



**DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
POLICY DEPARTMENT**



RESPONSIBILITY IN INVESTOR-STATE ARBITRATION IN THE EU

INTA



DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE UNION
DIRECTORATE B
POLICY DEPARTMENT

STUDY

**RESPONSIBILITY IN INVESTOR- STATE-ARBITRATION IN
THE EU**

- MANAGING FINANCIAL RESPONSIBILITY LINKED TO INVESTOR-STATE DISPUTE SETTLEMENT
TRIBUNALS ESTABLISHED BY EU'S INTERNATIONAL INVESTMENT AGREEMENTS -

Abstract

The Lisbon Treaty extends exclusive European Union competence to foreign direct investment (FDI). In this context the issue of dispute settlement will be included in future EU Investment Agreements. For such situations the European Commission has put forward a draft proposal on how financial responsibility could be shared between the EU and/or a Member State (MS). The proposal aims to address possible conflicts that may arise between the EU/Commission and the respective MS when claims are brought under investment agreements or chapters concluded between the EU (or the EU and its MSs) and a third state. Moreover, the proposal deals with the representation of the EU or MS in arbitral proceedings.

The study provides background under public international law by setting out the responsibility of states and international organisations, and considers the financial reimbursement laws and policies of several federal states.

Further analysis is provided on the proposal's respective provisions on financial distribution, respondent status, settlement and the technical aspects of reimbursement. Particular attention is given to the external competence of the EU in relation to the internal competences of MSs, specifically with regard to standards of treatment. Other issues addressed include executive federalism with respect to allocating financial responsibility and the balance between unity of external representation and MS' interests.

The conclusions are largely based on the issue of internal/external competence, acknowledging the importance of the language of future investment agreements and chapters in clarifying some of these technical aspects.

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

AUTHORS:

Dr Christian TIETJE, Professor of Law, LAW SCHOOL OF UNIVERSITY HALLE, GERMANY
Emily SIPIORSKI, M.A., J.D., Senior Researcher, LAW SCHOOL OF UNIVERSITY HALLE, GERMANY
Grit TÖPFER, Senior Researcher, LAW SCHOOL OF UNIVERSITY HALLE, GERMANY

ADMINISTRATOR RESPONSIBLE:

Elfriede BIERBRAUER, Roberto BENDINI
Directorate-General for External Policies of the Union
Policy Department
WIB 06 M 055
rue Wiertz 60
B-1047 Brussels

Editorial Assistant: Györgyi MÁCSAI

LINGUISTIC VERSIONS

Original: EN

ABOUT THE EDITOR

Editorial closing date: 3 December 2012.

© European Union, 2012

Printed in Belgium

ISBN: 978-92-823-4015-8

Doi: 10.2861/94695

The Information Note is available on the Internet at

<http://www.europarl.europa.eu/activities/committees/studies.do?language=EN>

If you are unable to download the information you require, please request a paper copy by e-mail : poldep-expo@europarl.europa.eu

DISCLAIMER

Any opinions expressed in this document are the sole responsibility of the author and do not necessarily represent the official position of the European Parliament.

Reproduction and translation, except for commercial purposes, are authorised, provided the source is acknowledged and provided the publisher is given prior notice and supplied with a copy of the publication.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	5
INTRODUCTION	8
1. WHO WILL BEAR THE FINANCIAL RESPONSIBILITY IN A DISPUTE?	9
1.1 PRINCIPLES OF RESPONSIBILITY IN THE PROPOSAL	9
1.2 RESPONSIBILITY OF THE EUROPEAN UNION	9
1.3 GENERAL PRINCIPLES OF PUBLIC INTERNATIONAL LAW CONCERNING RESPONSIBILITY	10
1.3.1 State Responsibility	10
1.3.2 Comparative Analysis of Responsibility in Federal States	10
1.4 RESPONSIBILITY OF INTERNATIONAL ORGANISATIONS	14
1.5 ANALYSIS	16
1.5.1 External Public International Law Responsibility	16
1.5.2 Financial Responsibility	18
1.5.3 Joint/Shared Responsibility	19
1.6 CONCLUSION	20
2. WHO ACTS AS THE RESPONDENT IN A CLAIM?	21
2.1 OBLIGATION FOR CONSULTATIONS BETWEEN MS AND THE COMMISSION	21
2.2 COMMISSION'S DECISION	22
2.2.1 Role of the Commission and International Arbitration Law	22
2.2.2 Role of the Commission and MS under EU Law	23
2.2.3 Further Problems Arising out of the Exceptions of Article 8(2)	24
2.2.4 Possibility of Turning Down the Responsibility on Purpose?	25
2.2.5 Procedure under a Domestic Court of MS	26
2.3 CONCLUSION	26
3. SETTLEMENT	26
3.1 ROLE OF THE COMMISSION TOWARDS MS	27
3.2 DIPLOMATIC SETTLEMENT	27
3.3 CONCLUSION	28
4. INTERNAL SYSTEM OF PAYMENT/REIMBURSEMENT	28
4.1 PROPOSED PROCEDURAL SYSTEM	28

4.2	LEGAL PROTECTION	28
4.3	ENFORCEMENT?	29
4.4	CONCLUSION	29
5.	FINAL CONCLUSIONS	30

EXECUTIVE SUMMARY

The competence for foreign direct investment has shifted from the Member States (MS) to the European Union (EU) pursuant to Article 207(1) Treaty on the Functioning of the European Union (TFEU). This shift means that future investment agreements and investment chapters of free trade agreements will in most cases be negotiated between the EU and respective third states. Future EU investment agreements (or investment chapters in free trade agreements) may be either concluded by the EU or by the EU and its MS. The Commission has proposed a regulation for the management of financial responsibility when disputes are brought against the EU and/or a MS by a third state, namely in respect to the distribution of financial responsibility between the EU and MS as well as division of responsibility for representation and settlement agreements.

This study considers the proposed regulation with respect to financial distribution, representation, settlement and the internal system of payments. In writing the study, the authors analysed the Proposal of the Commission and its accompanying explanatory memorandum with respect to public international law, EU law, comparative law and arbitration practice.

Financial distribution

The proposed regulation provides that the EU bears financial responsibility when the treatment of the foreign investor/investment at issue was 'afforded by the institutions, bodies or agencies of the Union' or when the law or action in dispute was required by EU law. Where, however, a law or action was outside the scope of EU authority, the financial responsibility would be shifted to the respective MS.

Under public international law, a federal state is responsible for the actions of its subdivisions, including bearing (external) financial responsibility.

- Federal states have responded to this issue of management of financial responsibility in diverse ways. The Federal Republic of Germany has enacted legislation to ensure that the federal government may claim reimbursement of compensation it paid because of a violation of public international law by a *Land*, federal subdivision. Thus, the responsible *Land* bears the financial burden when its actions have caused the adverse claim. In contrast, neither the United States of America nor Canada has legislation or mechanisms in place to shift the burden away from the federal government. Constitutional restrictions would likely prevent implementation of reimbursement legislation.
- Similarly, international organisations may bear responsibility for the actions of member states where the behaviour was required by the organisation or the organisation aided or assisted the state in committing the action. The responsibility of the organisation is only in addition to the responsibility of the member state. The member state still maintains individual responsibility and the organisation's responsibility is secondary. However, international organisations may enact different rules to manage this responsibility.
- The proposed regulation distinguishes between external responsibility of the EU or MS under public international law and internal allocation of financial responsibility (explanatory memorandum, p. 4 et seq.):
 - As to (external) responsibility under public international law, the Commission is of the opinion that 'this has to be decided not by the author of the act, but on the basis of the competence for the subject matter of the international rules in question, as set down in the

- Treaty. In this perspective, it is immaterial that a Member State has competence under the rules on the internal market allowing it to legislate in its domestic sphere’.
- The distribution of financial responsibility in the draft proposal provides for allocation based on whether the EU or a MS has afforded the treatment in question with the exception on the side of MS that the ‘treatment was required by the law of the Union’.
 - It is questionable whether this distinction is convincing. On the one hand, one may argue that public international law grants the EU as an international organisation the possibility to provide for this distinction. On the other hand, one could be of the opinion that Article 207(6) TFEU will be undermined by this. Article 207(6) TFEU provides that the competences of the EU ‘in the field of the common commercial policy shall not affect the delimitation of competences between the Union and the Member States, and shall not lead to harmonisation of legislative or regulatory provisions of the Member States in so far as the Treaties exclude such harmonization’.
 - In contrast to WTO law, international investment law has a much broader scope of potential application. It essentially applies to any governmental measure with economic effects, and not only, such as WTO law, to measures discriminating foreign products or unduly restricting international trade. This difference is largely based on the existence of the ‘fair and equitable treatment standard’ in international investment law, which is unknown in trade law. The systemic difference between WTO law and investment law is even more obvious if one looks at dispute settlement. WTO disputes are exclusively between States and/or the EU. Investment disputes are with very few exceptions investor-State disputes. WTO law has no direct effect within the EU legal order. Investment law is inherently aimed at granting individual rights. Because of these distinctive features of investment law and arbitration, it is likely that the international responsibility of the EU with regard to a very broad investment agreement touches upon internal competence of the MS with the consequence that MS law has to be changed (harmonised) because of international responsibility of the EU. This would be contrary to Article 207(6) TFEU.
 - Moreover, as to the exception of financial responsibility of MS in case the ‘treatment was required by the law of the Union’, it is questionable whether this criterion provides sufficient legal certainty in light of the typical characteristics of EU executive federalism.
 - Already the execution and implementation of EU regulations is not entirely based on EU law, but in most cases concerns also national law of organisation of administration and certain administrative procedural issues.
 - This becomes even more complicated with regard to implementation of EU directives, as the method of implementation can vary. This varied application may result in diverse domestic rules concerning the respective directive. Therefore, a law required by an EU directive may result in an adverse claim in one MS, even where laws implemented under the same directive in other MS may not similarly result in such arbitral actions by investors. Similar problems arise in situations of gold-plating—a lack of clarity between what is in fact required by the EU directive and independent MS legislation, thus blurring the lines of responsibility.
 - Finally, the draft regulation proposes a system of financial responsibility for either the EU or the MS, and thus may disregard the possibility of joint or shared responsibility. This division may not adequately represent the complexity of interests involved in a dispute.

Respondent Status

The draft proposal divides the responsibility for representation in a manner similar to the division of financial responsibility where the EU maintains responsibility for its actions and the responsibility transfers to the MS where it is responsible. However, some important differences exist, based on the EU's responsibility within public international law: the EU maintains the right to act as the respondent in a claim where it determines that similar actions could be brought against other MS, where the EU could bear financial responsibility or where the MS has chosen not to act as the respondent.

