

# Essentials of a Modern Investment Protection Regime – Objectives and Recommendations for Action

Organised by the Free University Berlin and the Association  
of German Chambers of Commerce and Industry (DIHK e.V.)



#### **Editors of the Harnack-Haus Reflections**

Prof. Dr. Steffen Hindelang, LL.M.  
Freie Universität Berlin  
Fachbereich Rechtswissenschaft  
Boltzmannstraße 3  
14195 Berlin  
mail@steffenhindelang.de

Prof. Dr. Stephan Wernicke  
Deutscher Industrie- und Handelskammertag (DIHK e.V.)  
Bereichsleiter Recht  
Breite Straße 29  
10178 Berlin  
wernicke.stephan@dihk.de

The statements in this document do not necessarily correspond with the personal positions of the editors, nor shall they be attributed to the institutions they represent in any way.

Editorial deadline 26. August 2015. This publication is also available in the German language.

Recommended form of citation

Hindelang/Wernicke (Eds.), Essentials of Modern Investment Protection - Harnack-Haus Reflections, 2015, available at <http://tinyurl.com/qylvb78>, p.

## Preface

The debate concerning reform of international investment protection law has expanded beyond the technical level and into general political discourse. Now, more than ever, it is important to identify specific legal problems and to offer solutions. This is the aim of this paper.

On April 17, 2015, in Berlin's Harnack-Haus, and upon invitation of the Association of German Chambers of Commerce and Industry (DIHK) e.V. and the Department of Law at Free University Berlin, 19 scholars and practitioners discussed various aspects and alternatives of international investment protection reform, as well as the opportunities, risks and challenges for the German economic, science and legal community and location. With input from participants, several working groups expanded on a thesis paper by the colloquium hosts to create concrete proposals for investment protection law reform. One of the points given special consideration was the current question of reasonable access to investment protection by small and medium-sized enterprises (SMEs).

You are holding the results of the "Harnack-Haus Reflections" in your hands. They reflect ideas, experiences, discussions and compromises among the members of the group. This paper represents a summary of views and broad lines of consensus achieved by the participants. The statements, therefore, do not necessarily express the position of each individual contributor or even the positions of the institutions to which they belong. Rather, the proposals shall provide a solid basis for the process of forming an opinion – as it will be the case within DIHK. Concerning certain highly controversial aspects the diverging views are made explicit.

We are grateful to the participants for their willingness to participate in this project, for the intensive discussions in the plenary and further discussions in the working groups, in particular: Dr. Matthias Bauer, European Centre for International Political Economy (ECIPE), Dr. Markus Burgstaller, Hogan Lovells, Dr. Christian Groß, DIHK, Jan von Herff, BASF, Dr. Roland Kläger,

Haver & Mailänder Rechtsanwälte, Prof. Dr. Karsten Nowrot, University Hamburg, Prof. Dr. Dr. h.c. Ingolf Pernice, Humboldt University Berlin, and Prof. Dr. Tobias Stoll, Georg-August-University Göttingen. Among others, Thomas Klippstein, Federal Ministry of Justice and Consumer Protection, and Dr. Christoph Rodenhäuser, Federal Ministry for Economic Affairs and Energy, were present as observers. We would also like to thank Patricia Sarah Stöbener de Mora, LL.M. (KCL), DIHK, for the academic preparation and, notably, the development of specific proposals and their corresponding explanations. Dr. Bettina Wurster, DIHK, also made helpful comments. Thanks is also due to Sonja Hilgert, Daniel-Thabani Ncube and Carl-Philipp Sassenrath (all of the FU Berlin) for the conscientious recording of discussions during the workshop, as well their, and Maria Mikoleit's, organisational support. The translation of the paper into English was diligently undertaken by Daniel Ncube. The layout was designed by Friedemann Encke and Andrea Rosenkranz. We thank you for your effort.

The editors expect that the proposed provisions (which were edited on the basis of the CETA text) and recommendations may contribute to the reform of international investment protection law and strengthen Germany as an attractive venue for international investment arbitration. They offer suggestions not only for the current discussions concerning TTIP and CETA, but also for the numerous existing agreements and those to be negotiated in the near future and currently under debate throughout the world.

Berlin, 26 August 2015

Steffen Hindelang  
Stephan Wernicke



# Content

- A. Summary in Theses..... 1
- B. Text suggestions and Recommendations for Action ..... 3
  - I. Substantive Investment Law: Balancing the Right to Regulate and a High Level of Protection .....3
    - 1. "Right to Regulate" ..... 3
    - 2. "Fair and Equitable Treatment" ..... 4
    - 3. Expropriation and Indirect Expropriation..... 6
    - 4. Interpretative Notes..... 9
  - II. Procedural Law, in Particular the Relationship of Domestic Courts to ISDS, Appeal Tribunal..... 10
    - 1. Relationship of Domestic Courts to Investor-to-State Dispute Settlement..... 10
      - a) Incentive to Make Use of a Functioning Domestic Legal System..... 10
      - b) Greater Consideration of Domestic Court Rulings by Arbitral Tribunals..... 13
    - 2. Selection of Arbitrators, Independence, Neutrality..... 14
    - 3. Appeal Tribunal..... 17
    - 4. Class Actions..... 20
    - 5. Admissibility Requirements and Admissibility Review..... 21
  - III. Access to Legal Protection for Small and Medium-Sized Enterprises..... 23



## A. Summary in Theses\*

1. Investment Protection Agreements, including investor-to-state dispute settlement (ISDS) are a pillar of German foreign trade policy and pursue important goals and interests. These include in particular

- robust protection of German foreign investments, granted to small and large companies alike,
- strengthening of equal opportunities in competition in the respective market and thus the willingness to invest abroad,
- creating an incentive for good law-making and the maintenance or, alternatively, the development of a functioning legal system in the contracting parties as well as the emergence of uniform international legal standards that bring public and private interests in a reasonable balance,
- active promotion of German and European investments domestically and abroad; to this end also other market mechanisms and State investment guarantees should be used.

2. International investment law must preserve State regulatory sovereignty and bring public and private interests in an appropriate balance. This applies especially to the elaboration of the right to fair and equitable treatment. In this context, the protection of legitimate expectations is to be incorporated as a case group in a non-exhaustive catalogue of potential violations; the principle of proportionality should be the means to create a reasonable balance of interests both regarding the right to fair and equitable treatment and in matters concerning expropriation.

3. There is a need for public international law to protect investments, buttressed by European Union law. International law protection standards and their application and regard by national law are important. They contribute to the realization of fundamental principles such as the rule of law and, hence, are also of significance for small and medium-sized enterprises (SMEs) in their international activities. The substantive provisions alone do not suffice, however; their procedural enforcement must also be guaranteed.

4. If domestic judicial systems are functioning and effective, this must be duly considered in the context of investor-to-state dispute settlement. This can be done in different ways: one option is to make the (at least partial) referral to domestic remedies a precondition for access to ISDS; the conditions should be defined as clearly as possible. An alternative option would be to consider in the course of the assessment of the merits of the case whether the investor has taken sufficient recourse to national law remedies. This could be possible, for example, under aspects of contributory negligence or within in the overall calculation of damages.

5. The continued existence of international investment protection depends on the promotion, development and positive perception of the rule of law of this field. This includes, in particular, independence, impartiality and transparency concerning the selection of arbitrators, the dispute settlement process itself, and the publication of the award. This ensures that public and academic discussion and monitoring may be further developed.

