AK EUROPA

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AK Position Paper

# „Investmentcourt System" ICS - Draft of the European Commission on Chapter II - Investment for TTIP dated 16 September 2015

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# About us

**The Austrian Federal Chamber of Labour is by law representing the interests of about 3.4 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.**

**The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.**

**Organisation and Tasks of the Austrian Federal Chamber of Labour**

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, communityand military service - of the 3.4 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Rudi Kaske
President

Werner Muhm
Director

# The AK position in detail

Since the European Commission has presented its long awaited draft on Chapter II Investment for the negotiations of the EU with the USA, the Austrian Federal Chamber of Labour (Bundesarbeitskammer, BAK) is taking this opportunity to present its critical analysis of investment protection, as well as the investment arbitration system, the Investment Court System. This analysis is based on the opinion of the BAK on the public consultation regarding ISDS in TTIP dated 14.05.2014 and the opinion of the BAK on the corresponding negotiating mandate dated 22.04.2013. But before we go into detail, we would like to make some general comments on this draft.

The European Commission has responded to criticism of the lack of rule of law of the private arbitration system ISDS in its draft on an investment court system (ICS). Development of the ICS will be oriented largely to the instructions of an international court. However, the core criticism, namely that foreign investors have privileged rights to sue, remains since this principle was not challenged. Therefore the new text also has many problematic provisions which still tend to override the public interest. In any case, the proposals are not sufficient to defuse the risks posed by investment protection:

- States still commit themselves to pay compensation if investors see themselves treated unfairly by new regulations. Countries' self-evident right to regulate can be threatened and even eroded, unhindered, by lawsuits.

- The outcome of the public consultation on ISDS in TTIP was clear: no special - and therefore no enhanced - rights for companies to sue, since US companies should not be treated better in the EU than any other persons or companies in our society.

- With the proposal for a new investment arbitration procedure the Commission wishes to restart the suspended negotiations with the USA. There is still need for extensive discussions in Europe. Negotiations with the USA would be precipitate as long as an extensive discussion on this has not taken place with the decision-making institutions in the EU and its Member States, as well as with social partners and the interested public.

The BAK **rejects investment protection provisions in TTIP on principle** because both the EU and the USA have highly developed legal systems which safeguard fundamental rights such as the right to property, equal treatment and the right to a fair trial and stipulate payment of compensation for expropriation. Therefore no courts outside the regular judicial system are needed. Furthermore we advocate **equal treatment of European companies vis-à-vis US investors in Europe. National courts**

**ensure this.** We reject discrimination of domestic investors in relation to companies domiciled in the USA.

**Analysis of the draft document:**

**Chapter II – INVESTMENT**

**Definitions for investment protection**

Every type of asset imaginable is supposed to be a "covered" investment and hence enjoy special investment protection - vis-à-vis domestic investors. We firmly reject the open list of so-called covered investments, which include apart from productive investments portfolio-investments, contractual agreements, intellectual property rights, indirect ownership, franchises, loans and "every other kinds of interest in an enterprise" and hence grants the same level of protection.

In its opinions on the investment policy of the EU, the BAK has repeatedly advocated a **precise definition of foreign direct investments** which promote long-term investment behaviour and socio-ecological investments in the future of recipient countries. We also demand that portfolio investments of any kind, as well as intellectual property and monetary claims of any type, are excluded from the scope of TTIP. Highly speculative investors, franchise holders, etc. systematically place national economies under financial pressure with their lawsuits; this has a fatal impact on the population and on economic development. Circumventions practices such as letterbox companies or "special purpose vehicles" should also be prohibited on principle. The current established practice of facilities must be taken into consideration in the definitions in order to effectively prevent "misuse" of the investment protection regulations. The interpretation of what is circumvention may not be left to the arbitration tribunals (Section 3, Article 15).

**Section 2, Investment Protection**

**Article 1, Scope of application**

Investment protection should be offered for any type of treatment that may affect the operation of such investment. This formulation is even less definite than the usual approach hitherto which talks of "measures". Provisions that are even vaguer than before are a contradiction to the latest developments to define concepts more clearly and therefore must be rejected.

**Article 2, Investment and regulatory measures / aims**

This article, announced as the **"right to regulate"** clause, is might be intended to pretend that in future the state's right to regulate shall remain unaffected by investment protection. However, the clause does not live up to its promise because claims for damages remain unchanged.