- Consultations as well as cooperation between the EU and MS are required where there are shared interests. Although not expressly defined, these consultations should be conducted with trust and mutual respect. Nonetheless, this exchange of information may interfere with the general premise of confidentiality at the centre of arbitral practice. Transparency in arbitration is, however, of a high priority for the EU (and the EP). Thus, such consultations will respect this ideal of openness of information.
- The Commission has significant power to determine whether it acts as the respondent and consequently the role of the MS. This power must be expressly defined in the dispute settlement clause of respective future investment agreements. Moreover, the proposed regulation provides that MS may be required to comply with requests by the EU to support a specific legal position in order to maintain unity of external representation. In addition, where the EU chooses to act as the respondent—even where it only bears part of the financial interest—it is important to maintain the MS's right to defend. In this regard, the draft proposal provides that the MS and the EU would be in cooperation in the defence and thus considers the interests of both the MS and the EU.
- Some of the provisions on representation may not be definite enough and also disregard the absence of any requirement to apply precedent in investment arbitration. For example, it may be difficult to predict where an issue may arise in another dispute with a MS. Moreover, allowing the EU to act as the respondent where 'the dispute raises unsettled issues of law' may allow too broad application of the exception.

Settlement

The procedures of the draft proposal allow settlement, an important alternative to taking a dispute to an arbitral panel. When acting as the respondent, the EU may choose to settle. Where, however, the MS partially afforded the treatment, consultations are required. The Commission maintains the power to override a MS's position on settlement where EU interests are involved. Either forcing a MS to settle or preventing a draft settlement agreement proposed by a MS may not fully respect the interests of the MS. The purpose of settlement often extends beyond simple resolution of a dispute and also includes maintenance of good relations with investors. Thus, the 'overriding interests of the Union' to either demand or prevent settlement should be balanced against MS interests. Moreover, it is not entirely clear why rules of comitology apply to settlement but not to the arbitral procedure as such.

Internal System of Payment/Reimbursement

The Commission can adopt a decision, after consultations with the MS, regarding reimbursing the EU for an award when the EU acted as the respondent. A decision could be adopted either before or after the arbitral proceedings. Where the MS disagrees, the Commission can be sued at the ECJ. Under Articles 258 and 259 TFEU, mechanisms exist in EU law to provide safeguards for refusal to pay.

Investors would not be impacted by the internal distribution of payments. However, enforcement under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to which the EU is not a contracting party, should be confirmed in order to provide legal certainty for third-state investors.

Conclusions

The draft proposal is comprehensive and anticipates many of the internal issues that could arise in the context of investor-state disputes. However, some matters should be considered in respect to the proposal and in light of the differences between the EU and federal states. First, several rules in the proposed regulation are dependent on the language of future investment agreements and investment chapters of trade agreements. Thus, complete understanding of the proposal is in part dependent on the provisions of these future agreements. Second, the external competence of the EU over foreign investment may not impact the internal competence of MS over matters related to foreign investment (Article 207(6) TFEU). Moreover, some technical details need further clarification.

INTRODUCTION

The following study analyses the European Commission's proposal to manage payment burdens and representation responsibilities in investor-state arbitration. The study specifically addresses the Proposal for a Regulation of the European Parliament (EP) and of the Council 'establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international investment agreements to which the European Union is a party'.¹ This proposal provides a set of rules for managing the distribution of payment of costs and awards in investor-state dispute claims established under an international investment agreement of the European Union (EU).² In particular, the draft regulation defines the responsibility of the EU and the Members States (MS), allocating the representative and financial responsibilities when an investor from a non-EU state brings an investment claim. In the proposal, the Commission has identified internal conflicts that may arise in investor-state disputes and has clarified many of these points.

The EU has gained exclusive competence over foreign direct investment through the Treaty of Lisbon since 1 December 2009, according to Article 207(1) Treaty on the Functioning of the European Union (TFEU).³ Although the Energy Charter Treaty (ECT)⁴ is currently the only agreement to which the EU is a contracting party that provides the possibility of investor-state dispute resolution, most future investment treaties will likely be concluded between the EU and respective third states. Thus, the regulation will gain importance for the commitments of the EU and the MS to external investors.

At the core of the draft regulation is the allocation of financial responsibility. This study specifically addresses financial responsibility in four parts. First, with consideration to public international law and comparative law, the study considers the allocation of financial responsibility in a federal state. Second, the study will turn to the provisions on Respondent status, addressing the procedures for determining

¹ COM(2012) 335 final.

² COM(2012) 335 final.

³ For details see e.g. Christian Tietje, 'Die Außenwirtschaftsverfassung der EU nach dem Vertrag von Lissabon', Christian Tietje & Gerhard Kraft (eds.), *Beiträge zum Transnationalen Wirtschaftsrecht*, Heft 83, January 2009, available at: <<http://www.jura.unihalle.de/telc/publikationen.html>> (visited 10 October 2012).

⁴ The Energy Charter Treaty (Annex 1 to the Final Act of the European Energy Charter Conference), available at: <http://www.encharter.org/fileadmin/user_upload/document/EN.pdf> (visited 30 September 2012).

whether the Commission or the MS acts as the respondent in an investment dispute. Third, the study will consider the procedures for settling awards before taking them to tribunals. Finally, the technical system of payments will be analysed.

1. WHO WILL BEAR THE FINANCIAL RESPONSIBILITY IN A DISPUTE?

1.1 Principles of Responsibility in the Proposal

The proposed regulation provides that the EU bears financial responsibility when the treatment of the foreign investor/investment at issue was 'afforded by the institutions, bodies or agencies of the Union' or when the law or action in dispute was required by EU law. Where, however, a law or action was outside the scope of EU authority, the financial responsibility would be shifted to the respective MS (Article 3 (1)).⁵

However, this concerns only questions of financial responsibility. The proposed regulation distinguishes between external responsibility of the EU or MS under public international law and internal allocation of financial responsibility.⁶ As to (external) responsibility under public international law, the Commission is of the opinion that 'this has to be decided not by the author of the act, but on the basis of the competence for the subject matter of the international rules in question, as set down in the Treaty. In this perspective, it is immaterial that a Member State has competence under the rules on the internal market allowing it to legislate in its domestic sphere'.

1.2 Responsibility of the European Union

Article 47 of the Treaty on the European Union (TEU) provides that the EU is considered a subject of public international law, thus allowing for the conclusion of treaties.⁷ Such status also allows the EU to be a party to international arbitration proceedings.⁸ Despite the power of the EU to conclude treaties, it is not considered a 'state' under public international law since it is an international organisation.⁹ Thus, from the perspective of public international law, rules on 'state' responsibility are not directly applicable to the EU. Instead, as the EU is an international organisation, the special rules on responsibility of international organisations that have been developed in the international legal order must be considered. However, taking into account the supranational character of the EU and thus systemic differences from 'ordinary' international organisations, one should also consider federal domestic law, EU law and, where applicable, specific rules and principles of international arbitration law.

⁵ Articles referred to in this study without further explanation are those of the proposed regulation, COM(2012), 335 final, 21 June 2012.

⁶ COM(2012) 335 final, Explanatory Memorandum, p. 4 et seq.

⁷ Conclusively confirming: Declaration no. 24 ('Declaration concerning the legal personality of the European Union') filed in the declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, available at: <<http://eur-lex.europa.eu/Notice.do?val=476044:cs&lang=de&list=512388:cs,476044:cs,464742:cs,514696:cs,-388192:cs,&pos=2&page=1&nbl=5&pgs=10&hwords=Rechtspersönlichkeit%20der%20Europäischen%20Union~&checkboxtext e=checkbox&visu=#texte>> (visited 30 September 2012).

⁸ ECJ, Opinion 1/91, 1991, ECR I-6079, para. 40.

⁹ Christoph Vedder, in: Waldemar Hummer & Walter Obwexer (eds.), *Der Vertrag von Lissabon*, Nomos, Berlin, 2009, p. 289.

1.3 General Principles of Public International Law Concerning Responsibility

1.3.1 State Responsibility

Under public international law, a contracting state has liability for any wrong committed by the state. This responsibility extends to the actions of regional governments.¹⁰ Therefore, when a municipal or regional law or action causes the wrong, the contracting state remains liable. In other words, the subject of international law, the contracting state, maintains general responsibility for external actions, disregarding the internal responsibility.¹¹ The International Court of Justice (ICJ) has held that in international law, 'the domestic distribution of functions between federated entities is irrelevant.'¹² In public international law, only the state itself will be the respondent in a claim.¹³ Similarly, under Article 4 of the International Law Commission (ILC) Articles on State Responsibility for Internationally Wrongful Acts¹⁴, a state is responsible for actions of governmental subdivisions.¹⁵ This principle of responsibility has been affirmed in several arbitration cases as well as by the World Trade Organization (WTO).¹⁶

This idea that the central government maintains responsibility for actions of subdivisions can also be seen in the Vienna Convention on the Law of Treaties (VCLT). Article 29 provides that a treaty is binding upon a party with respect to its entire territory.¹⁷ Reading this provision in conjunction with Article 26 which provides that the treaty must be performed by the state in good faith, this could be understood to also fulfil the financial responsibilities of the entire state where a treaty breach has occurred.¹⁸ Therefore, regardless of the internal regulations, a contracting party can be assured of the fulfilment of the treaty.

1.3.2 Comparative Analysis of Responsibility in Federal States

Federal states must recognise the international responsibility for actions of the governmental subdivisions. The central state alone, and not the subdivisions of a federal state, will be responsible for a

¹⁰ James Crawford, *Brownlie's Principles of Public International Law*, 8th Edition, Oxford Univ. Press, Oxford, 2012, pp. 547-548.

¹¹ Robert Jennings & Arthur Watts, *Oppenheim's International Law*, Vol. 1, 9th Edition, Oxford University Press, Oxford, 1996, § 76 (pp. 253 et seq.); Aleksej Muchanov, 'Die völkerrechtlichen Verträge der Europäischen Union', *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 66, 2006, pp. 737-768, p. 743.

¹² *LaGrand (Germany v US)*, Provisional Measures, ICJ Reports 1999, pp. 9, 16; James Crawford, *Brownlie's Principles of Public International Law*, pp. 547-548.

¹³ Robert Jennings & Arthur Watts, *Oppenheim's International Law*, § 76 (pp. 253 et seq.); W. Kluth, *Föderalismusreformgesetz*, Art. 104a GG, para. 12; J. Hellermann, in: von Mangoldt, Klein & Starck (eds.), *GG-Kommentar*, Band 3, Vahlen Franz, Berlin, 2005, para. 194.

¹⁴ International Law Commission, Draft Articles on State Responsibility of States for Internationally Wrongful Acts, 2001, Res. 56/83 of 12 December 2001, available at: <http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/9_6_2001.pdf> (visited 30 September 2012)

¹⁵ Article 4 provides: 'The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State.'