6. The selection of arbitrators, especially the presiding arbitrator, must be made more transparent and open. Initially, in order to strengthen transparency, changes to the provisions governing the composition of a tribunal are necessary. The neutrality and professional qualifications of each arbitrator should be the decisive selection criteria. This applies *mutatis mutandis* for the appointment of judges to a possible permanent international investment court. Rosters, i.e. closed lists of arbitrators can be counterproductive. A complete ban of the possibility to work as an arbitrator and counsel would lead to a considerable reduction of potential arbitral candidates, thus endangering the system as a whole. Rather, the number of qualified, active arbitrators (or judges) must be increased significantly in order to prevent the system from being shaped by few. Furthermore, a stronger role of European arbitration institutions on a global scale is desirable.

---

\* Statements in this summary as well as the document in its entirety do not necessarily reflect the position of each individual participant. In no way do the views in this paper reflect the views of the institutions represented by each participant, nor shall they be attributed to those institutions in any way.

7. To increase the acceptance of investor-to-state tribunals and to avoid conflicting assessments between national and international law, tribunals should take into consideration the decisions of the national courts of the contracting parties to the investment protection agreement.

8. A permanent appeal tribunal for a particular agreement would give investors and host states the possibility to correct legally erroneous arbitral awards if necessary. This appeal tribunal could also lead to a uniform interpretation of a specific agreement and thus enhance the legal certainty and predictability of arbitral awards. The presence of qualified judges or arbitrators from the legal traditions of each contracting party would ensure that legal principles, customs, and the parties' sensitivities are sufficiently considered. Furthermore, narrowly construed provisions regarding the conditions of admissibility of an appeal and the deadlines, could help to avoid a prolongation of proceedings; the deadlines adopted by the WTO Dispute Settlement Body may be an example. Such review must be limited to points of law. The admission of the legal remedy by the appeal tribunal should be made a prerequisite. Preexisting monitoring mechanisms must – as far as this is legally possible – be replaced by the appeals tribunal in order to avoid parallel mechanisms.

9. It is not always practical or politically feasible to establish such a permanent appeal tribunal simultaneously with an agreement entering into force. However, ad hoc bodies could assume the task of an appeal tribunal for a transitional period. Due to their lean structures, these ad hoc appeal tribunals could be established directly within an agreement.

10. The parties may also open a permanent appeal tribunal to proceedings based on third-country agreements and hence achieve a gradual "plurilateralisation", unifying substantive law standards. Such an appeal tribunal could be transferred to a permanent international investment court in the mid- to long-term.

11. Class actions should be rejected in investment law. There is no need for instruments of collective redress; rather, these entail a high risk of abuse. To avoid the further strengthening of a "litigation industry" in this field, collective action must, therefore, be expressly excluded.

12. It is important to have an efficient set of rules governing admission of a claim to investment arbitration that is aiming at the rejection of abusive or obviously unfounded claims in an early stage of proceedings. This procedure should be as straightforward, quick and inexpensive as possible, not entail considerable procedural effort and be based on clear criteria.

13. Small and medium-sized enterprises (SMEs) face special challenges in investment disputes with their host states. Often, they lack access to political and administrative channels of communication in their host or home states, by which possible conflicts can be resolved at an early stage. Additionally, SMEs are regularly overwhelmed by the effort and the average cost of an investment arbitration, even if there are opportunities of third-party arbitration financing. The SME-related regulations in the CETA text do not tackle this problem sufficiently. Improvements in this regard require more decisive action on the part of states, both on the agreements level as well as within their own jurisdictions. In investment protection agreements, a special SME schedule of fees for counsel and arbitrators, possibly linked to a strict time regime for arbitration proceedings, could be a reasonable solution to this problem. At the national and European levels, programs for SMEs may be launched that eliminate, or at least reduce, the financial and organisational hurdles of access to investor-to-state arbitration on the basis of an investment protection agreement. To this end, national investment guarantees might be associated with legal expenses insurance. Furthermore, Member States and/or the EU could grant SMEs help similar to the concept of legal aid – so-called "technical assistance" – in the arbitration proceedings. The corresponding application process and allocation should be detached from discretionary policy considerations to the greatest possible extent.



## B. Text suggestions and Recommendations for Action

### I. Substantive Investment Law: Balancing the "Right to Regulate" and a High Level of Protection

#### 1. "Right to Regulate"

##### 1. PREAMBLE<sup>1</sup>

The parties resolve to

[...]

**REAFFIRMING** their commitment to promote sustainable development and the development of international trade and investment in such a way as to contribute to sustainable development in its economic, social and environmental dimensions;

**DETERMINED** to implement this Agreement in a manner consistent with the enhancement of the levels of labour and environmental protection and the enforcement of their labour and environmental laws and policies, building on their international commitments on labour and environment matters;

[...]

**RECOGNIZING** that the provisions of this Agreement preserve the right to regulate within their territories and resolving to preserve their flexibility to achieve legitimate policy objectives, such as public health, safety, environment, consumer protection, ~~public morals~~ and the promotion and protection of cultural diversity;

[...]

#### Commentary

In the past, investment protection agreements have provided investors affected by cases of wrongful discrimination, expropriation, and violations of the rule of law with the necessary remedies. However, abusive claims have contributed to the concern that public interests might not be sufficiently taken into account in arbitration proceedings. Each reformed investment protection agreement or chapter must therefore ensure the preservation of a sufficient degree of regulatory autonomy or of the "right to regulate", as it has been labeled lately, of the contracting parties and allow for balancing private and public interests. The "right to regulate" may not be undermined by investment protection provisions; conversely, a minimum standard of rights must be guaranteed through investment protection. Creating a balance between public interests, such as environmental and consumer protection on the one hand, and the protection of property on the other is central to the legitimacy of investment protection agreements and the preservation of room for political activity to the benefit of the community.

An international law "safeguard" of the "right to regulate" has so far not been deemed necessary, because it is considered inherent in state sovereignty. The explicit mention of national regulatory sovereignty and concrete common interest objectives in the preamble and text of an agreement could ensure that these elements are sufficiently appreciated by arbitral tribunals. This applies, for example, to consumer protection, that is not expressly mentioned in either the preamble or the investment protection chapter of the CETA text. For clarification, this was included in the text suggested here.

---

<sup>1</sup> The text suggestions are based on the consolidated version of the draft Chapter X, Comprehensive Economic Trade and Investment Agreement between Canada and the European Union, 26.9.2014. Available at [http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152806.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf); last access on 26.8.2015.

The concept of "public morals", which is included in the CETA preamble, however, is problematic because it is very broad and could be used by States as a gateway for measures of all kinds (e.g. for discriminatory measures due to sexual orientation). Although the term can still be found in EU treaties today, it no longer seems contemporary.

Furthermore, the catalogue of public interests contained in the preamble should not be exhaustive; it must be kept open for further policy objectives which are possibly not evident at present. Moreover, the right to regulate must not lead to breaking legitimate expectations on part of investors (more on the "Fair and Equitable Treatment", Art. X.9).