Article 2, paragraph 1 stipulates that arbitration tribunals shall determine whether legitimate policies are followed in measures implemented in areas such as healthcare, social, consumer and environmental protection, etc. This provision does not prohibit arbitration tribunals from deciding on politics in general interests as it empowers them to examine whether regulations or measures are legitimate and whether they are necessary and proportionate. The approach of a case-by-case examination is substantiated in Annex I Expropriation.

Paragraph 2 further clarifies the "right to regulate" clause and states that the Contracting Parties to TTIP do not enter into a "standstill obligation" vis-à-vis foreign investors. What can we deduce from this statement?

This "right to regulate" clause does not establish any connection between the no-standstill obligation, assessment of proportionality and compensation rights of foreign investors. It does not provide any information on how the conflict between legitimate political aims in the general public interest, especially in sensitive areas, and individual investors' economic interest in profits should be handled, hence the Contracting Parties' obligation to provide compensation remains unchanged. More specific provisions on this matter can still only be found in Annex I Expropriation; here, too, no corresponding detailed definitions were attempted.

An exemption to the application of investment protection for state aid has been formulated in paragraphs 3 and 4, unless the Member State has committed itself by law or contract to the investor to pay such compensation. In particular when EU institutions act within the state aid procedure, the minimum standard of "fair and equitable treatment" cannot be violated. This results from the manifestly catastrophic experience of the European Commission with the bilateral investment protection agreement.

Such an effective exemption from the scope of application must apply to all measures in the public interest, and not only for those areas on which the European Commission has focused most recently. All measures in the public interest must be granted a comparable exemption as for state aid legislation.

The proposed "right to regulate" clause **adheres persistently to the principle of investment protection**, from which claims for compensation can be deduced under changing general conditions. We cannot find any improvements or progress in comparison with the controversial status quo. It stills falls to the arbitration tribunals to decide whether claims for compensation exist or not regarding measures in the general public interest. Even if the arbitration tribunal comes to the conclusion that a legitimate public interest is being pursued, this has no direct consequence on claims for compensation.

The BAK calls for **sensitive sectors** such as, for example, education, health, culture, services in the public interest and public transport, as well as political areas such as work and social matters, labour law, environment, regulation of financial markets, taxes and fiscal policy **to be exempt from the scope of the investment protection-chapter** by prepending a **"carving out" clause** aright at the beginning of the chapter, as has already been done, for example, in the case of cultural industries, audiovisual services and financial services in CETA.

**Article 3, Treatment of investors and covered investments**

The clause of "fair and equitable treatment" (FET) has emerged in arbitration as the "catch-all" clause; it is as the basis for claims for compensation in cases of regulations in the public interest and has resulted in very wide and contra-

dictory interpretations in judgments. The European Commission is trying to create a restrictive definition in TTIP, as in CETA, by listing facts which run contrary to the principles of the rule of law (obvious arbitrariness, etc.). However, in paragraph 4 these efforts to make the FET clause "calculable" are nullified: the arbitration tribunal can take the "legitimate expectations" of the investor at the time of investment into consideration. Hence fair and equitable treatment is violated if the legitimate expectations, which the investor was counting on, are frustrated during the course of the investment. Whether this is the case is decided by the arbitration tribunal. Paragraph 4 does not state that one of the elements of the case listed in paragraph 2 must be satisfied before paragraph 4 is applied. The expert opinion compiled by Professor Markus Krajewski for the German government in May 2015 also comes to the conclusion that paragraph 2 is not linked to paragraph 4 (page 13 et seqq. of the legal opinion: model investment contract with investor-state arbitration for industrial countries with regard to the USA). In order to ensure this, the following text must be included: "For greater certainty, change or repeal of measures of general application such as laws, regulations and other general rules shall not be considered a violation of the fair and equitable treatment standard unless the conditions of section 2 are met."

**The BAK is decidedly against the FET clause which discriminates against domestic investors on principle and furthermore gives arbitrators explicit authorisation to consider the expectations of investors.** However, we support a **"no greater rights" clause** so that foreign investors are not given better protection than domestic investors. It would be sufficient to include a non-discrimination standard as a systematic standard of protection. If this is not enforceable, at least paragraph 4 should be supplemented: "Such a promise cannot waive any binding obligations of the investor contrary to national law and cannot limit the right of a Contracting Party to adopt, maintain or repeal any laws or regulations in accordance with domestic law."
Paragraph 3 creates a panel which is to be given extensive rights: the elaboration of binding interpretation notes on individual provisions of the agreement, nomination of arbitrators and the office of the presiding judge of the investment court systems (ICS), etc. The BAK is decidedly against the agreement creating panels which are given the authority to further develop contents to a decisive extent. For this would override the principles of the rule of law such as, for example, the voice of Parliament and supervision.