¹⁶ *Metalclad Corporation v United Mexican States*, 2000, 119 ILR 615; *SD Myers Inc v Canada*, 2000, 121 ILR 72; Panel Report, *Australia-Salmon (21.5)*, WT/DS18/RW, 18 February 2000, §7.12.

¹⁷ Vienna Convention on the Law of Treaties, 23 May 1969, 1155 U.N.T.S. 331; Syméon Karagiannis, 'Article 29: Territorial Scope of Treaties' in: Olivier Corten & Pierre Klein (eds.), *The Vienna Convention on the Law of Treaties: A Commentary*, Oxford University Press, Oxford, 2011, pp. 731-763, p. 746.

¹⁸ Aleksej Muchanov, 'Die völkerrechtlichen Verträge der Europäischen Union', p. 749; Kirsten Schmalenbach, 'Article 26: *Pacta sunt servanda*', in: Oliver Dörr & Kirsten Schmalenbach (eds.), *Vienna Convention on the Law of Treaties: A Commentary*, Springer, Berlin/Heidelberg, 2012, pp. 427-451, p. 448.

breach; thus, it is irrelevant to the third state at which level the violation occurred.¹⁹ Where a federal state intends to limit its liability, it must independently construct legislation to distribute the responsibility away from the central government and to the governmental subdivisions. The following section will consider the manner in which Germany, the United States of America and Canada allocate financial responsibility specifically in the context of international investment arbitration.

a) Germany

The German Constitution, the *Grundgesetz* (GG), provides a basis for the division of financial responsibility within Germany. Supranational and international breaches of law are regulated by paragraph 6 of Article 104a GG.²⁰ This provision creates a set of rules for financial responsibility. Any action by the state is covered by Article 104a VI GG, including executive, legislative and judicial acts,²¹ and applies to new cases as well as cases in progress.²²

This law is based on the originator principle (*Verursacherprinzip*).²³ This means that the entity that has violated the obligation bears the financial responsibility for that breach. Within the Federal Republic, competences and general tasks have been allocated between the central state and the *Länder*, the federal subdivisions.²⁴ The financial responsibility follows this division, irrespective of actual fault (*verschuldensunabhängig*).²⁵ The division of responsibility between the central state and the federal subdivisions is regulated in Article 104a paragraph 6, 1st sentence GG. This division ensures that the government responsible for the action in dispute carries the financial burden.²⁶ The law also extends to breaches that occur because of judicial decisions.²⁷ When a regional court decides in accordance with an opinion from a federal court, the financial responsibility will be divided evenly between the central state and the federal subdivision. Finally, the law allows the central state to claim for reimbursement against a subdivision where liability was based on the actions of that government.²⁸

Although straightforward, problems arise when both the central state and subdivision violate an obligation. For example, if an EU directive is implemented after a deadline and both the federal state and *Länder* are obliged to implement the directive, then both entities would be responsible.²⁹ To address this issue, an implementing law (*Ausführungsgesetz*) to Article 104a GG was adopted, the *LastG*,³⁰ that ensures that only those federal subdivisions that have actually committed the breach of an obligation bear the financial responsibility.³¹ Where payment obligations must be shared, only a percentage of the amount will be carried by each.³² This apportionment is laid down in the *Königsteiner*

¹⁹ W. Kluth, *Föderalismusreformgesetz*, para. 12; J. Hellermann, *GG-Kommentar*, para. 194.

²⁰ Art. 104a (6) GG reads as follows: 'In accord with the internal allocation of competencies and responsibilities, the Federation and the Länder shall bear the costs entailed by a violation of obligations incumbent on Germany under supranational or international law. [...]'

²¹ W. Kluth, *Föderalismusreformgesetz*, para. 24; J. Hellermann, *GG-Kommentar*, paras. 198, 204.

²² BVerwG, NVwZ 2007, 1198 (1200); NVwZ 2008, 86 (86 et seq.); J. Hellermann, *GG-Kommentar*, Art. 104a GG, para. 199.

²³ BT-Drucks.16/813,S.19; W. Kluth, *Föderalismusreformgesetz*, Art. 104a GG, para. 12; J. Hellermann, *GG-Kommentar*, para. 203.

²⁴ GG, Arts. 30, 70 et seq. and 83 et seq. GG.

²⁵ BT-Drucks. 16/813, S. 19; W. Kluth, *Föderalismusreformgesetz*, Art. 104a GG, para. 26; J. Hellermann, *GG-Kommentar*, para. 206.

²⁶ W. Kluth, *Föderalismusreformgesetz*, para. 27.

²⁷ § 4 *LastG*.

²⁸ § 5 *LastG*.

²⁹ W. Kluth, *Föderalismusreformgesetz*, para. 27.

³⁰ Gesetz v. 5.9.2006 zur Lastentragung im Bund-Länder-Verhältnis bei Verletzung von supranationalen oder völkerechtlicher Verpflichtungen (*Lastentragungsgesetz – LastG*), BGBl. I, S. 2098.

³¹ § 1 II *LastG*.

³² W. Kluth, *Föderalismusreformgesetz*, para. 27.

Schlüssel, a special system that goes back to a state agreement in 1949 concluded in Königstein. According to this system, the amount that each *Länder* pays is calculated yearly: two-thirds according to the tax income and one-third according to its population.³³

b) United States of America

The United States bears responsibility for the actions of the individual states in the context of international law generally, and also specifically in international investment law. In the context of international investment agreements, the North American Free Trade Agreement (NAFTA) provides a basis for understanding the compatibility with federalism in the US international investment agreements. Although non-NAFTA-compliant state and local laws were 'grandfathered in' when NAFTA entered into force, no concessions were made for future non-compliant laws.³⁴ Therefore, in the early stages of NAFTA, there were few claims based on a local or state law. Beginning in 1998, claims have been brought based on state laws; none of these claims, however, have resulted in monetary awards.³⁵ The federal government has great interest in ensuring that the state and local laws are compliant with international trade and investment obligations as it bears legal, as well as financial, responsibility.³⁶ The relationship of the US states with the NAFTA agreement is regulated through 19 United States Code States § 3312(b). State representation is limited to the InterGovernmental Policy Advisory Committees and the Trade Representative assists the states in identifying non-compliant laws.³⁷ This limited involvement may in part explain the lack of basis for securing financial reimbursement from states in adverse awards.

The governments of US states are largely protected from actions in investment arbitration. NAFTA tribunals cannot compel a sub-government entity to change the contravening law.³⁸ The same principle applies generally in the context of investment arbitration. The US federal government, however, can compel a state to change a non-compliant law. Where a state government law is not compliant with trade obligations, 19 United States Code § 3312(b)(2) provides that the federal government can declare a respective state law invalid pursuant to NAFTA obligations.³⁹ The federal government, however, cannot bring suit against the state courts for retroactive payment of monetary damages that resulted

³³ W. Kluth, *Föderalismusreformgesetz*, para. 27.

³⁴ G. Alan Tarr, 'NAFTA and Federalism: Are They Compatible?', *Norteamérica*, Year 2, number 2, July-December 2007, pp. 133-160, p. 149.

³⁵ *Glamis Gold Ltd. v. United States of America*, Award, 8 June 2009; *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America*, Award, 12 January 2011; *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, Award, 26 June 2003; *Methanex Corp. v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 8 August 2005; *Mondev International Ltd. v. United States of America*, Award, 11 October 2002.

³⁶ G. Alan Tarr, 'NAFTA and Federalism: Are They Compatible?', pp. 149-150.

³⁷ 19 USC § 3312(b)(1)(B)(i); see also Intergovernmental Policy Advisory Committee (IGPAC), Charter, available at <<http://www.ustr.gov/about-us/intergovernmental-affairs/advisory-committees/intergovernmental-policy-advisory-committee-i>>. Criticism has been brought against the US federal government for its limited use of the IGPAC. In this regard, see Letter from Utah State Rep. Sheryl Allen to the US House Ways and Means Committee, available at <<http://www.forumdemocracy.net/article.php?id=537>> : 'With IGPAC's limited access to our federal trade representatives, and the absence of state and local elected officials on other trade advisory committees, I feel that the concerns of U.S. state and local governments are not afforded the consideration that they are due.'

³⁸ See generally G. Alan Tarr, 'NAFTA and Federalism: Are They Compatible?', p. 140; see also *Methanex v. United States*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005.

³⁹ 19 USC § 3312(b)(2): 'No State law, or the application thereof, may be declared invalid as to any person or circumstance on the ground that the provision or application is inconsistent with the Agreement, except in an action brought by the United States for the purpose of declaring such law or application invalid.'

from the non-compliant legislation.⁴⁰ A separate legislative act would need to be passed in order to provide a mechanism for monetary contribution by a US state. These limitations are largely based on the constitutional distribution of powers between the federal government and the states.⁴¹

c) Canada

The Canadian government is also limited in its ability to regulate the conduct of the provinces with regard to compliance with international investment agreement obligations. Constitutionally, certain areas of jurisdiction are reserved for the provincial governments.⁴² Legislative power is provided for in the Constitution Act, 1867, sections 91 and 92.⁴³ Section 91 provides *inter alia* that Parliament is authorised 'to make laws for the Peace, Order, and good government of Canada in relation to all Matters not [...] assigned exclusively' to the provinces.⁴⁴ Provincial legislatures may make all laws local in nature.⁴⁵ Even where a provincial measure is non-compliant with a treaty obligation, if that matter is within the jurisdiction of the provincial government, the federal government cannot force compliance with the treaty.⁴⁶

In contrast to the involvement of US states in negotiations, in Canada, the 'provinces demanded "full participation" in the negotiation of NAFTA and the federal government was quite willing to oblige, particularly given the crucial role that the provinces would have to play in the treaty's implementation.'⁴⁷ The interests of provinces are represented by the International Trade Advisory Committee and the fifteen Sectoral Advisory Groups on International Trade.⁴⁸ Nonetheless, there does not appear to be a constitutional mechanism nor are there any domestic laws or policies available to sue a province for monetary compensation.⁴⁹ Cases have been successfully brought against Canada based on provincial legislation, and despite statements by the federal government indicating a desire for the respective province to bear the financial burden, the federal government maintained responsibility.⁵⁰ The most recent example is the Canadian \$130 million Abitibi Bowater settlement which was the responsibility of the Canadian federal government.⁵¹

⁴⁰ *Pennhurst State School & Hospital v. Halderman*, 465 U.S. 89, 104 S. Ct. 900, 79 L. Ed. 2d 67 [1984]: '[F]ederal court[s] may award an injunction that governs [a state] official's future conduct, but not one that awards retroactive monetary relief'.

⁴¹ Article I, Section 8 of the U.S. Constitution provides that the federal government *inter alia* has the power '[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes; [...]'. In addition with regard to power of the federal government, treaty making power is within the authority of the executive branch under Article II, Section 2, Clause 2.