## 2. "Fair and Equitable Treatment"

### Article X.9: Treatment of Investors and of Covered Investments

- [1.] Each Party shall accord in its territory to covered investments of the other Party and to investors with respect to their covered investments fair and equitable treatment and full protection and security in accordance with paragraphs 2 to 6.
- [2.] A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 where a measure or series of measures constitutes:
  - [(a)] Denial of justice in criminal, civil or administrative proceedings;
  - [(b)] ~~Fundamental~~A breach of due process, including a ~~fundamental~~ breach of transparency, in judicial and administrative proceedings;

[(c)] ~~Manifest arbitrariness;~~

## Commentary

"Fair and equitable treatment" (FET) is essentially an expression of the rule of law as a general principle of law and, as such, does not constitute a curtailment of the "right to regulate". However: a clarification of the – in arbitral practice – largely indefinite prohibition of unfair and unequitable treatment is important to ensure legal certainty and predictability of arbitral awards and thus prevent the abuse of that provision. The protection of legitimate expectations of investors is, in this context, a difficult concept to grasp. Frustrated earnings expectations of investors cannot be financed by the public.

Nevertheless, protection of legitimate expectations is a fundamental principle of the rule of law and must, therefore, not be completely excluded from a modern FET provision. If a government makes a written commitment, both said and subsequent governments are bound thereto according to the principle of the protection of legitimate

- [[d]] ~~Targeted~~–Discrimination on ~~manifestly~~ wrongful grounds, such as gender, race or religious belief;
  - [[e]] Abusive treatment of investors, such as coercion, duress and harassment;
  - [[f]] A substantive frustration of a legitimate expectation based on an express and specific representation towards the investor, made in writing by the competent authority, with the aim to encourage an investment and concerning a significant aspect of the covered investment, and upon which a prudent investor could reasonably rely and upon which the investor acted by making or maintaining the covered investment or part of it;<sup>2</sup>
  - [[g]] An unfair treatment of similar intensity and relevance as the measures cited above; or
  - [[h]] A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph [4] of this Article.
- [3.] In assessing a breach of the obligation of fair and equitable treatment and full protection and security, a tribunal shall take into account whether the measure is appropriate for attaining the legitimate policy objectives pursued by that measure and whether the measure goes beyond what is necessary to achieve those objectives. Each Party enjoys a margin of appreciation in determining the legitimacy of a measure's objective, the appropriateness and the necessity of a measure to achieve this objective.<sup>3</sup>

expectations. Likewise, the legislator must take into account that legal practitioners rely on the relative stability of a once created provision subject to a serious change in circumstances.

A list of case types should not, in contrast to the CETA draft, be exhaustive, as a catalogue does not necessarily contain all cases in which unfair treatment can occur. Otherwise, it could possibly exclude relevant cases, thereby lowering the level of investment protection in general. Rather, it is preferable to extend the protection to cases that exhibit similar degree of gravity as those mentioned in the text. The principle of proportionality would minimise the risk of awards negating or massively curtailing the right to regulate. Furthermore, there is a possibility to control abuse of interpretive powers during the enforcement procedure via the exemptions of *ordre public* and public morals. Additionally, an appeal tribunal would develop moderating forces.

Above all, FET requires balancing the conflicting interests of States and investors. The principle of proportionality has proven itself in European, and in many other, legal traditions as a means to resolve similar conflicts, especially in connection with the interpretation of general clauses. It is a useful tool to structure and improve the quality of the often varying and opaque balancing processes seen to date in arbitral awards. States should be granted a margin of appreciation when defining legitimate aims and the necessity of measures. As part of the proportionality test, the existence of appropriate transitional arrangements in the course of regulatory changes could be considered.

---

<sup>2</sup> Paragraph [2 lit. f)] replaces para. 4 of the CETA text. The inclusion and the specific wording of the clause were discussed controversially. In the end, a majority decided in favor of the clause, including the narrow prerequisites, in particular for the purposes of legal certainty. Should there be ambiguity concerning a government assurance, the investor can and must obtain clarification (comparable to a due diligence). For some participants, however, the clause did not go far enough; the provision was considered too tight and some conditions, such as a written assurance by the competent authority, was said to give States too great opportunities to "extricate" themselves from assurances. The existence of State assurances of the kind envisioned was also considered very rare. Furthermore, the concept of a "competent authority" could appear troublesome if multiple public authorities were involved in the approval of an investment.

<sup>3</sup> The formulation of an open list as part of the Fair and Equitable Treatment clause was discussed controversially. Ultimately, the majority was in favor of such an open list. However, participants critically noted that, given such a list, the discretion of the arbitral tribunals would not be sufficiently limited and that an exhaustive list would better serve the aim of a more uniform jurisprudence.

[4.] The Parties shall regularly, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment. The Committee on Services and Investment may develop recommendations in this regard and submit them to the Trade Committee for decision.

~~[4.] When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated. [...]~~

### 3. Expropriation and Indirect Expropriation

#### Article X.11: Expropriation

1. Neither Party may nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation"), except:

- (a) for a public purpose;
- (b) under due process of law;
- (c) in a non-discriminatory manner; and
- (d) against payment of prompt, adequate and effective compensation.

For greater certainty, this paragraph shall be interpreted in accordance with Annex X.11 on the clarification of expropriation.

2. Such compensation shall amount to the fair market value of the investment at the time immediately before the expropriation or the impending expropriation became known, whichever is earlier. Valuation criteria shall include going concern value, asset value including the declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

#### Commentary

A clarification of the concept of indirect expropriation shall give the arbitral tribunals clearer guidance in order to create more legal certainty and also to protect the right to regulate. The proposed definition associated with the rule of interpretation incorporated in the annex could be useful in assessing the alleged expropriation. However, this catalogue of criteria should not be considered exhaustive.

A new development contained in the CETA draft is a restriction by which a non-discriminatory state regulation, that aims to protect legitimate public interest objectives such as health, safety and the environment, can constitute an expropriation only in exceptional cases if it appears manifestly excessive. Consequently, the proportionality test is, by virtue of the limit to a ban of obviously disproportionate measures, generally reduced to a test of arbitrariness. This cuts back the concept of indirect expropriation too strongly. Rather, there should be a normal proportionality test with a wide margin of appreciation. Limiting the principle of proportionality to a determination of arbitrariness is acceptable for legislative measures, on condition that they are truly general and do not in fact target specific situations and/or companies.

3. The compensation shall also include interest at a normal commercial rate from the date of expropriation until the date of payment and shall, in order to be effective for the investor, be paid and made transferable, without delay, to the country designated by the investor and in the currency of the country of which the investor is a national or in any freely convertible currency accepted by the investor.
4. The investor affected shall have a right, under the law of the expropriating Party, to prompt review of its claim and of the valuation of its investment, by a judicial or other independent authority of that Party, in accordance with the principles set out in this Article.
5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, to the extent that such issuance is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights in Annex 1C to the WTO Agreements ('TRIPS Agreement').
6. For greater certainty, the revocation, limitation or creation of intellectual property rights to the extent that these measures are consistent with TRIPS and Chapter X (Intellectual Property) of this Agreement, do not constitute expropriation. Moreover, a determination that these actions are inconsistent with the TRIPS Agreement or Chapter X (Intellectual Property) of this Agreement does not establish that there has been an expropriation.

The Annex to X.11 should, due to the importance of the provisions therein, be integrated into the main text of X.11.

#### **Annex X.11: Expropriation**

The Parties confirm their shared understanding that:

1. Expropriation may be either direct or indirect:
  - [(a)] direct expropriation occurs when an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and
  - [(b)] indirect expropriation occurs where a measure or series of measures of 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 of title or outright seizure.

