege encouraging the request, where appropriate, of preliminary rulings of the ECJ giving guidance to the arbitration tribunal, if needed, on the interpretation of EU law
  - c. a prior involvement-clause for the ECJ to be given the right to take a decision where questions of (validity of) EU law are at stake in so far, as no other authoritative interpretation is available.
6. IPAs including ISDS-clauses should provide for the establishment of a standing court responsible for all settlements under each particular IPA, with permanent judges chosen by the contracting parties under rule-based, democratic and transparent procedures, and subject to a strict ethical code of conduct. This court – or if an ad hoc tribunal is established – this tribunal shall
  - a. provide for public access to the documents submitted in each case
  - b. accept submissions of third parties and NGO’s
  - c. hear the case in a public hearing
  - d. develop its case-law on a comparative law basis with a view to ensuring legal certainty
  - e. provide for an appeal mechanism giving the contracting parties the opportunity to scrutinise an award and, if necessary, nullify it or give an authentic interpretation to the relevant terms of the IPA.
7. A joint institution should be established, composed of representatives of the contracting parties as well as of the president of the arbitration tribunal, to act as a “special committee” with all necessary powers to

- a. serve as a mediator making every possible effort to find an amicable settlement of the disputes
  - b. assess whether or not a claim to the tribunal is abusive for it constitutes a threat to the national legislative autonomy
  - c. allow for an accelerated procedure where interim measures seem to be necessary for avoiding irreparable damage
  - d. give authoritative guidance upon the interpretation of relevant provisions of the IPA and suggest general solutions for harmonised approaches in all policy areas relevant for the full implementation of the IPA.
8. The principle of transparency should also apply to the negotiation of IPAs by the EU institutions. The opportunity should be taken for developing and negotiating a new model of cooperation between the EU and third countries regarding international investment protection in an open and public process as a first step towards conditions that Article 21 (2) (h) TEU calls "good global governance".

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