⁴² Laura Barnett, 'Canada's Approach to the Treaty-making Process, Legal and Legislative Affairs Division', Current Publications: Law, justice and rights, Current Publications: Law, Justice and Rights, 24 November 2008, available at: <<http://www.parl.gc.ca/Content/LOP/ResearchPublications/prb0845-e.htm>> (visited 5 October 2012).

⁴³ Laura Barnett, 'Canada's Approach to the Treaty-making Process, Legal and Legislative Affairs Division'.

⁴⁴ G. Alan Tarr, 'NAFTA and Federalism: Are They Compatible?', p. 146.

⁴⁵ G. Alan Tarr, 'NAFTA and Federalism: Are They Compatible?', p. 146.

⁴⁶ *Attorney General for Canada v. Attorney General for Ontario* [1937] 1 D.L.R. 673 (J.C.P.C.); Laura Barnett, 'Canada's Approach to the Treaty-making Process, Legal and Legislative Affairs Division'.

⁴⁷ G. Alan Tarr, 'NAFTA and Federalism: Are They Compatible?', p. 148. In this regard, a Committee of federal and provincial officials was developed (C-NAFTA) and met numerous times during 1991.

⁴⁸ Christopher J. Kuchucha, *The Provinces and Canadian Foreign Trade Policy*, UBC Press, Vancouver, 2008, pp. 108-109.

⁴⁹ Anonymous Telephone Interview with Employee of a Provincial Government, Department of Trade Negotiations and Dispute Resolution, 16 November 2012.

⁵⁰ *AbitibiBowater v. Government of Canada*, Consent Award, 15 December 2010 (Dispute was based on legislation passed by the Government of Newfoundland and Labrador which resulted in the loss of AbitibiBowater Inc.'s main assets in the province.); *Mercer v. the Government of Canada*, Notice of Intent, 26 January 2012; *Mobil Investments Inc. and Murphy Oil Corporation v. Government of Canada*, Notice of Intent, 3 August 2007 (Investors were awarded damages for research and development requirements by the provincial governments of Newfoundland and Labrador which were found to be in

d) General Conclusions

A key difference arises with regard to the federal systems described above in comparison to the EU proposal: the division of competences within a federal system may be clearer than the one within the EU. Thus, the possibility of a proportionate financial responsibility may be more easily applied in a federal state. For example, only the central state may be party to an international treaty. As a result, contracting parties to a treaty always can only make claims against the central state. With regard to the EU, future investment treaties may be concluded exclusively by the EU or as a mixed agreement by the EU and its MS. Where an EU investment agreement is mixed, and both the MS and the EU share competences, at least in theory a claim could be brought against either a MS or the EU.⁵² Moreover, even where competences are clearly distributed in federal states, such as the US and Canada, retroactively securing payments from regional governments can be difficult if not constitutionally impossible. Therefore, mechanisms must be in place to ensure that the EU can establish an effective regime for reimbursement.

1.4 Responsibility of International Organisations

The ILC issued Draft Articles on the Responsibility of International Organizations⁵³ in 2011. These rules provide a basic framework for the responsibility of an organisation when it is party to an international treaty. The Draft Articles also include a special provision that accounts for the particular structure of the EU. The draft proposal on financial responsibility follows the general rule as provided in these Draft Articles.

Chapter IV, Part II (Articles 14-19) of the Draft Articles deals specifically with the responsibility of an international organisation with regard to the actions of member states. When an organisation aids or assists the state in the wrongful act or where the organisation directs, controls the State or exercises coercion, the organisation bears responsibility for the actions of the member state. Furthermore, where an international organisation circumvents its international obligations by 'adopting a decision binding member States [...] to commit an act that would be internationally wrongful if committed by the former organization', the organisation maintains the responsibility for the wrongful act.⁵⁴ Similarly, where an international organisation authorises a member state to commit an act that circumvents its international obligations, the organisation bears responsibility.⁵⁵ The Draft Articles, however, only provide an additional layer of responsibility for the organisation.⁵⁶ State responsibility remains intact

violation of NAFTA Article 1106.); *GL Farms LLC and Carl Adams v. The Government of Canada*, Notice of Arbitration, 5 June 2006; *V.G. Gallo v. Government of Canada*, Award of the Tribunal, 15 September 2011 (The claim was dismissed based on lack of jurisdiction.).

⁵¹ Lawrence Herman, 'Federalism and International Investment Disputes', *Investment Treaty News Quarterly*, 12 July 2011, available at: <www.iisd.org/pdf/2011/iisd_itn_july_2011_en.pdf> (visited 5 October 2012).

⁵² Frank Hoffmeister, 'The European Union and the Peaceful Settlement of International Disputes', *Chinese Journal of International Law* 11, 2012, pp. 77-105, p. 81.

⁵³ International Law Commission, Draft Articles on State Responsibility of International Organizations 2011, A/66/10, available at: <http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/9_11_2011.pdf> (visited 30 September 2012).

⁵⁴ International Law Commission, Draft Articles on State Responsibility of International Organizations 2011, Art. 17.

⁵⁵ International Law Commission, Draft Articles on State Responsibility of International Organizations 2011, Art. 17.

⁵⁶ International Law Commission, Draft Articles on State Responsibility of International Organizations 2011, Art. 19.

and the organisation's responsibility may be 'secondary' or 'concurrent'.⁵⁷ The result may be the responsibility of both the member state and the organisation for the action in question.⁵⁸

A special provision, with respect to the EU has been adopted in Article 64 of the Draft Articles.⁵⁹ This article provides:

'These draft articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the international responsibility of an international organization, or of a State in connection with the conduct of an international organization, are governed by special rules of international law. Such special rules of international law may be contained in the rules of the organization applicable to the relations between an international organization and its members.'

This recognition for special regulations has been noted in several conventions and treaties. For example, Annex IX, Article 4 of the UN Convention on the Law of the Seas provides that international organisations shall be members to the treaty to the extent of its competence and such organisations are similarly required to recognize the rights and obligations of the treaty.⁶⁰ Article 24(2) of the Kyoto Protocol recognises similar rights and responsibilities for international organisations⁶¹: 'Any regional economic integration organization which becomes a Party to this Protocol without any of its member States being a Party shall be bound by all the obligations under this Protocol.' Sentence 3 of the same provision provides that the organisation clarifies the extent of its competence.

The EU has previously followed this designation of authority in international treaties. In a declaration by the EU concerning the ratification of Article 26 of the ECT, the EU noted that as both the EU and MS are parties to the ECT, it was possible that both are internationally responsible for fulfilling the respective treaty obligations.⁶² Based on the competences, it can be determined who is the party to the proceeding irrespective of the investor's ability to initiate proceedings against either.

⁵⁷ Andrew Stumer, 'Liability of Member States for Acts of International Organizations: Reconsidering the Policy Objections', *Harvard International Law Journal* 48, pp. 553-580, p. 555.

⁵⁸ C.F. Amerasinghe, *Principle of the Institutional Law of International Organizations, 2nd Edition*, Cambridge University Press, Cambridge, 2005, p. 68; Frank Hoffmeister, 'Litigating against the European Union and Its Member States – Who Responds under the ILC's Draft Articles on International Responsibility of International Organizations?', *European Journal of International Law* 21, 2010, pp. 723-747, p. 727

⁵⁹ Frank Hoffmeister, 'Litigating against the European Union and Its Member States – Who Responds under the ILC's Draft Articles on International Responsibility of International Organizations?', p. 729.

⁶⁰ Tillmann Rudolf Braun, 'For a Complementary European Investment Protection', in: Marc Bungenberg, Steffen Hindelang & Joern Griebel (eds.), *European Yearbook of International Economic Law, Special Issue: International Investment Law and EU Law*, Springer, Heidelberg, 2011, pp. 95-104, p. 102; Thomas Eilmansberger, 'Bilateral Investment Treaties and EU Law', *Common Market Law Review* 46, Issue 2, 2009, pp. 383-429, p. 396.

⁶¹ Tillmann Rudolf Braun, 'For a Complementary European Investment Protection', p. 102; Thomas Eilmansberger, 'Bilateral Investment Treaties and EU Law', p. 396.

⁶² Official Journal L 69/115 of 9 March 1998; Thomas Eilmansberger, 'Bilateral Investment Treaties and EU Law', p. 383.

1.5 Analysis

1.5.1 External Public International Law Responsibility

Although the European Court of Justice (ECJ) has indicated that international responsibility follows the division of competence between the EU and MS,⁶³ it is questionable whether this will always lead to a clear situation in which the EU is always comprehensively externally responsible under public international law, whereas MS only internally might have financial responsibility. This is the model followed by the proposed regulation. As already indicated, the draft proposal divides financial responsibility between the Commission and the MS depending on which has caused the investor's loss. Therefore, the EU bears financial responsibility when the treatment was attributed to institutions, bodies or agencies of the EU, and the MS maintains responsibility when the conduct arises from treatment by the MS. The proposal provides an exception to the basic rule of dividing financial responsibility where the MS 'treatment was required by the law of the Union.' However, this concerns only questions of financial responsibility. As to external responsibility under public international law, the Commission is of the opinion that 'this has to be decided not by the author of the act, but on the basis of the competence for the subject matter of the international rules in question, as set down in the Treaty. In this perspective, it is immaterial that a Member State has competence under the rules on the internal market allowing it to legislate in its domestic sphere'.

It is questionable whether this distinction is convincing. On the one hand, one may argue that public international law grants the EU as an international organisation the possibility to provide for this distinction. Article 64 of the Draft Articles of the ILC on Responsibility of International Organizations provides for this possibility.⁶⁴ On the other hand, Article 207(6) TFEU could be undermined by this division. Article 207(6) TFEU provides that the competences of the EU

'in the field of the common commercial policy shall not affect the delimitation of competences between the Union and the Member States, and shall not lead to harmonisation of legislative or regulatory provisions of the Member States in so far as the Treaties exclude such harmonisation'.

In contrast to WTO law, international investment law has a much broader scope of potential application. It essentially applies to any governmental measure with economic effects, and not only, such as WTO law, to measures discriminating foreign products or unduly restricting international trade. This difference is largely based on the existence of the 'fair and equitable treatment standard' in international investment law, which is unknown in trade law. The systemic difference between WTO law and investment law is even more obvious if one looks at dispute settlement. WTO disputes are exclusively between States and/or the EU. Investment disputes are normally investor-state disputes, with very few exceptions. WTO law has no direct effect within the EU legal order. Investment law is inherently aimed at granting individual rights.⁶⁵ Because of these distinctive features of investment law

⁶³ ECJ, Opinion 1/91, 1991, ECR I-6079, para. 33: 'The expression "Contracting Parties" is defined in Article 2(c) of the agreement. As far as the Community and its Member States are concerned, it covers the Community and the Member States, or the Community, or the Member States, depending on the case. Which of the three possibilities is to be chosen is to be deduced in each case from the relevant provisions of the agreement and from the respective competences of the Community and the Member States as they follow from the EEC Treaty and the ECSC Treaty'.