2. The determination of whether a measure or series of measures of a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:

[(a)] the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;

[(b)] the duration of the measure or series of measures by a Party;

[(c)] the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and

[(d)] the character of the measure or series of measures, notably their object, context and intent.

3. A non-discriminatory measure of a Party does not constitute indirect expropriation if it is appropriate for attaining legitimate policy objectives, such as health, safety and the environment, and if it does not go beyond what is necessary to achieve them. Each Party enjoys a wide margin of appreciation in determining the legitimacy of a measure's objective, the appropriateness and the necessity of a measure to achieve this objective.<sup>4</sup>
4. If the measure of a Party controlling the use of property is of a general legislative nature it does not constitute indirect expropriation if it is non-discriminatory and designed to protect legitimate public welfare objectives, such as health, safety and the environment, except in the rare circumstance where the impact of the legislative measure or series of measures is so severe that it appears manifestly excessive.

---

<sup>4</sup> The introduction of a proportionality check was discussed. Some participants felt that this would not grant sufficient protection in this context. In general, the majority voted in favor of the proportionality check so as to improve the protection of investors beyond the reduction to "manifest arbitrariness" as provided in CETA.

## 4. Interpretative Notes

### Article X.27: Applicable Law and Interpretation

[...]

- [2.] Where serious concerns arise as regards matters of interpretation that may affect investment, the Committee on Services and Investment may, pursuant to Article X.42(3)(a), recommend to the Trade Committee the adoption of interpretations of the Agreement. An interpretation adopted by the Trade Committee shall be binding on a Tribunal established under this Chapter. **It shall be binding from the date of approval but shall not have effect to the detriment of the investor if a provision created a legitimate expectation of protection upon which the investor relied in deciding to make or maintain the covered investment.**

## Commentary

Interpretative notes and the possibility of participation in ongoing arbitrations guarantee the contracting parties the possibility of clarifying ambiguities in the treaty text that arise later and, more particularly, during a specific ISDS proceeding. Uncertainties in the interpretation of the agreement can hence be eliminated and details readjusted, particularly if the decisions of arbitral tribunals should turn out to be inconsistent. This joint interpretation and development of the law can contribute to the legal clarity, legal certainty and uniform application of the agreement. Awards are thus more predictable. Moreover, in this manner the states involved retain control of the agreement. The threats to the interests of investors appear manageable in this context if the contracting parties apply the usual methods of interpretation and respect protection of legitimate expectations and the principle of "non-retroactivity". The interpretative notes must therefore in principle be limited to future investments.

## II. Procedural Law, in particular the Relationship of Domestic Courts to ISDS, Appeal Tribunal

### 1. Relationship of Domestic Courts to Investor-to-State Dispute Settlement

#### a) Incentive to Make Use of a Functioning Domestic Legal System

##### Preamble

[...]

RECOGNIZING the fundamental role which domestic authorities must play in guaranteeing and protecting rights accruing to an investor, irrespective of whether domestic or foreign, at the domestic level. In this respect, the Parties undertake to provide effective legal remedies in their domestic legal systems.

##### Article X.21 Procedural and Other Requirements for the Submission of a Claim to Arbitration

[1.] An investor may submit a claim to arbitration under Article X.22 (Submission of a Claim to Arbitration) only if the investor:

[...]

[(f)] where it has initiated a claim or proceeding seeking compensation or damages before a tribunal or court under domestic or international law with respect to any measure alleged to constitute a breach referred to in its claim to arbitration, provides a declaration that:

[(i)] a final award, judgment or decision has been made; or

[(ii)] it has withdrawn any such claim or proceeding;

The declaration shall contain, as applicable, proof that a final award, judgment or decision has been made or proof of the withdrawal of any such claim or proceeding; and

##### Commentary

International law protection standards enforced by investor-to-state arbitration are widely regarded as one of the most effective ways to control the political risks associated with foreign investment. They are intended to protect foreign investors in the host state against discrimination on grounds of origin or of abusive exercise of state power. Functionally comparable to national administrative and constitutional jurisdictions, the legal protection of investment offered by international law serves to control state power.

Opening access to Investor-to-State Dispute Settlement ("ISDS") as neutral international forum allows the investor to gain independence from State redress mechanisms if these cannot guarantee a procedure governed by the rule of law. ISDS lends credibility to the substantive protection standards in an agreement and demonstrates a certain minimum level of legal certainty in the host State. In addition, ISDS renders the investors independent of their home countries, as they are not compelled to rely on diplomatic protection. ISDS thus also minimises politicisation of investment disputes, as the investor's home state must not grant diplomatic protection, thereby adopting the investor's cause, and thus possibly straining intergovernmental relations.

Finally, investment protection provisions and their dispute settlement mechanisms contribute to a strengthening of an international rule of law. Investment protection chapters with an investor-to-state dispute settlement mechanism are important instruments for ensuring fundamental rights positions abroad. Bilateral and regional investment protection agreements can thus be understood as the extension of a centuries-old idea in international law: namely that everyone should, at any time, be treated in accordance with a general minimum standard abroad.



[(g)] waives its right to initiate any claim or proceeding seeking compensation or damages before a tribunal or court under domestic or international law with respect to any measure alleged to constitute a breach referred to in its claim to arbitration.

#### Art. X.[Neu] Encouraging the use of effective domestic remedies

1. With a view to encouraging the use of effective domestic remedies, if the claimant omitted to seize domestic courts of the respondent or to take other domestic legal remedies readily available in the jurisdiction of the respondent prior to submitting a claim to arbitration and the respondent can establish that in all probability the measure would have been annulled or in any other way be rectified in reasonable time if domestic remedies had been sought, the tribunal shall take this into account, particularly when calculating damages and by allocating costs of the proceedings.
2. The tribunal shall, when establishing in a summary review whether the measure would have been annulled or in any other way been rectified in the domestic jurisdiction of the respondent, take into account:
  - (a) the overall degree of development of the domestic legal system;
  - (b) the availability of a domestic remedy in the individual case; availability means that a domestic remedy must exist within the domestic legal system and can be pursued by the investor without difficulties or impediments;
  - (c) the effectiveness of a domestic remedy in the individual case, effectiveness means that a domestic remedy must offer a reasonable prospect of success.<sup>5</sup>

Investment protection agreements and ISDS in particular have proven themselves for German investors in countries with less developed legal systems. The international law dispute settlement mechanism grants the investor access to a neutral forum and guarantees an international minimum standard. The exhaustion of domestic remedies cannot reasonably be required in some jurisdictions, be it for reasons of delay, out of reasonable suspicion regarding judicial independence or because of prohibitive costs of legal action.

With a view to "developed" jurisdictions, whose courts should in principle be able to impartially and independently adjudicate a dispute without regard to the origin of the investor, however, the question of the justification of opening an "international option" for foreign investors arises. It is primarily the responsibility of national legislators, authorities and courts to protect the property rights of domestic and foreign investors alike. National law must be interpreted and implemented in accordance with international agreements. This is also the most effective means to ensure adequate legal protection.

In developed legal systems with a strong rule of law, domestic courts act within a legal environment that is arguably both more coherent and foreseeable and also permits a more uniform jurisprudence by supreme courts than the current ISDS practice. Domestic courts, embedded in the specific social and cultural context of a State, are the most appropriate dispute settlement authority and, therefore, in principle, preferable. In addition, erroneous decisions by domestic courts can be corrected more easily at the appellate level as opposed to the current ISDS model.