**Article 4, Compensation for losses**

Compensation for losses in the case of war, armed conflicts, unrest, etc. is not acceptable. In such cases a government liability is created which can only be attributed conditionally to the state and its citizens or institutions and which represents an unpredictable rollover risk. A risk which can scarcely be calculated and therefore not covered by insurance becomes the responsibility of the country concerned. Foreign investors must bear the same political risks as we all do in society.

The approach pursued here is anachronistic since globalisation of the economy has reached a level where foreign

companies are most certainly active stakeholders in their host country and influence general political conditions (e.g. regulatory cooperation in TTIP as well as the duty of care to comply with human rights in the value added chain). Therefore foreign investors should no longer be seen as the victims of governmental power in the host country, as was the case during the Cold War.

**Article 5, Expropriation**

The concept of indirect expropriation is much too comprehensive and cannot be accepted. Such an extensive regulation allows investors - despite exemption clauses - to challenge state-regulation to a considerable extent.

The BAK advocates limitation of foreign investors' claims for compensation. A claim for compensation must be based on the right to compensation under civil law of the individual state and must conform with this (principle of equal treatment). Only the actual loss in value can be compensated, and not lost future profits and depreciation. Therefore the type and amount of compensation must be limited and various factors to be considered when calculating compensation must be defined anew. It would make sense to calculate a cap precisely in order to limit the attractiveness of investor claims as well as the financial self-interest of arbitrators in cases of claims for compensation.

**Article 6, Transfer**

Paragraph 3 is too comprehensive and overly restricts the freedom of the national legislator. A clause where legal provisions in the public interest can be challenged by indefinite legal terms ("equitable and non-discriminatory manner", "disguised restriction") must also be rejected, in the opinion of the BAK. It must also be clarified that investor debts vis-à-vis public corporations and public authorities (e.g. fiscal debts, payroll tax debts) are to be offset against any compensation payments.
An additional horizontal provision for EMU measures, problems with the balance of payments, etc. must also include economic sanctions in the movement of capital taken on the basis of political landmark decisions.

**Article 7, Umbrella clause**

We reject the protection offered by the umbrella clause to all contractual agreements with investors, especially since no such clause is provided for in CETA and this would offer undesirable opportunities for evasion.

**Annex I, Expropriation**

This annex allows claims to be taken against regulations or measures in the public interest, whereby the tribunals are empowered to determine the amount of compensation paid on the basis of an assessment of proportionality.

The BAK criticizes the fact that a state obligation of the Contracting Parties to pay compensation is codified, which goes beyond the respective national legislation. There is no factual argument which justifies treating foreign investors better than domestic investors by ensuring them compensation for so-called "indirect expropriation". This must be emphatically rejected.
Should this not be enforceable, the reference to the "legitimate" expectations

of investors must be deleted –, as for the FET clause. Also the provisions to protect national laws and measures must be formulated more clearly. Non-discriminatory measures to protect health, environment, social aspects, labour law, etc. may not be defined as indirect expropriation. Therefore paragraph 3 should read: „For greater certainty, non-discriminatory measures of a Contracting Party that are designed and applied to protect public welfare objectives, such as protection of health, safety, labour and social policies, consumer protection, the environment, taxes, cultural diversity, media freedom and pluralism, do not constitute indirect expropriations by themselves."

**Annex II: Public debt**

If an investment protection provision is violated due to a restructuring of public debt instruments, then the right to an investment protection procedure should be significantly restricted in cases of **negotiated restructuring**.

The BAK advocates that restructuring of public debt should not in principle give rise to investor rights to sue. After all, the main functions of the financial market lie in lending and the assumption of risk; investors also receive interest for this. The market system would definitely be brought to the point of absurdity if investors were to be compensated for a risk which ultimately they do not assume. Furthermore the value of public debt instruments is subject to abrupt fluctuations which are often not transparent; this often makes refinancing conditions of countries difficult to calculate and can even result in insolvency. Hence the right to investment protection actions due to restructuring of public debt instruments amounts overall to a weakening of the public interest to the benefit of the interests of private creditors.