⁶⁴ This is not to say that Article 64 ILC is customary international law. This question shall be left undecided in this study.

⁶⁵ See, e.g., *BG Group Plc. v. Argentina*, UNCITRAL Arbitration, Award of 24 December 2007, para. 145; *Corn Products International, Inc. v. Mexico*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility of 15 January 2008, para. 167 et seq.; *Plama Consortium Ltd. v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction of 8 February 2005, para.

and arbitration, it is likely that the international responsibility of the EU with regard to a very broad investment agreement touches upon internal competence of the MS which may result in the consequence that MS law has to be changed (harmonised) because of the international responsibility of the EU. Changes would be contrary to Article 207(6) TFEU.

Thus, for example, even though the EU may⁶⁶ conclude an international investment agreement that applies also to investment in the area of education, the organisation and conduct of domestic education remains a regulatory competence of the MS.⁶⁷ Consider a situation where a third-country investor in the education sector claims that a certain legislative measure by the MS was in violation with the fair and equitable treatment standard of the bilateral investment treaty in force between the EU and the investor's home country. The investor brings a claim against the MS, but the EU, represented by the Commission, acts as the respondent. The Tribunal rules that the investment agreement has been violated. As the Tribunal has the authority to rule on both financial compensation as well as primary remedies,⁶⁸ it requires that the EU bring the MS's law in conformity with the investment treaty.

Taxation is another area of MS competence that could be affected by EU investment agreements. Investment agreements typically contain certain treatment standards (e.g. national treatment, most-favoured nation treatment, fair and equitable treatment). Moreover, investment agreements apply in general to any measure in any sector with regard to any investment. Thus, the agreements are not concluded with application only to specific economic sectors or governmental measures. Through application of the treatment standards, the EU may conclude an investment agreement according to Article 207 TFEU that also affects taxation measures.⁶⁹ Therefore, an investment agreement concluded by the EU always has the potential of touching on the exclusion internal competence of MS, including taxation.

In this respect, as already indicated the approach of investment agreements is different from, e.g., WTO law. The scope of application of WTO law is defined more precisely, namely because WTO has a strong focus on non-discrimination with regard to domestic measures (i.e. leaving aside border measures). Different to this, international investment law is potentially applicable to any governmental measure having some economic effects. This is due to the fact that investment law is not restricted to non-discrimination, but includes the fair and equitable treatment standard that does not exist in WTO law.

141; comprehensively Arbitrator *Rovine*, Concurring Opinion, in: *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/04/5 (NAFTA), Award of 21 November 2007, para. 17 et seq.

⁶⁶ This may be subject to the requirement of unanimity decision in the Council according to Art. 207(4) TFEU.

⁶⁷ Art. 165(4) TFEU: 'In order to contribute to the achievement of the objectives referred to in this Article: the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, after consulting the Economic and Social Committee and the Committee of the Regions, shall adopt incentive measures, excluding any harmonisation of the laws and regulations of the Member States.'

Art. 6 TFEU: 'The Union shall have competence to carry out actions to support, coordinate or supplement the actions of the MSs. The areas of such action shall, at European level, be: [...] (e) education, vocational training, youth and sport [...].'

Art. 2(5) TFEU: 'In certain areas and under the conditions laid down in the Treaties, the Union shall have competence to carry out actions to support, coordinate or supplement the actions of the Member States, without thereby superseding their competence in these areas.'

⁶⁸ For details see Anne van Aaken, 'Primary and Secondary Remedies in International Investment Law and National State Liability, A Functional and Comparative View', in: Stephan W. Schill (ed.), *International Investment Law and Comparative Public Law*, Oxford, 2010, p. 721 et seq.

⁶⁹ Christian Seiler, in: Eberhard Grabitz, Meinhard Hilf & Martin Nettesheim (eds.), *Das Recht der Europäischen Union*, Beck, Munich, 2012, Volume 2, Art. 113 AEUV, para. 12.

The obvious problem that occurs in these cases is that there is no strict and overall parallelism between external competences of the EU in the area of common commercial policy and internal distribution of competences between MS and the EU. This is clearly indicated by Article 207(6) TFEU. Thus, in the examples above, even though the EU may conclude an international investment agreement that applies also to investment in the area of education, the organisation and conduct of domestic education remains a regulatory competence of the MS. The same is also true with regard to taxation.⁷⁰

One could argue that this situation is a logical consequence of the external competence of the EU in the area of investment. However, with such argumentation, the remaining scope of application of Article 207(6) TFEU is unclear. Moreover, even though one might accept the describe consequences in cases in which the EU exclusively signed and ratified an international investment agreement, it is questionable whether this would also be a convincing solution if the investment agreement (or free trade agreement with an investment chapter) would be a mixed agreement.

1.5.2 Financial Responsibility

Article 3(1)(b) of the draft proposal provides that the EU would bear the financial responsibility when the law is the result of EU law. However, 'executive federalism', i.e. the decentralised structure of implementation and execution of EU law which characterises large parts of EU-MS relations,⁷¹ may cause specific problems with regard to the question of who should be financially responsible for violations of public international law in cases in which MS implement and/or apply EU law. When a MS transposes a directive into its national law, there is no single standard for implementation; instead a directive only requires that a MS achieve a certain result.⁷² In accordance with Article 288(3) TFEU, the ECJ consistently held that the form and method of implementing a directive was the choice of the MS, provided such implementation ensured effective functioning of the directive. In this regard, the MS does not simply incorporate the wording and terms of a directive, instead the MS is under the 'obligation as to the result to be achieved' and the directive is binding with regard to the specific aims.⁷³ The case law concerning implementation of directives provides that such literal transposition of the directive into a formal law by the MS legislature is not necessary. Instead, a general set of rules consisting of constitutional and administrative principles that guarantee the directives application is sufficient, provided the law is executed *de facto* and in its entirety.⁷⁴ However, a simple administrative circular is not sufficient to properly implement the EU law, in particular where a directive grants certain

⁷⁰ See Arts. 113 and 114(2) TFEU.

⁷¹ See e.g., *European Communities – Selected Customs Matters*, Report of the Panel of 16 June 2006, WT/DS315/R, para. 2.13: 'Community customs law is executed by the national authorities of the member States. This arrangement is referred to as "executive federalism". [footnote omitted] The principle of executive federalism within the European Communities reflects the principle of subsidiarity, which is enshrined in Article 5(2) of the EC Treaty, according to which the Community should take action only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the member States.'

⁷² Art. 288(3) TFEU.

⁷³ Opinion of Advocate General Geelhoed, ECJ, Case C-62/00, 2002, para. 31 (*Marks&Spencer*).

⁷⁴ ECJ, Case 29/84, *Commission v Germany*, 1985, 1661, para. 23, 28; Case 363/85, *Commission v Italy*, 1987, 1733, para. 7; Case 247/85, *Commission v Belgium*, 1987, 3029, para. 9; Case 262/85, *Commission v Italy*, 1987, 3073, para. 9; Case 252/85, *Commission v France*, 1988, 2243, para. 5; Case C-339/87, *Commission v Netherlands*, 1990, I-851, para. 6 et seq.; Case C-360/87, *Commission v Italy*, 1991, I-791, para. 11 et seq.; Case C-131/88, *Commission v Germany*, 1991, I-825, para. 6; Case C-361/88, *Commission v Germany*, 1991, I-2567, para. 15; Case C-59/89, *Commission v Germany*, 1991, I-2607, para. 18; Case C-58/89, *Commission v Germany*, 1991, I-4983, para. 13; Case C-190/90, *Commission v Netherland*, 1992, I-3265, para. 17; Case C-365/93, *Commission v Greece*, 1995, I-499, para. 9, Case C-433/93, *Commission v Germany*, 1995, I-2303, para. 18; Case C-96/95, *Commission v Germany*, 1997, I-1653, para. 35; Case C-340/96, *Commission v UK*, 1999, I-2023, para. 37.

rights to a person.⁷⁵ Because of the lack of conformity in MS laws implementing EU law, Article 3(1)(b) of the draft proposal may not be easy to apply in practice. The system of ‘executive federalism’ within the EU makes it hard to clearly identify whether ‘treatment was required by the law of the Union’.

Problems get even more intensive in case of ‘gold-plating’, i.e. situations in which national legislative bodies exceed the provisions of EU directives when implementing them into national law. Gold-plating typically leads to a situation in which it is legally highly complicated to identify those areas of a respective domestic law that are based on EU law and those that derive out of an autonomous decision of the MS. This is illustrated by the fact that the ECJ has jurisdiction for a preliminary ruling (Article 267 TFEU) in ‘gold-plating’ situations even if the respective provision of domestic law is outside the scope of legislative power of the EU.⁷⁶

Also in a situation of decentralised implementation of a regulation, the MS could be seen as an agent of the EU.⁷⁷ This could extend to where the regulation has not been correctly implemented. As a regulation is generally binding on the MS (Article 288(2) TFEU), a MS must apply a regulation with conformity, but only the ECJ is competent to declare a possible incompatibility with mandatory EU standards.⁷⁸ As such, the determination of whether implementation was in compliance with an EU directive will always need to be determined on a case-by-case basis. This again might raise concerns as to whether the formula ‘was required by the law of the Union’ is sufficiently clear in order to provide for legal certainty. Moreover, the possibility of an annulment procedure at the ECJ based on the application of Article 3(1)(b) of the draft regulation does not solve this problem; this would mean that legal certainty is never required as long as a court can decide at a later stage.

1.5.3 Joint/Shared Responsibility

SCENARIO A

An investor from State X brings a complex dispute against the EU. The claim is based on aspects of both EU law applied by the MS as well as independent MS legislation. The violations of treatment cannot be easily distinguished between EU and MS responsibility.

⁷⁵ ECJ, *Commission v Germany*, Case C-131/88, 1991, I-825; Case C-361/88, *Commission v Germany*, 1991, I-2567, para. 10 et seq.; Case C-59/89, *Commission v Germany*, 1991, I-2607, para. 9 et seq.; Case C-13/90, *Commission v France*, 1991, I-4327; Case C-14/90, *Commission v France*, 1991, I-4331; Case C-64/90, *Commission v France*, 1991, I-4335; Case C-58/89, *Commission v Germany*, 1991, I-4983, para. 14 et seq.; Case C-433/93, *Commission v Germany*, 1995, I-2303, para. 17 et seq.; Case C-96/95, *Commission v Germany*, 1997, I-1653, para. 38; Case C-315/98, *Commission v Italy*, 1991, I-8001, para. 10.