---

<sup>5</sup> The question of the primacy of domestic courts over ISDS was discussed controversially. In line with the current debate, there were partially concerns about an unfettered parallelism of domestic courts and international law arbitration in legal systems which are functioning well. Nevertheless, there was – based on practical experience – a clear trend against the express precondition of an obligation to use domestic remedies before taking recourse to ISDS.

In addition, domestic courts can provide a uniform forum in which a legal dispute may be adjudicated both with regard to the question of whether the contested host state measure is in accordance with national law as well as with the international law obligations of the host state. Even if domestic courts were to be prevented from directly applying the international law provisions of an investment protection treaty, this would still not be an argument against their primacy over arbitration proceedings. Protecting against the abuse of state power is a "standard task" of national law. In developed systems, the respective standard should generally not fall behind that of the international level: the requirements of international investment law. Germany in particular has a functioning legal system which grants an adequate level of legal protection for domestic and foreign investors. These advantages of the German legal system shall not be undermined.

Nevertheless, it seems reasonable to offer investors in countries with developed legal systems the remedy of arbitration. Even courts in states with a robust rule of law can violate the minimum standards of investment protection agreements. Counteracting such deviations would be impossible were one to generally rule out ISDS following actions in national courts. An obligation to make a final choice between ISDS and national legal protection at the beginning of proceedings would deter enterprises that usually opt for domestic remedies first because they would no longer be able to use ISDS thereafter. This would be detrimental to the aim of strengthening national legal protection.

Finally, one must bear in mind that TTIP and CETA will act as models for future global investment protection. These agreements must - even if they are concluded with states governed by the rule of law - consider the impact of changes on the global level of investment protection and must not endanger the conclusion of agreements endowed with a high level of investment protection.

The proposals for the preamble and the treaty text should reflect all of these considerations. Previous recourse to domestic courts should be considered in the course of the merits stage, especially regarding possible contributory negligence theories and the calculation of damages. With regard to admissibility and in accordance with the CETA draft, no prior exhaustion of domestic remedies is prescribed, but parallel proceedings for damages before domestic courts and investor-to-state tribunals are ruled out. Arbitral tribunals must consider a revocation of the contested measure or compensation under domestic law.<sup>6</sup> Likewise, multiple claims based on differing international agreements are to be coordinated and arbitral tribunals insofar obliged to consider other arbitrations and awards and, possibly, also to suspend proceedings.<sup>7</sup>

## b) Greater Consideration of Domestic Court Rulings by Arbitral Tribunals

### Article X.27: Applicable Law and Interpretation

[...]

- [3.] Where a case has already been decided by a domestic court the Tribunal shall, in general, respect this decision and the underlying balance of interests.

## Commentary

In those cases in which an investor's attempts at securing compensation have failed before a domestic court or even a supreme or constitutional court, said court's decision and reasoning must in principle be respected by the arbitral tribunal. The national court has usually already made a comprehensive assessment of the facts and weighed up the relevant legal assets and interests, hereby considering any national particularities.

---

<sup>6</sup> See Art. X.36 (3) CETA: "[...] For the calculation of monetary damages, the Tribunal shall also reduce the damages to take into account any restitution of property or repeal or modification of the measure."

<sup>7</sup> See Art. X.23 CETA-Text.

## 2. Selection of Arbitrators, Independence, Neutrality

### Article X.25: Constitution of the Tribunal

- [1.] Unless the disputing parties have agreed to appoint a sole arbitrator, the Tribunal shall comprise three arbitrators. One arbitrator shall be appointed by each of the disputing parties and the third, who will be the presiding arbitrator, shall be appointed by agreement of the disputing parties. If the disputing parties agree to appoint a sole arbitrator, the disputing parties shall seek to agree on the sole arbitrator.
- [2.] If a Tribunal has not been constituted within 90 days from the date that a claim is submitted to arbitration, or where the disputing parties have agreed to appoint a sole arbitrator and have failed to do so within 90 days from the date the respondent agreed to submit the dispute to a sole arbitrator, the ~~Secretary-General of ICSID~~ **appointing authority of the chosen arbitration institution or any other appointing authority determined by the parties to the dispute (competent appointing authority)** shall appoint the arbitrator or arbitrators not yet appointed in accordance with paragraph 3.
- [3.] The ~~Secretary-General of ICSID~~ **competent appointing authority** shall, upon request of a disputing party, appoint the remaining arbitrators from the list established pursuant to paragraph 4, **in principle, in the order established therein**. In the event that such list has not been established on the date a claim is submitted to arbitration, the ~~Secretary-General of ICSID~~ **competent appointing authority** shall make the appointment at his or her discretion taking into consideration nominations made by either Party and, to the extent practicable, in consultation with the disputing parties. The ~~Secretary-General of ICSID~~ **competent appointing authority** may not appoint as presiding arbitrator a national of either **[the other contracting party]** or a Member State of the European Union unless all disputing parties agree otherwise.

## Commentary

Investment law arbitration is, so far, relatively closed and not transparent. There is public concern regarding the independence and impartiality of arbitrators. In order to increase the legitimacy and acceptance of investor-to-state dispute settlement, the selection of arbitrators must become more transparent, objective and comprehensible. To this end, amendments to the provisions on the establishment and composition of the arbitral tribunal will be necessary. The dispute settlement procedure stipulated by CETA does not respond sufficiently to these fears. In particular, fears with regard to the concern of bias or partiality of arbitrators and arbitration institutions cannot be mitigated in a lasting manner by CETA's envisioned provisions.

Especially the role of arbitral institutions – such as ICSID – that coordinate proceedings seems in need of improvement, as there is still some indication of possibly illegitimate political interference in arbitrator selection. This concerns, in particular, the selection of the third, presiding arbitrator in the event that the arbitrators of the parties to a dispute are in disagreement. In the CETA draft, the presiding arbitrator is selected by the ICSID Secretary-General from a list of potential presiding arbitrators previously compiled by the contracting parties. Traditionally, certain states play a more dominant role within the ICSID Secretariat than others. Although the above-mentioned list limits the discretion of the ICSID Secretary-General, there is a danger that the process of appointing arbitrators can be politically influenced.

One method to reduce or rule out a possible partiality of arbitration institutions in the appointment of the third arbitrator might be to introduce an objective element in the selection process. A simple but effective option would be to maintain a list of highly qualified arbitrators who are principally appointed in a fixed order of their appearance on the list; they are eligible for reappointment only when the list has been "exhausted". Such a list of arbitrators is already envisioned in CETA, but the method of appointment would have to be specified.

