

European Commission proposal for a new Investment Court System: from investor protection to State protection?

In May this year, the European Commission published a concept paper calling for the creation of a permanent investment court in the context of the free trade agreement negotiated with the US, known as the Transatlantic Trade and Investment Partnership Agreement (TTIP). Criticisms voiced by both opponents and supporters of investor-state dispute settlement (ISDS) did not deter the Commission, which has now approved a proposal for a new Investment Court System for TTIP and other EU trade and investment negotiations (including the recently announced Free Trade Agreement with Vietnam) to replace the existing ISDS model.

The Commission proposal published in September contains three key aspects:

- governments' right to regulate is guaranteed in the provisions of the agreement;
- investors will only be able to bring claims in restricted circumstances; and
- the setting up of a public Investment Court System comprised of a Tribunal of First Instance and an Appeal Tribunal, staffed by publicly appointed judges.

Governments' right to regulate

One of the issues that the Commission proposal tries to address is the perception that ISDS, and the prospect of an adverse award for (often significant) damages, ties government hands when it comes to regulating in the public interest. The Commission proposal is intended to safeguard governments' right to change their policies to achieve legitimate policy objectives such as protection of the environment, public health or consumers, even where such changes negatively affect covered investments.

The text also explicitly deals with illegal state aid, an issue that has been particularly thorny in the context

of intra-EU bilateral investment treaties. The starting point is that if a member state changes its regulations to comply with EU state aid rules, an investor will not be able to complain, even if adversely affected. But the Commission proposal goes even further. Where state aid already granted is found to be illegal, the European Commission will ordinarily order reimbursement of the amount granted. To cover for this eventuality, the Commission proposal specifically permits member states to take steps for reimbursement, while at the same time precluding the possibility of equivalent compensation being granted to the investor. This is in line with the recent Commission decision in *Micula*, where the Commission took the view that paying an investment arbitration award constitutes illegal aid which must be recovered, in circumstances where the award represented compensation for the discontinuation of subsidies which Romania had repealed as incompatible with EU state aid rules.¹

Bringing a claim

The proposal contains five guarantees for foreign investors, who may only bring a claim if one of them is breached.²

1. As an exception to the right to regulate, states must honour commitments (arising under either contract or law) to issue, renew, or maintain a subsidy.

2. Fair and equitable treatment and physical security. The proposal includes a closed list of breaches of this obligation (with the ability to add to the list in the future), which includes denial of justice, breach of due process, manifest arbitrariness, discrimination on the

¹ Commission decision (EU) 2015/1470 of 30 March 2015 on state aid SA.38517 (2014/C) (ex 2014/NN) implemented by Romania – Arbitral award *Micula -v- Romania* of 11 December 2013 OJ [2015] L232/43.

² According to the Commission, these are in addition to a further guarantee contained in its proposal to the US on Trade in Services, Investment and E-Commerce, namely non-discrimination on the basis of nationality.

grounds of gender, race or religious belief, harassment or abuse of power.

3. Compensation for losses in certain circumstances linked to war or other armed conflict.
4. No expropriation, whether direct or indirect without prompt, adequate and effective compensation.
5. No restrictions on transfer and repatriation of any monies relating to the investment.

These protections are fairly standard in investment treaties. What is different is the fact that the requirement to afford fair and equitable treatment is restricted to a closed list of circumstances where this requirement will be breached. Thus the Commission is trying to provide more certainty for states and restrict arbitrators' discretion.

The creation of a public Investment Court

As foreshadowed in the May concept paper, the Commission now proposes the creation of a two-tier permanent "public" court system. The term "public" appears to reflect the set up and composition of the Court, rather than its funding, as the costs of the proceedings will be borne by the disputing parties in the proportions that the Court decides in a way similar to arbitral proceedings.

The Tribunal of First Instance will comprise 15 judges, five to be nationals of an EU member state, five US nationals and five nationals of third countries. Judges must possess the qualifications necessary to hold judicial office in their respective countries. Cases will ordinarily be heard before three judges (one of each nationality group) but applicants, in particular SMEs, may ask for a sole judge, who will be a national of a third country. The judges will need to abide by a prescribed code of conduct.

The proposal contains further novel elements to reflect the EU's modern approach to ISDS, as is already apparent in the free trade agreements negotiated with Canada and Singapore. These are:

- Transparent proceedings, which includes documents being available online and the right for third parties to intervene.
- To avoid parallel proceedings by requiring the claimant to either withdraw any domestic proceedings (other than for interim relief) or wait until a final award has been rendered in such proceedings, before being able to bring an investment claim. Once a claim is brought before

the Tribunal, claimants waive their right to go before domestic courts (no u-turn).

- To deter frivolous or unfounded claims, by allowing respondent states to file preliminary objections that the claim is manifestly without legal merit, or that the claim is not one for which an award in favour of the claimant may be made. Costs will also be ordered against the unsuccessful party, unless the Tribunal determines that this would be unreasonable.

While the Tribunal will have power to order interim measures, it may not order seizure of assets or prevent the application of the treatment alleged to constitute a breach. The Tribunal will also have the power to order security for costs.

The Appeal Tribunal will comprise six judges, two of each nationality group. Parties may appeal an award within 90 days of its issuance on three limited grounds:

- error of law;
- error of fact, including the appreciation of relevant domestic law; or
- on the grounds specified in Article 52 of the ICSID Convention,³ which include corruption on the part of a member of the Tribunal, the Tribunal exceeding its powers, or that the award failed to state reasons.

A potential deterrent to appeal is the fact that a party lodging an appeal must provide security for the costs of the appeal and for the amount in the award.

What next?

The proposal will now be debated with the EU member states and the European Parliament, following which the Commission will formally present it to the US. The Commission also intends to work in parallel with other countries towards a permanent International Investment Court. As to foreign investors, they are unlikely to welcome provisions aimed at safeguarding governments' right to regulate. The US Chamber of Commerce's reaction was swift, commenting that the Commission's proposal is "deeply flawed". The date for conclusion of the TTIP does not seem to have been brought any closer.

A copy of the proposal is available [here](#).

³ Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18 March 1965.

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