⁷⁶ ECJ, Case C-297/88, *Dzodzi*, ECR 1990, I-3763; Case C-231/89, *Gmurzynska-Bscher*, ECR 1990, I-4003; Case Rs. C-384/89, *Tomatis*, ECR 1991, I-127; Case C-88/91, *Federconsorzi*, ECR 1992, I-4035; Case C-73/89, *Fournier*, ECR 1992, I-5621; for further details on the problems that occur see, e.g., Frank Burmeister & Erik Staebe, ‘Grenzen des sog. gold-plating bei der Umsetzung europäischer Richtlinien in nationales Recht’, *EuR* 2009, pp. 444-457, pp. 445 et seq. Also, see generally Commission Staff Working Document: ‘Report on More Stringent National Measures Concerning Directive 2004/109/EC, On the Harmonization of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market’, SEC (2008) 3033 final (10 December 2008), available at <http://ec.europa.eu/internal_market/securities/docs/transparency/report_measures_122008_en.pdf> (visited 18 October 2012).

⁷⁷ Frank Hoffmeister, ‘Litigating against the European Union and Its Member States – Who Responds under the ILC’s Draft Articles on International Responsibility of International Organizations?’, p. 741.

⁷⁸ Frank Hoffmeister, ‘Litigating against the European Union and Its Member States – Who Responds under the ILC’s Draft Articles on International Responsibility of International Organizations?’, p. 741.

SCENARIO B

An investor from State X submits that the treatment standard was breached by MS legislation, and in the alternative, the treatment standard was breached as a result of the MS implementation of an EU directive. It is unclear which argument will be favoured by the tribunal.

There is no provision allowing for a dispute to be brought simultaneously against the EU and a MS. There are agreements that allow for joint responsibility and attempts made in international courts to affirm this joint responsibility.⁷⁹ For example, Article 7(3) of Annex IX of the UNCLOS⁸⁰ allows both the organisation and the member state to be liable.⁸¹ Joint responsibility could provide an alternative to the approach currently presented in the proposal. The issue of whether joint responsibility or the approach of the draft regulation of trying to identify 'single' responsibility of the EU or of a MS beforehand is more appropriate is essentially a political question and thus outside the scope of this study. However, one should consider that international investment law and arbitration as it currently stands grants the investor the right to bring a claim. 'Forum shopping' is thus not inappropriate behaviour by the investor but a logical consequence of granting investors the exclusive right to initiate an arbitral proceeding. Moreover, the draft regulation is based on '[t]he central organising principle [...] that financial responsibility flowing from investor-state dispute settlement cases should be attributed to the actor which has afforded the treatment in dispute'.⁸² Based on this principle, one could argue for allowing joint representation in a case of joint responsibility instead of referring to a possible procedure under Article 17 of the draft regulation. However, from a legal perspective it is, of course, also possible to choose a way of dealing with the issue as in the proposed regulation. The problem that remains concerns the fact that Article 17 of the draft regulation only deals with shared responsibility in a dispute in which the EU acts as the respondent. It is left open in the draft regulation how to deal with a case in which there is shared responsibility and a MS acts as the respondent.

1.6 Conclusion

The proposal provides a logical distribution of the financial responsibility of investor-state arbitral proceedings. However, one might discuss whether the distinction between fully and exclusive (external) public international law responsibility of the EU and internal distribution of financial responsibility is convincing and in line with Article 207(6) TFEU. This is not so much a problem for foreign investors. Rather, the fact that, in contrast to federal states, the MS of the EU are still competent under public international law in regulatory areas which may also be subject to investment agreements concluded by the EU,⁸³ raises the question whether it is sufficient to refer to competences of the EU with

⁷⁹ Andrew Stumer, 'Liability of Member States for Acts of International Organizations: Reconsidering the Policy Objections', p. 557 (noting the attempt by Yugoslavia to bring joint and several liability against ten NATO members).

⁸⁰ When an international organization and one or more of its member States are joint parties to a dispute, or parties in the same interest, the organization shall be deemed to have accepted the same procedures for the settlement of disputes as the member States; when, however, a member State has chosen only the International Court of Justice under article 287, the organization and the member State concerned shall be deemed to have accepted arbitration in accordance with Annex VII, unless the parties to the dispute otherwise agree.'

⁸¹ Frank Hoffmeister, 'The European Union and the Peaceful Settlement of International Disputes', p. 82. In that case, the EU has to accept the same procedures for the settlement of the dispute as the MS.

⁸² COM(2012) 335, p. 2.

⁸³ Consider, e.g., a situation in which a MS concludes a double taxation agreement with a third state and the EU concludes an investment agreement with the same state and that this investment agreement potentially applies also to taxation (which it would if taxation would not be explicitly excluded).

regard to foreign investment. The problem of external public international law responsibility also determines the issue of who should act as respondent in a specific investment arbitration.

2. WHO ACTS AS THE RESPONDENT IN A CLAIM?

Chapter III (Articles 4 to 11) of the Proposal provides for the distribution of responsibility for representation in an arbitral dispute. Similar to financial responsibility, where the EU has afforded the treatment, pursuant to Article 4, it will act as the respondent in the claim. Likewise, according to Article 8(1), the MS acts as the respondent where it has afforded the treatment. Exceptions are clear, however, thus allowing the EU greater liberty to act as the respondent, and consequently represent its interest. The first exceptions under the clauses of Article 8(2) allow the Commission to act as the respondent when (1) the EU may bear financial responsibility; (2) the treatment arises out of EU institutions, bodies or agencies; (3) similar claims may be brought; or (4) the dispute is based on unsettled issues of law that may arise again. The EU will also act as the respondent when the MS has not confirmed its intention to act as the respondent within 30 days. Both these categories of exceptions will be analysed in more detail below.

This distribution of authority by the Commission may create conflicts from the perspective of both the EU as well as the MS. The Commission may determine that one of the criteria under Article 8(2) has been met, and therefore, choose to act as the respondent. The MS may disagree with such determination. This situation could be particularly problematic where the MS is then financially responsible for the results. To ensure unity of external representation, the Commission has determined such distribution necessary.⁸⁴ The potential for conflicting arguments is a great risk to allowing the MS to act as the respondent in addition to the EU. Other problems with regard to division of competence and award of costs creates logistical problems with multiple respondents. Nonetheless, the question remains whether this distribution allows the MS sufficient authority in its actions.

2.1 Obligation for Consultations between MS and the Commission

In several provisions of the draft proposal, it is provided that the Commission and MS are obliged to notify, as well as consult, the other to provide for the necessary exchange of information. Articles 6 and 7 specifically provide for this exchange. Further, Articles 9(1) and 10 require cooperation between the EU and the MS. Once the Commission has been informed of a dispute, it must remain involved at all times. As part of this involvement, the Commission may also adopt a decision pursuant to Article 8(2). This provision is important because investment arbitration proceedings previously have been initiated without the Commission being informed by the MS.⁸⁵

The first concern with these requirements is that the scope of the consultations is not defined. The Commission and the MS may have certain expectations for these consultations, and in the event that the expectations are not met, an internal conflict may arise. However, it is questionable whether one could solve this problem in a legislative way. Any attempt to give clear guidance to required consultations could lead to overregulation. It seems to be sufficient to trust the duty of mutual respect and cooperation as it derives out of Article 4(3) TEU. Positive experience of the practice in WTO dispute

⁸⁴ COM(2012)335, p. 6 et seq.

⁸⁵ See e.g. the case of *Eastern Sugar (Eastern Sugar B.V. (Netherlands) v. The Czech Republic*, UNCITRAL ad hoc Arbitration, SCC No. 088/2004, Partial Award of 27 March 2007. See also Christian Tietje, 'EU-Investitionsschutz und -förderung zwischen Übergangsregelungen und umfassender europäischer Auslandsinvestitionspolitik', *EuZW*, 2010, pp. 647-652, p. 652.

settlement supports this. However, one should be aware of the fact that investment arbitration is conducted differently from the more diplomatic dispute resolution in the WTO context.

Despite the advantage to an exchange of information, Article 9(1) may interfere with the respect for confidentiality in arbitral proceedings.⁸⁶ In this regard, the UNCITRAL⁸⁷, the ICC⁸⁸ and the SCC⁸⁹ arbitration rules do not require publication of a dispute or disclosure of information. Transparency, however, is more established under the International Centre for the Settlement of Investment Disputes (ICSID). Investment arbitration and awards rendered under the ICSID Convention⁹⁰ are typically published. The need for more transparent proceedings in all venues is currently being internationally considered⁹¹ and is of high priority for the European Parliament.⁹²

Requiring a MS to disclose certain information to the Commission may be a point of contention for the MS depending on the dispute at issue. Nonetheless, by providing necessary legal advice to a MS in a dispute, the MS will be assisted by the Commission in defending its case. The Commission could enter into an agreement which ensured that the information remained confidential and was not published. This cooperation, of course, becomes more complicated where a MS is deliberately withholding certain information from the Commission, or where the information required to be shared for defending the case is contrary to the requirements under EU law.

2.2 Commission's Decision

Pursuant to Article 8(1)(a), the Commission can independently take the decision that the EU will act as the respondent when a situation described in the four clauses of Article 8(2) is present. This grants the Commission significant power to determine its responsibility in the dispute, especially without the consent of the respective MS. The question remains whether such power to decide is in conformity with the relevant arbitration laws and EU law in general.

2.2.1 Role of the Commission and International Arbitration Law

In order for such independent determination to be available to the Commission, future agreements need to expressly provide that the Commission/EU possesses this power. The possibility to unilaterally determine the respondent on the side of the EU is comprehensively dependent on a respective authorisation in an arbitration clause. Only if the applicable arbitration clause—as part of a respective investment agreement of the EU—provides that when a dispute has been brought by an investor against

⁸⁶ Stephen Woolcock, 'The EU approach to international investment policy after the Lisbon Treaty', Study for the European Parliament of 21 October 2010, p. 45, available at: <<http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=33990>> (visited 4 October 2012).

⁸⁷ UNCITRAL Arbitration Rules as revised in 2010, UN General Assembly Resolution A/RES/65/22 of 10 Jan 2011, available at: <<http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N10/513/86/PDF/N1051386.pdf?OpenElement>> (visited 16 October 2012).

⁸⁸ Rules of Arbitration of the International Chamber of Commerce, 2012, available at: <<http://www.iccwbo.org/WorkArea/DownloadAsset.aspx?id=2147489109>> (visited 10 October 2012).

⁸⁹ Stockholm Chamber of Commerce, Arbitration Rules, 2010, available at: <http://www.sccinstitute.com/filearchive/3/35894/K4_Skiljedomsregler%20eng%20ARB%20TRYCK_1_100927.pdf> (visited 10 October 2012).