- [4.] Pursuant to Article X.42(2)(a), the Committee on Services and Investment shall establish, and thereafter maintain, a list of individuals who are willing and able to serve as arbitrators and who meet the qualifications set out in paragraph 5. It shall ensure that the list includes at least ~~15~~ 90 individuals. **Individuals may apply to the Committee on Services and Investment to be included in this list. The Committee on Services and Investment shall include the individual if he or she qualifies as arbitrator in accordance with paragraph 5.** The list shall be composed of three sub-lists each comprising at least ~~five~~ 30 individuals: one sub-list for each Party, and one sub-list of individuals who are neither nationals of **[the other contracting party]** nor the Member States of the European Union to act as presiding arbitrators.<sup>8</sup>
- [5.] Arbitrators appointed pursuant to this Section shall have expertise or experience in public international law, in particular international investment law. It is desirable that they have expertise or experience in international trade law and the resolution of disputes arising under international investment or international trade agreements.
- [6.] Arbitrators shall be independent of, and not be affiliated with or take instructions from, a disputing party or the government of a Party with regard to trade and investment matters. Arbitrators shall not take instructions from any organisation, government or disputing party with regard to matters related to the dispute. Arbitrators shall comply with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration or any supplemental rules adopted pursuant to Article X.42(2)(b) (Committee on Services and Investment). Arbitrators who serve on the list established pursuant to paragraph 3 shall not, for that reason alone, be deemed to be affiliated with the government of a Party.

[...]

There is the suspicion that an arbitrator decides one case "opportunistically" and then receives a "pay-off" by being appointed to another arbitration based on a similar investment protection agreement. It is paramount that this must be avoided. It does not suffice for CETA to formulate objective selection criteria; rather it is questionable whether the designation of ICSID as the "appointing authority" is in the interest of the EU and its Member States. The appointment mechanisms and bodies of other arbitration institutions should also be considered. Accordingly, the reference to the Secretary-General of ICSID needs to be replaced by a reference to the "competent institution."

Moreover, academic and political circles criticise the use of ad hoc arbitrators because it can cause conflict given that the professional role as arbitrator and counsel may change depending on the case. Due to the content of investment protection agreements – CETA being no exception in this regard – claims for arbitration are raised almost exclusively by investors. Although a large number of cases has been won by states so far, there is concern in the public that an arbitrator might have a self-serving interest in interpreting an investment protection chapter in favour of investors, thereby enabling new claims for arbitration. In addition, previous awards are often called on to interpret clauses in the same or other investment protection chapters. This leads to a "migration" of interpretations of similarly worded provisions between different agreements that is hardly reconcilable with general international law. The phenomenon described entails not only the inherent risk of an imbalance in the interpretation and application of investment protection agreements, but also leads to an *imbroglio* that outwardly continues to nourish the concern of bias, lack of neutrality and independence on part of arbitrators.

---

<sup>8</sup> The usefulness of a list and the question of its exhaustiveness were discussed in depth. Even if a list raises many problems, a compromise was developed in this regard.

A permanent international investment protection court staffed with salaried judges granted fixed terms and mandated to decide on the basis of a multilateral investment protection agreement is discussed as a possible attempt at a solution. It would replace the arbitration institutions and ad hoc arbitrators currently in the focus of criticism. To date, such a permanent court was not internationally feasible; but in the future, it seems an open question whether a majority of States will support this option. Bearing necessary effort and costs in mind, the establishment of a permanent court would only make sense and prove economically feasible if a sufficient number of States would participate in such an endeavour. Moreover, the installation of the court would presumably take a relatively long time.

Above all, it is doubtful if such a permanent court of first instance is even necessary. From the perspective of German foreign trade promotion, investment arbitration has principally stood the test, despite the need for reform illustrated elsewhere in this document. For this reason, the establishment of an appeal tribunal and the reforms described above – particularly those regarding the transparency of proceedings and the selection of arbitrators – could be sufficient to render investment arbitration fit for decades to come.

In addition, one must not forget that the free choice of arbitrators also has its advantages. Such choice permits the selection of arbitrators who have particular expertise or experience in the respective area. The right to choose an arbitrator is also a key aspect of arbitration. Lists of preselected arbitrators or a definitive catalogue of a few arbitrators, as previously suggested by CETA, could be counterproductive and – especially if they contain only a very small number of arbitrators – increase the suspicion of abuse than eliminate it. The pre-selection of arbitrators using lists must not lead to the selection of politically agreeable candidates by the contracting parties. At any rate, regarding the selection of the first two arbitrators on each

side - in contrast to the choice of the presiding arbitrator - there are grounds to oppose restrictions, at least if the arbitrators have the appropriate qualifications. A definitive list appears problematic in this respect. The compromise proposal presented here calls for the possibility of self-nominations by qualified persons for inclusion on the list.

### 3. Appeal Tribunal

#### Article X.42: Committee

[2.] The Committee on Services and Investment shall provide a forum for the Parties to consult on issues related to this Section, including:

[(c)] whether, and if so, under what conditions, a permanent appellate mechanism ("Investment Appeals Court") between [the other contracting party] and the EU with judges appointed by [the other contracting party] and the EU could be created under the Agreement to review, on points of law, awards rendered by a tribunal under this Section, or whether awards rendered under this Section could be subject to such an appellate mechanism developed pursuant to other institutional arrangements. Such consultations shall take into account the following issues, among others:

[(i)] the establishment, the nature, and composition of an appellate mechanism;

[(ii)] the applicable scope and standard of review;

[(iii)] the establishment of an admissibility procedure allowing for the admission of an appeal

### Commentary

Participants were particularly interested in the concept of an appeal tribunal. As arbitral awards may be challenged only under very limited conditions, or not at all in domestic courts, a few abusive claims have given rise to the concern that public interests are not adequately taken into account in arbitration proceedings. An appeal tribunal would have the benefit of enabling investors and host states to review erroneous arbitration awards where need be. In the long term, an appeal tribunal could also lead to a more uniform interpretation and thus enhance legal certainty and predictability of awards on the basis of the same agreement. Concurrently, considerable delays in the settlement of disputes or significant cost burdens must be avoided. Delays and prohibitive costs inhibit the course of justice.

In the long run, an appeal tribunal may even give way to or be integrated in an international investment court. However, multilateral agreement or an institutionalised court for investment disputes has not been achieved so far. Therefore, one must consider first a bilateral approach. The relevant treaty body (in CETA: Committee on Services and Investment) shall, within three years, submit a proposal for the establishment of a permanent appeal tribunal to the treaty parties.

only in cases of arbitrary or abusive decisions or manifest errors of law by a tribunal;

[(iv)] transparency of proceedings of an appellate mechanism;

[(v)] the effect of decisions by an appellate mechanism;

[(vi)] the relationship of review by an appellate mechanism to the arbitration rules that may be selected under Article X.22 (Submission of a Claim to Arbitration); and

[(vii)] the relationship of review by an appellate mechanism to domestic laws and international law on the enforcement of arbitral awards.

The Committee on Services and Investment shall present its final proposals on the establishment of an appellate mechanism three years after entry into force of this agreement at the latest for the further consideration of the Parties.<sup>9</sup>

Until a permanent appellate mechanism has been established and is functioning, a disputing party may appeal a partial or final award which amounts to an outrage, to bad faith, or to willful neglect of duty, on grounds of manifest errors of law which, if corrected, alter the ultimate result of the award.

Upon receipt of the appeal, the [President of the International Court of Justice] shall appoint three arbitrators ("ad hoc appellate tribunal"). Two members may hold the respective nationality of the disputing parties. The third presiding member may not hold the nationality of either disputing party. The members of the ad hoc appellate tribunal shall comprise persons of highest moral character and have demonstrated a high level of professional independence and

The bench of a permanent appeal tribunal could be staffed by the contracting parties. The presence of judges from the legal traditions of both contracting parties could ensure that legal principles, but also customs and sensitivities of both sides are sufficiently taken into account.