While we welcome the intention of the approach of the Annex on public debt, the details require careful attention. It is apparent that the provisions on investment protection cannot be repaired by individual regulatory addenda in the public interest. This is a further reason to remove the investment protection clauses from TTIP altogether to ensure that the right to legal action for investment protection is excluded in the case of restructuring of public debt instruments.

Looking at the details we notice that in CETA the possibility for investors to sue is limited to the chapter "Establishment of Investments" and "Non-discrimination" and in the Vietnam Peace Accord limited at least to the chapter "Non-discrimination". In contrast, this draft refers only to the provisions of investment protection.

The draft contributes essentially to a situation where, firstly, negotiated restructuring is excluded in principle by legal action by investors and, secondly, public debt instruments held by public institutions can be treated differently and, thirdly, retroactive non-discriminatory collective action clauses (CACs) are also excluded from legal action by investors.

Even though this limitation of possible legal action taken by foreign investors when restructuring government securities appears positive at first glance, the risk of legal action by investors is by no means averted adequately. The problem of workouts remains, namely, that the

minority of creditors do not accept the result of restructuring and take legal action as investors. Furthermore this results in a problem for the countries concerned with the subsequent implementation of CACs if the relevant debt certificates were issued according to the legal system of another country. And finally negotiated restructuring by definition presupposes the agreement of creditors. Conversely, this means that legal action by investors is most certainly possible if creditors do not agree to a restructuring measure. This also means that considerable pressure is exerted by creditors during such negotiations or restructuring measures could be completely "rejected" in view of the threat of legal action by investors. This example illustrates that even if individual steps appear to be going in the right direction, the risks to the common good are anything but averted due to investment protection. Therefore the BAK advocates that legal action by investors be excluded on principle due to restructuring of public debt instruments.

Provisions on the chapter not yet presented on financial services are connected to the restructuring of public debt instruments. Since there is no TTIP draft available, we refer to the CETA Agreement, Article 15 (chapter on financial services) which provides for prudential carve-out, as well as the annex "Investment Disputes in Financial Services". CETA provides filters to legal action by investors through precautionary measures, for example, to stabilise the financial sector or to lower the risk of turbulence in financial markets. The recovery of a financial institution is mentioned explicitly. Even if we do not consider these filters to be sufficient to protect the public interest in the case of a financial crisis, for example, such provisions are lacking in TTIP. Special attention should be paid to ensure that in restructuring, as in the case of Hypo Alpe Adria, no additional taxpayers' money is raised to compensate individual foreign investors.

**Section 3, Resolution of Investment Disputes and Investment Court System**

In comparison with the practice hitherto in resolution of investment disputes, considerable progress in the rule of law has been achieved in this draft. However, this does not change the fact that in our opinion there is no need to create a separate legal system between two highly developed constitutional states in addition to the common courts of the Contracting Parties. We also reject the creation of two-class law. Foreign investors may not enjoy privileged treatment by giving them direct access to jurisdiction which is not available to others from that country.

It must be assumed that political forces wish to create a type of investment arbitration. Therefore we would like to review some critical points from the Commission's draft.

**Article 9, Tribunal of First Instance**

Article 9 (2) regulates the **appointment of judges**, but does not clarify how this should be done in practical terms. How will the committee come to a decision? Who will the committee be composed of and what powers will be assigned to it? How will arbitrators be nominated and appointed? According to which criteria will judges from third countries be selected? The proposal does not contain any possibility of removing registered arbitration judges.

With regard to the **composition of the tribunal** the criticism can be voiced that five judges can be nominated from third countries since the necessary independence of the judiciary cannot be determined by special guarantees of the rule of law. The statement that all judges must be qualified to hold the position of a judge in the relevant country is not sufficient as a qualification from third countries if the legal system of that country is itself not operational. This issue is exacerbated by the fact that Article 9 (9) foresees that the parties can agree that only one judge - who must then be from a third country - can decide the case. Furthermore, the presiding judge and deputy will be appointed solely from the group of judges from third countries. Therefore the guarantees under the rule of law with regard to selection of judges from third countries are especially important.

The requirement that judges must satisfy the requirements to hold judicial office in their own country is a fundamental **criterion for qualification**. However, Article 9 (4) also allows lawyers with generally recognised competence as judges in the proposed tribunal of first instance. This is problematic in terms of the rule of law, given that lawyers and university professors, who were granted such competences, became active in international arbitration. Hence personnel issues are simply continued and not resolved. This problem is exacerbated by the fact that special expertise is required in international law. Normal judges do not usually have such expertise, but rather those who have already worked in international arbitration.