⁹⁰ Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18/3/65, available at: <https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc_en-archiv/ICSID_English.pdf> (visited 30 September 2012).

⁹¹ See, e.g., Settlement of commercial disputes: preparation of a legal standard on transparency in treaty-based investor-State arbitration, Note by the Secretariat, UN General Assembly Doc. A/CN.9/WG.II/WP.172 of 2 August 2012; Stephen Woolcock, 'The EU approach to international investment policy after the Lisbon Treaty', p. 45.

⁹² See, e.g., 'Report on the future European international investment policy (2010/2203(INI))', Committee on International Trade, Rapporteur: Kader Arif, 22 March 2011, A7-0070/2011.

the EU, the EU has the possibility to determine the respondent through a unilateral decision of the Commission, will this determination be binding upon an international tribunal. However, if the arbitration clause applicable provides for the respective possibility, an international tribunal is bound to accept this.

Thus, as it is not yet clear to the public nor to the authors of this study what the language of investment chapters of future EU investment agreements with third states will provide, it is impossible to make a final legal assessment on this issue. The questions remains whether arbitration clauses negotiated by the Commission will be in conformity with both Articles 8 and 9 of the draft regulation and the applicable arbitration rules in a specific dispute, e.g. UNCITRAL arbitration rules, ICC or ICSID.

2.2.2 Role of the Commission and MS under EU Law

Both Articles 8 and 9 provide the Commission with significant power to regulate the conduct of the proceedings. Under Article 9(2) of the proposal, the Commission can require a MS to assert a specific legal position based on its interest to the EU. Article 9(3) further allows the Commission to request the MS to apply for an annulment, appeal or review of an arbitral award. The purpose of these provisions is to guarantee unity of external representation as well as the duty of cooperation as established in Article 4(3) Treaty of the European Union.⁹³ The proposal, however, fails to offer a remedy for situations where the MS chooses not to take the requested position, especially where the proceedings are then lost. Thus, general EU law would apply, namely Article 258 TFEU.

There may also be instances where the MS has no interest in applying for an annulment or considers such process to be without success. The proposal does not indicate whether the financial consequences will then be the responsibility of the MS. However, as both Articles 3 and 17 of the draft regulation do not provide for any exception, this seems to be the case. Whether the thus quite far-reaching power of the Commission according to Article 9(2) and 9(3) of the draft regulation causes legal problems has to be assessed on the basis of general EU law. Article 4(3) TEU specifically provides that the MS shall '[...] refrain from any measure which could jeopardise the attainment of the Union's objectives.' This commitment includes the obligations of the MS to cooperate, inform and consult whenever necessary to guarantee the unity and coherence of EU's international actions.⁹⁴ These obligations, however, have limits.⁹⁵ The commitments of Article 4(3) TEU bind not only the MS but also inversely oblige the organs of the EU to cooperate and support the MS⁹⁶, at least in the context of mixed agreements⁹⁷ as a possible scenario of future EU investment agreements. The EU is not allowed to act unilaterally or even centrally⁹⁸, arising also out of the obligation to respect the sovereignty of the MS under Article 4(2) TEU. Based on these duties, disproportionate intervention by the EU organs is thus prohibited.⁹⁹ Therefore, it must be analysed on a case-by-case basis whether the action by the EU organ—in this context, the Commission—has been disproportionate, taking into account the principle of proportionality from

⁹³ Recital No. 11, 13, COM(2012) 335 final, p. 17.

⁹⁴ Thorsten Kahl, in: Christian Calliess & Matthias Ruffert (eds.), *EUV/AEUV*, Beck, 2011, Art. 4 EUV, para. 54; Armin von Bogdandy & Stephan Schill, in: Grabitz, Hilf & Nettesheim, *Das Recht der Europäischen Union*, Volume 1, Art. 4 EUV, para. 97; Rudolf Streinz, in: Rudolf Streinz (ed.), *EUV/AEUV*, Beck, Munich, 2012, Art. 4 EU, para. 59; Christoph Vedder, in: Christoph Vedder & Wolff Heintschel von Heinegg (eds.), *Europäisches Unionsrecht*, Nomos, Baden-Baden, 2007, Art. 4 EUV, para. 21.

⁹⁵ Mauro Gatti & Pietro Manzini, 'External representation of the European Union in the conclusion of international agreements', *Common Market Law Review* 49, Issue 5, 2012, pp. 1703–1734, p. pp. 1728–1729.

⁹⁶ ECJ, Case C-339/00, *Ireland v Commission*, 2003, I-11757, para. 72.

⁹⁷ ECJ opinion 1/94 (*WTO*), 1994, I-5267, para. 108.

⁹⁸ Rudolf Streinz, *Europarecht*, Heidelberg, 2012, para. 170.

⁹⁹ Thorsten Kahl, Art. 4 EUV, para. 106.

Article 5(4) TEU. Elements of proportionality would include effects of the particular investment dispute on domestic legal structures of the respective MS, the concrete financial implications of the case or danger of factual precedence. In sum, the Commission is in principle allowed to adopt decisions where necessary provided that those decisions are proportionate.

2.2.3 Further Problems Arising out of the Exceptions of Article 8(2)

Generally, the authority given to the EU under Article 8(2) of the Proposal may be problematic in relation to the investors and the MS. In this regard, under Article 8(2)(a), it is unclear why the EU can act as the respondent even where it will bear only part of the financial responsibility. Leaving the MS out of representation in the dispute while still requiring that it maintain some financial responsibility could be interpreted as disregarding a MS's right to defend itself. Such a right to defend itself could follow out of Article 4(3) TEU with regard to the possible financial burden for a MS. Nonetheless, the right of the Commission to act as the respondent in such situations follows the standard within the proposal that the EU acts as the respondent where there exists an overall interest of the Union. Moreover, even where the EU only bears part of the financial responsibility, there is strategic advantage to having the Commission act as the respondent as there will be consultations with the MS. A MS's cooperation with the Commission and vice versa as provided for in Article 10 of the proposed regulation ensures that EU law as well the MS's interests are considered.

Another potential problem arises out of Article 8(2)(c) of the Proposal, in which the Commission may decide that the EU will act as the respondent when it is likely that similar claims will be raised against another MS. The basis for this situation could be considered as being thin as it is uncertain if a similar case may arise at any time in the near future. Thus, this provision may be too loose and, as a result, provide too much empowerment to the Commission. Moreover, every case is based on its own specific facts and would be decided on a case-by-case basis—newly and independently. This absence of precedent is a key aspect of arbitral procedures.¹⁰⁰ Even though arbitral tribunals in practice at least try to follow the decision-making practice of previous cases, it is hard to precisely predict the outcome of a specific dispute. However, even though these arguments could lead to the conclusion that Article 8(2)(c) of the proposed regulation is too vague, international arbitral practice and knowledge of the legal systems and administrative practice of MS probably will give sufficient guidance for a sound application of Article 8(2)(c).

Article 8(2)(d) allows the EU to act as the respondent when the dispute raises unsettled issues of law that may occur again in a dispute against another MS. Every dispute has unsettled issues of law—thus the need for a tribunal to hear the dispute. This, of course, does not only apply to the level of compensation due in a specific case, but to any aspect of interpretation and application of law. Thus, one could argue that it is dangerous to use such a broad standard to act as the respondent. Furthermore, as noted above, the lack of precedent in arbitration ensures that each case is heard and decided individually, so the relevance of the provision may be limited. However, it is of course also possible to make a similar argument as with regard to Article 8(2)(c), i.e. to point to arbitral practice as a factual circumstance for providing legal certainty. Article 8 provides no explanation for how the parties should proceed if an argument arises between the MS and the Commission about the determination of which acts as the respondent. Answers for this are addressed in the TFEU: a decision by the Commission can be reviewed by the ECJ in accordance with Article 263(1) TFEU and the MS has the opportunity to

¹⁰⁰ See, e.g., Andrés Rigo Sureda, 'Precedent in Investment Treaty Arbitration', in: Christina Binder, Ursula Kriebaum, August Reinisch & Stephan Wittich (eds.), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer*, Oxford University Press, Oxford, 2009, pp. 830–842.

raise a claim against the Commission under Article 263(2) TFEU. Despite this opportunity, such proceedings are time-consuming. This time factor might be a serious disadvantage for the investor involved. In addition, clauses providing deadlines for the settlement of disputes or filing a claim would be difficult to maintain under such circumstances. An investor must have the possibility to bring a claim even if an internal dispute persists past the deadlines. There are two possibilities to solve this problem: first, one could provide for special procedural rules, including rules on juridical review, in the regulation. This, however, would be subject to Article 251 et seq. TFEU, i.e. the rules on the ECJ and respective procedures in the Treaty. Second, it might be necessary to provide special arrangements in the arbitration clause in a respective investment agreement of the EU and a third state. Such a rule could, e.g., provide for the possibility of delay in the arbitral proceeding based on necessary EU internal procedures. Only if such specific provisions are included in an international investment agreement would an arbitral tribunal be obliged to respect a time delay on the side of the EU because of EU internal circumstances.

Furthermore, where the MS acts as the respondent, the role of the Commission and the EU in that defence is not clear, particularly as the Commission cannot adopt a decision regarding representation with reference to Article 8(2). Nonetheless, the interrelationship and necessity of consultations requires that legal advice be exchanged between the Commission and the MS at every point of the dispute, even where the MS is required to be the respondent. Details on this are laid down in Article 9(1) of the draft regulation.

2.2.4 Possibility of Turning Down the Responsibility on Purpose?

Article 8(1)(b) leaves the possibility that a MS may turn down responsibility by not reacting within 30 days after receiving the notice of initiation of the arbitral proceedings.

SCENARIO C

An investor from State X brings a claim against a MS, based entirely on MS law. The MS law had not yet implemented the EU directive. The MS has not confirmed its intent to represent itself in the proceeding. Pursuant to Article 8(1)(b), the Commission acts as the respondent. As the law at that time was not in conformity with the directive, the Commission is not well-informed to defend the MS law but must do so to avoid financial liability.

Certainly situations could occur where a MS would prefer not to be party to an arbitral proceeding and thus intentionally decline by not responding. For a financially weak MS, such option may be appealing. Although Article 17 regulates the reimbursement by a MS to the EU, a MS may choose to wait for those mechanisms to be put into place instead of simply accepting financial responsibility in the first instance. As the Commission¹⁰¹ maintains that the investor shall not be impacted by the internal regulation, the EU as the respondent would be required to manage an advance payment for the respective MS. This system of payments is normal once the EU acts as the respondent; however, it is at least politically questionable whether the MS should have the possibility to delay payment of compensation for breach of international obligations by using the possibility of Article 8(1)(b) of the draft regulation.