The appellate procedure must, however, be limited to the annulment of unlawful or abusive arbitration awards. If the scope is not limited, the use of an appeals process could cause the kind of delays and increases in legal fees that arbitration was designed to prevent. The admissibility requirements must therefore be correspondingly narrow. The review on part of the appeal tribunal must be limited to points of law. In addition, recourse to the board would have to be tied to an admission decision by the same (in analogy to the certiorari procedure before the U.S. Supreme Court), in order to prevent the protraction of proceedings lacking manifest errors of law with a serious impact on the result of the award.

Until the establishment of such an appeal tribunal, intergovernmental ad hoc investment arbitration tribunals of appeal could correct arbitral awards containing gross errors of law. Access to these should be configured similarly restrictive to the access to a future appeal tribunal.

---

<sup>9</sup> Inserted due to constitutional law concerns regarding the creation of an appeal tribunal solely by organs of the international level ("Commission" referred to in the Article).



impartiality. They shall be recognized and respected experts of public international law, in particular international investment law. They shall be available at all times and on short notice during their appointment. They shall serve in their individual capacity and decide on a neutral basis.

The appeal shall be filed by a disputing party within four weeks of an award of the tribunal and must be admitted or rejected as inadmissible for review by the ad hoc appellate tribunal within four weeks upon its constitution on the basis of a summary evaluation. The final decision of the ad hoc appellate tribunal on an appeal shall be rendered within twelve weeks.

The arbitration rules selected for the governance of an arbitration on the basis of this agreement are applicable to the appeals arbitration to the extent deemed possible by the ad hoc appellate tribunal and not altered or amended by provisions of this agreement.

A final decision of the ad hoc appellate tribunal is binding and enforceable in the same way as an award of a tribunal constituted on the basis of this agreement is binding and enforceable. An award of a tribunal which (1) can be appealed, or (2) has been appealed and the appeal has neither been rejected nor finally decided is not binding and enforceable during this period.<sup>10</sup>

[...]

---

<sup>10</sup> Compromise suggested by the editors.

## 4. Class Actions

### Article X.22: Submission of a Claim to Arbitration

- [1.] If a dispute has not been resolved through consultations, a claim may be submitted to arbitration under this Section **only** by:
- [(a)] **one or more~~an~~ investors** of the other Party on its **or their** own behalf; or
  - [(b)] an investor of the other Party, on behalf of a locally established enterprise which it owns or controls directly or indirectly.
- [2.] **A claim submitted in the name of a class of claimants by a representative intending to conduct the proceedings by representing the interests of such claimants and making all decisions relating to the conduct of the claim on their behalf shall not be admissible.**<sup>11</sup>
- [...]

## Commentary

The reform of investment arbitration must preserve German and continental European legal traditions. Continental European or German approaches and voices are facing increasing difficulties. It is, however, worth noting that German law is often more efficient, cost-effective and predictable than other countries' legal structures, thus offering tangible benefits to the economy. The label "Made in Germany" is also an indication of quality with regard to the law in international commerce. The reform of ISDS should therefore, in accordance with the initiative of "Law Made in Germany" ([www.lawmadeingermany.de](http://www.lawmadeingermany.de)), be geared to strengthen Continental European and German procedural principles.

No recognition should be accorded to class actions in ISDS, i.e. cases in which many, or even an entire category, of investors are collectively represented by a claimant asserting their rights on their behalf. Such actions raise many problems which are difficult to solve in ISDS and contribute little to the protection of individual investors. In particular, the risk of abuse and emergence of a "litigation industry" cannot be dismissed. Class actions are especially dangerous if they are configured with a so-called opt-out procedure similar to class actions in the United States. This problematic legal institution may therefore under no circumstances be transferred to Germany and Europe and find its way into investment protection agreements entered into by the EU.

---

<sup>11</sup> The exclusion of class actions was discussed by the participants. Some participants saw class actions as a means to create better access to ISDS, especially for SMEs. The possibility of consolidating proceedings (Art. X.41 Consolidation) is not deemed as sufficient by the participants. Overall, the majority opted for the exclusion of class actions due to the associated risks of abuse.

## 5. Admissibility Requirements and Admissibility Review

### Article X.22:

#### Submission of a Claim to Arbitration

[...]

[3.] In order to admit a claim, the tribunal shall, on its own motion and in appraising the relevant legal and factual information submitted by the disputing parties, establish that an award in favor of the claimant may not seem entirely improbable from the outset, even if the information submitted by the Parties were assumed to be true.

### Article X.29: Claims Manifestly without Legal Merit or Manifest Lack of Jurisdiction

[1.] The respondent may, no later than 30 days after the constitution of the tribunal, and in any event before the first session of the Tribunal, file an objection that a claim is manifestly without legal merit or that there is a manifest lack of jurisdiction.

[2.] An objection may not be submitted under paragraph 1 if the respondent has filed an objection pursuant to Article X.30 (Claims Unfounded as a Matter of Law).

~~[3.] The respondent shall specify as precisely as possible the basis for the objection.~~

[4.] On receipt of an objection pursuant to this Article, the Tribunal shall suspend the proceedings ~~on the merits~~ and establish a schedule for considering any objections consistent with its schedule for considering any other preliminary question.

[5.] The Tribunal, after giving the disputing parties an opportunity to present their observations, shall at its first session or promptly thereafter, issue a decision or award, stating the grounds therefor. In doing so, the Tribunal shall assume the alleged facts to be true unless the violation of the substantial standard is improbable or implausible or the allegations are contradictory.

[6.] This Article shall be without prejudice to the Tribunal's authority to address other

## Commentary

Admissibility requirements aiming at preventing abusive and manifestly unfounded claims are important. Claims which only put the respondent state under pressure must be identified and stopped at an early stage of the proceedings. Even pursuing pending claims can lead to a large administrative burden, and can pressure the state to making concessions, not only because they bind human and financial resources, but also because of the legal uncertainty they cause.

A check on the admissibility of a suit is therefore also important in regular arbitration, not only in the appeals procedure currently under discussion. It must be conducted as simply and efficiently as possible, without great administrative burdens and following clear criteria. In this respect, the CETA draft provides for two different procedures. Even though there is already case practice with regard to the (partially similar) ICSID rules, the conditions under which a claim may be considered "manifestly without legal merit" and "unfounded as a matter of law" must be more clearly defined, as well as the relationship of these two cases to each other. Under the CETA draft, this question remains unanswered.

Clarification of the term "manifestly without legal merit" (Art. X.29) is necessary because the case practice developed to Rule 41 (5) of the ICSID Arbitration Rules has so far established varying standards. As currently defined, only the "legal merits" are of concern. Therefore, the facts put forward must always be taken for granted (Art. X.29). However, the mere assertion of a violation may not be enough, at least not if it is contradictory, implausible, or unlikely, or if the respondent conclusively contradicts the exposition of the facts. This has also been noted by some arbitral tribunals and should be expressly established due to differing opinions among tribunals.

In relation to the possible infringement of an investor's interests, the term "manifestly" in the CETA text sets high demands pertaining to the rejection of a claim. In order to reject the claim as inadmissible, it must be clearly and obviously unfounded. Moreover, the burden of proof is imposed upon the respondent. Instead, the burden of presentation and proof of an

objections as a preliminary question or to the right of the respondent to object, in the course of the proceeding, that a claim lacks legal merit or jurisdiction.