The required qualifications for judges must be specified; only persons holding judicial office are suited to this function. We also ask ourselves whether it is sensible to use the same judges who would decide a dispute in court as pretrial mediators.

**The protection of judges' independence and freedom from instructions** is a decisive factor for future jurisprudence. Therefore fulltime judges should be appointed who are forbidden to undertake any other activities and who are not only independent from the government of a contracting state, but also from the influence of possible investors. In our opinion the latter consideration is not addressed sufficiently in the draft. Remuneration of € 2,000 per month means it is impossible for registered judges not to undertake another professional activity, which in turn compromises their independence.

Strict incommensurability only exists in relation to other arbitration procedures. Furthermore, there may be no conflict of interest with regard to the independence and neutrality of members of the arbitration panel. A strict interpretation of these provisions can result in a high level of independence; conversely, a generous interpretation means that judges are assigned to individual cases and hence the members of the arbitration tribunal can continue to benefit from the structure of the system through their position as judge in a court in other commercial matters. A code of conduct is intended for the function of judge; however, since no consequences are linked to a violation of the code, this reduces the code of conduct to a non-binding recommendation. Furthermore no provisions have been formulated on how to remove a judge from office.

We still reject the fact that small and medium-sized companies will be able to undertake this procedure with a **single judge** in mutual agreement of the parties to the dispute. For reasons of legal security a panel of three judges should be stipulated.

We are most decidedly against the option of **"third party funding"** (Article 8). The possibility of financing a lawsuit by a third party poses the risk that more lawsuits will be brought and hence also that the intended mediation and consultation procedures are no longer seriously sought. On the other hand, the value of the matter in dispute could be set considerably higher in order to make the legal dispute correspondingly lucrative and interesting for the party financing the lawsuit. The intended transparency rules are by no means adequate.

**Fees and costs of proceedings**: The BAK is against setting the fees and expenses for arbitrators in individual cases according to the value of the matter in dispute. This form of remuneration means judges will have a personal interest in many cases with an especially high value in litigation, whereby the core criticism of the current ISDS remains unchanged. Therefore the amount of procedural costs must be defined. A maximum threshold for procedural costs or fees must be set according to the maximum amount of claims for compensation. When creating the role of amicus curiae, the allocation of costs should not act as a deterrent to participation, therefore no fees should be incurred in this case.

**Article 13** (3) regulates the applicability of legal provisions, whereby national legislation should not be applied, according to paragraph 3. However, it is unclear to what this regulation is ultimately referring. National substantive law especially can be material to a lawsuit, whereby the arbitration tribunal must decide whether this is the case. In that case provision must be made for the arbitration panel to request a binding interpretation of national or European laws from the relevant courts in a preliminary ruling.

The possibility of a review by the European Court of Justice with regard to the assessment of European legislative conformity of the decisions of the investment court is required, since it must be assumed that European legislative measures can also be of importance.

**Article 15 (Anti-circumvention provision)** is intended to prevent investors applying circumvention techniques (e.g. letterbox companies) from surreptitiously gaining the right to sue. The proposed text is very vague. Furthermore, the tribunal must prove in every case that an investor is using an evasion technique. The criticism of the BAK is that the proposed text by no means lives up to the aims, in particular since more specific formulations ("substantial business") are standard practice in other agreements.

**Safeguarding the rights of third parties:** The tribunal must, of its own accord, involve the parties affected in an appropriate manner by ensuring them due process of law without costs being charged. Key stakeholders such as trade unions and the regional authorities affected must be granted a significant role in the arbitration procedure.

**Transparency:** The BAK advocates provisions which go beyond the UNCITRAL rules. The agreement must be published even for settlements out of court. Furthermore, dissenting opinions of the tribunals must be made public. Particular attention must be paid to effective implementation of transparency rules.

**Investment Committee:** In our opinion the question of which competences this panel should have and how it should be composed is still open. Here, too, care should be taken that structures in accordance with the rule of law are not thwarted by the creation of such panels.

The BAK requests that our comments and demands be taken into consideration in Austria's evaluation and point of view in the ongoing discussion at a European level.

Should you have any further questions
please do not hesitate to contact

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