**Article X.30: Claims Unfounded as a Matter of Law**

- [1.] ~~Without prejudice to a tribunal's authority to address other objections as a preliminary question or to a respondent's right to raise any such objections at any appropriate time,~~ The Tribunal shall address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim, or any part thereof, submitted pursuant to Article X.22 (Submission of a Claim to Arbitration) is not a claim for which an award in favour of the claimant may be made under this Section, even if the facts alleged were assumed to be true.
- [2.] An objection under paragraph 1 shall be submitted to the Tribunal no later than the date the Tribunal fixes for the respondent to submit its counter-memorial.
- [3.] If an objection has been submitted pursuant to Article X.29 (Claims Manifestly Without Legal Merit or manifest Lack of Jurisdiction), the Tribunal may, taking into account the circumstances of that objection, decline to address, under the procedures set out in this Article, an objection submitted pursuant to paragraph 1.
- [4.] On receipt of an objection under paragraph 1, and, where appropriate, after having taken a decision pursuant to paragraph 3, the Tribunal shall suspend any proceedings ~~on the merits~~, establish a schedule for considering the objection consistent with any schedule it has established for considering any other preliminary question, and issue a decision or award on the objection, stating the grounds therefor.
- [5.] ~~This Article shall be without prejudice to a tribunal's authority to address other objections as a preliminary question or to a respondent's right to raise any such objections at any appropriate time.~~

infringement should be imposed on the claimant in the course of the admissibility review: as is the case in German procedural law, the claimant would initially have to demonstrate that an infringement appears possible (Art. X.22.). This provision would in turn be complemented by the admissibility review. Finally, not only the merits but also the jurisdiction should be examined summarily in the course of an admissibility review (see supplement in Art. X.29).

Should Art. X.29 continue to exist in parallel to the procedure of Art. X.30, despite comparable goals, pertaining to claims that are "unfounded as a matter of law", the content of this provision should be clearly delineated from that of Art. X.30; the respective conditions are to be specified accordingly.

### III. Access to Legal Protection for Small and Medium-Sized Enterprises

#### Article X.42: Committee

[1.] The Committee on Services and Investment shall provide a forum for the Parties to consult on issues related to this Section, including:

[...]

[[d)] the establishment of a special schedule of fees for party representatives and arbitrators and the establishment of a special dispute settlement schedule setting out fixed dates for the completion of the different procedural phases for disputes with a value of not more than 10 Million Euros ("small claims") with a view to accelerating the proceedings and, thereby, to facilitate access to dispute settlement also for small or medium-sized enterprises.

The Committee on Services and Investment shall present its final proposals on the establishment of a special schedule of fees for party representatives and arbitrators and a special dispute settlement schedule for small claims three years after entry into force of this agreement at the latest for the further consideration of the Parties.

Until a special schedule of fees for party representatives and arbitrators is established by the Parties for small claims, the fees have to be fixed as follows:

The fee of an arbitrator or presiding arbitrator respectively, including any expenses may not exceed:  
15,000 or 22,000 Euros if the value of the dispute equals 500,000 Euros or less;  
25,000 or 35,000 Euros if the value of the dispute equals 1,000,000 Euros or less;  
35,000 or 45,000 Euros if the value of the dispute equals 5,000,000 Euros or less;

#### Commentary

Small and medium-sized enterprises (SMEs) face particular challenges in investment disputes in their host states. Not only do they have limited political and administrative channels of communication in their host or home States, through which possible conflicts can be resolved at an early stage. SMEs are also regularly not capable of conducting arbitration proceedings on the basis of investment protection agreements, as they are overwhelmed by the respective effort and costs (an average of about 8 million US dollars per procedure; 3-4 million US dollar per party to the dispute), which are also partly due to the length of proceedings. On the domestic market – understood as the national market and, with a view to European SMEs, the EU Single Market – SMEs fear that foreign enterprises could gain competitive advantages by a "special right of action." Although the problem of different treatment of domestic and foreign competitors seems less critical today if one bears CETA's balanced protection standards in mind, the costs – and also the complexity – of investment protection legal proceedings represent a serious hurdle for the effective assertion of respective guarantees.

The SME related regulations in the CETA text do not tackle this problem sufficiently. Only Art. X.22 (5) CETA proposes that the respondent shall, if possible and at the request of a claimant SME, agree to proceedings presided over by a sole arbitrator. However, the costs of arbitrators are only a relatively small item in the total cost calculation. In addition, it is hardly likely that both the claimant and the respondent would readily renounce "their" arbitrator from a procedural viewpoint. The provision is therefore only of limited value and by no means sufficient to enable access to ISDS for SMEs.

40,000 Euros or 50,000 Euros if the value of the dispute exceeds 5,000,000 Euros.

The total fees of party representatives or a disputing party may not exceed:  
50,000 Euros if the value of the dispute equals 500,000 Euros or less,  
85,000 Euros if the value of the dispute equals 1,000,000 Euros or less,  
150,000 Euros if the value of the dispute equals 2,000,000 Euros or less,  
200,000 Euros if the value of the dispute equals 3,000,000 Euros or less,  
300,000 Euros if the value of the dispute equals 4,000,000 Euros or less,  
400,000 Euros if the value of the dispute equals 6,000,000 Euros or less,  
500,000 Euros if the value of the dispute exceeds 6,000,000 Euros.

If the value of the dispute exceeds 10,000,000 Euros this provision does not apply.<sup>12</sup>

Until a special dispute settlement schedule for small claims is established by the Parties, a claim submitted follows, to the extent applicable, the schedule provided for panel proceedings under the 1994 WTO Dispute Settlement Understanding.

Rather, decisive action on part of the contracting parties by means of provisions both in the agreement itself and within the national legal systems is required. In order to reduce costs, two measures should be implemented on treaty level:

For smaller claims (no more than 10 million Euros in dispute), a special schedule of fees more closely corresponding to the financial capacity of SMEs, which will initiate such claims more frequently, should be established: fees for counsel and arbitrators would then depend on the amount in dispute in a specific case. Hourly rates, daily rates and total billable fees would be subjected to a realistic upper limit (such is the regulatory proposal here). Alternatively, these could be replaced by lump sums.

Secondly, this special schedule of fees could also be linked to stricter deadlines for arbitration proceedings. As long as the parties to the agreement have not agreed on a specific time regime within the framework of the Committee on Services and Investment, proceedings with smaller claims for damages should analogously follow the strict procedural time frame of the Dispute Settlement Understanding (DSU) of the WTO for the so-called panel process (see esp. Art. 4.7, 12.9 DSU). For these panel proceedings, decisions are envisaged within less than a year.

At the national and European levels, programs for SMEs may be initiated that eliminate or at least reduce the financial and organisational hurdles of access to investor-to-state arbitration on the basis of an investment protection agreement, thus facilitating access to these. Investment guarantee regimes for SMEs, such as those that have been implemented by Germany within the framework of international trade could be expanded and linked to "legal expenses insurance" in the event of arbitration.

A body could be set up in the Member States or the European Commission which would not only abstractly instruct SMEs on the legal remedies existent in the context of investment protection

---

<sup>12</sup> The capping of fees was controversial among some participants. In part, the limitation of reimbursement to a specific fee rate was brought into play.

agreements, but also provide legal aid or legal services for investor-to-state arbitration after a summary examination ("Technical Assistance"). These services in the form of legal advice could be tendered and procured by the competent authority on European level, thereby realizing volume discounts which could then be passed on to the SMEs.