¹⁰¹ COM(2012) 335 final, p. 2.

2.2.5 Procedure under a Domestic Court of MS

No provision exists concerning what happens if the investor initiates the proceedings under a domestic court of the respective MS. The investment protection chapters or treaties generally provide for this scenario. Moreover, domestic law of MS may provide for the possibility that international treaties, including investment protection treaties, have a self-executing nature, i.e. under domestic law an individual may directly rely on such a treaty and bring a claim before a domestic court on the basis of the respective treaty. In such a situation, however, the Commission would not have the right to interfere into the domestic proceedings. Thus, the EU could not be the respondent in such a situation. As the possibility to participate in domestic court proceedings is a matter of domestic law of MS, this situation could not be changed by reference in a respective international investment agreement, at least not directly. Whether a MS might be obliged to change its domestic law in order to give the Commission the possibility to participate in domestic court proceedings concerning an international investment treaty is an open question that is outside the scope of this study.

2.3 Conclusion

In order for the determination of the respondent to be successful, there must be clear communication between the MS and the Commission. Although the consultation process provides for such communication, one could consider clarifying the steps involved. Without such clarity, problems could arise in the conduct of an arbitral proceeding. An investor may be uncertain about how to proceed in a claim. A MS may not support a unilateral Commission decision that stops it from representing itself. Finally, the Commission may be forced to step in where a MS refuses. These potential problems are largely considered in the proposal, but must be more clearly addressed, namely in the disputes settlement chapters of future EU investment agreements.

3. SETTLEMENT

An option to settle a dispute before taking it to an arbitral tribunal is an important alternative, providing savings of cost and time as well as avoiding potentially unnecessary proceedings.¹⁰² This option has been incorporated into the regulation in Chapter IV (Articles 12 to 14). The provision distinguishes (1) where the EU afforded the treatment, (2) where the MS partially afforded the treatment and (3) where the MS is fully responsible for the treatment afforded.

The basic rules provide that where the Commission has afforded the treatment, it may settle—provided that the settlement is in accordance with procedural issues. The Commission can approve such a settlement through an implementing decision, in accordance with the procedure of EU Regulation No. 182/2011, Article 5.¹⁰³ Thus, the rules of comitology, the regulation on the control of the Commission when implementing EU law by the MS, must be respected. This is the only time in the regulation where the rules of comitology are applicable.

Where the MS partially afforded the treatment and the EU acts as the respondent, there must be consultations between the Commission and the MS before the Commission can settle the dispute,

¹⁰² See the draft recital 16, COM(2012) 335 final, p. 17.

¹⁰³ Regulation (EU) No. 182/2011 of the European Parliament and of the Council of 16 February 2011, laying down the rules and general principles concerning mechanisms for control by the Member States of the Commission's exercise of implementing power, Official Journal L 55 of 28 February 2011, pp. 13-18.

pursuant to Article 13(1). This, of course, applies only where the Commission considers settlement to be within the interests of the EU. When the MS agrees, the Commission and MS together make the necessary arrangements for the completion of the settlement. When, however, the MS does not agree with the decision of the Commission to settle, the Commission may override the MS's decision and maintain that the settlement is within the interests of the EU. Such a settlement is subject to the examination procedure of Regulation 182/2011.¹⁰⁴

Where the treatment was exclusively afforded by the MS but the EU is acting as the respondent, the MS may settle under certain circumstances. First, the MS must accept any financial responsibility. Therefore, any settlement arrangements must be enforceable only against the MS. Also, the terms of settlement must be in compliance with EU law. Finally, the EU must not have any overriding interest against the settlement. The Commission may decide not to accept the settlement arrangement in accordance with the advisory procedure of Article 4, Regulation No. 182/2011.¹⁰⁵ Because the regulation of comitology requires the involvement of all MS, as they send representatives to a committee that assists the Commission, Article 3(2) Regulation No. 182/2011, the question remains whether it is necessary for all MS to be involved where only one will be responsible. This could be justified with reference to the fact that overall policy interests of the EU are always involved.

3.1 Role of the Commission towards MS

Similar issues regarding the Commission's ability to unilaterally act as the respondent also arise regarding settlement. The Commission is empowered in Articles 13(3) to settle a dispute that the MS does not want settled and in Article 14(3) to prevent a MS from settling. As already noted above, although the Commission may have the power to make these decisions, the interests of the MS must also be taken into consideration. To be entirely effective, the 'overriding interest of the Union' should be clarified. Furthermore, where conflicting interests may arise, those interests need to be balanced before the Commission unilaterally determines that settlement is the best alternative (Article 13(3)) or that it is not in the interest of the Union (Article 14(3)). At least some of the concerns in this regard may be resolved because of the applicable procedures of Regulation No. 182/2011.

3.2 Diplomatic Settlement

Where international disputes arise, even before initiating a formal request for consultations, an investment dispute may be settled by diplomatic actions rather than through formal arbitration procedures.¹⁰⁶ The regulations of Chapter IV do not apply to settlements prior to initiation of arbitral proceedings. Thus, there is legal uncertainty regarding what rules to apply when there are costs involved in the settlement. Namely, who is ultimately financially responsible?

The proposed regulation obviously does only apply to cases where consultations were conducted. As it stands, from a purely legal perspective diplomatic protection is an unattractive means of protecting an investment as there is no right to request such a settlement and local remedies must first be

¹⁰⁴ Applying the examination procedure essentially means that the Committee delivers a majority opinion which is binding on the Commission. The decision of the Committee may be subject to an appeal procedure. For details see Art. 5, Reg. No. 182/2011.

¹⁰⁵ See Art. 4(2) Reg. No 182/2011: '(1) Where the advisory procedure applies, the committee shall deliver its opinion, if necessary by taking a vote. If the committee takes a vote, the opinion shall be delivered by a simple majority of its component members. (2) The Commission shall decide on the draft implementing act to be adopted, taking the utmost account of the conclusions drawn from the discussions within the committee and of the opinion delivered.'

¹⁰⁶ August Reinisch, '§ 18 Die Beilegung von Investitionsstreitigkeiten', para. 5 et seq.

exhausted.¹⁰⁷ However, in practice ‘diplomatic protection’ in a non-technical sense, i.e. not in the formal sense of public international law but as an informal means of political and diplomatic support of economic interests of investors, is highly relevant and should not be underestimated.

3.3 Conclusion

Although a provision for settlement may be important for reducing costs of future disputes, it is equally important that this provision be considered in light of the needs of the MS in addition to the interests of the EU. The provision may need to more carefully account for the consequences of a settlement. Specific interests of MS in this regard could be, e.g., the maintenance of good relations to a specific investor and reciprocal investment opportunities in the home state of the investor for investors from the respective MS. It is not entirely clear whether specific interests of this kind could be outbalanced by ‘overriding interests of the Union’.

4. INTERNAL SYSTEM OF PAYMENT/REIMBURSEMENT

4.1 Proposed Procedural System

The investor can be assured that the Commission will pay an award or settlement. The procedure for payment of awards is only for internal regulation of payments. The draft regulation divides the responsibility for that payment between the EU and the respective MS. The proposed payment of final awards and settlements in Chapter V (Articles 15 to 19) is only applicable where the EU acts as the respondent. Thus, where the MS acts as the respondent, the MS is financially responsible.

Where the EU acts as the respondent but the Commission determines that the MS must pay, whether fully or partially, the Commission has several options. First, after consultations with the MS, the Commission can adopt a decision stating the amount that the MS must pay. This allows the EU to be reimbursed for the awards paid.¹⁰⁸ Where the MS objects to the decision by the Commission, the Commission can adopt another decision that similarly requires that the MS pay. Rather than waiting until after the award has been paid by the Commission, a decision could be adopted that requires the MS to make financial contributions prior to the proceedings.¹⁰⁹ These payments would be considered as internal assigned revenue, therefore, not impacting the EU budget. Where the tribunal determines that the investor is liable for the costs, the MS would be reimbursed.¹¹⁰

4.2 Legal Protection

When a MS disagrees with the assessment of financial responsibility, the MS can sue the Commission at the ECJ.¹¹¹ The ECJ could, depending on the circumstances of the respective case, be forced to consider the arbitral award in addition to the decision by the Commission. This could be necessary, e.g., in order to assess what kind of measure was giving rise to responsibility. Moreover, it is also possible that the ECJ could examine the award and find reasons for dismissal based on criteria in the New York Convention

¹⁰⁷ ICJ Report, *Interhandel* (Switzerland v USA), 1959, 6, p. 27; see also August Reinisch, ‘§ 18 Die Beilegung von Investitionsstreitigkeiten’, paras. 7, 8.

¹⁰⁸ Arts. 17(2), 17(3).

¹⁰⁹ Art. 18(1).

¹¹⁰ Art. 18(2).

¹¹¹ Art. 263 TFEU.

for the Recognition and Enforcement of Arbitral Awards (New York Convention).¹¹² Thus, the financial obligations of the MS would also need to be dismissed. The possibilities of revision of an award are, however, narrow.¹¹³ Therefore, even if review of the award was a mandatory element of the ECJ's consideration of a dispute, there is not significant likelihood that the award will be set aside. Nonetheless, the extent of the ECJ's scope of review should be established. This is even more relevant if one takes into account that the EU is legally not bound to the New York Convention in a strict sense. One could only argue that the EU and thus also the ECJ will consider the New York Convention because of the general 'friendliness' of the EU legal order toward public international law.¹¹⁴ However, at least in theory, it would still be possible for the ECJ to undertake a *de novo* review of an arbitral award without taking into account the limitation of the New York Convention. In such a situation, it could be possible for the ECJ to conclude that the award should not stand and thus does not lead to financial obligations of a MS according to Article 17 of the proposed regulation. Such an approach would seriously impair the integrity of the international arbitral system and in turn compromise the use of the system by the EU and MS.

4.3 Enforcement?

For enforcement of the awards, the Commission refers to the New York Convention and the ICSID Convention, in particular Article 54. The EU would always respect the obligation and it would be applicable to any agreement concluded by the EU.¹¹⁵ Property and assets of the EU must not be subject to administrative or legal measures without authorisation of the ECJ.¹¹⁶ Thus, for enforcement of an award against the EU (not a MS), the investor could bring the dispute to the ECJ for enforcement. Using the ECJ would be comparable to an investor bringing a claim for enforcement to the national court of the breaching state. This explanation of enforcement—currently only in the explanatory memorandum—should be included in the regulation in order to ensure consistent application and in order to provide legal certainty for third-state investors who could bring a respective enforcement action to the ECJ, even though such an enforcement action is unlikely.

4.4 Conclusion

The system of payments assumes a level of compliance by the MS. In situations where the Commission and the MS agree about the responsibility for the costs of the award, there is unlikely to be a problem with the system of payments as provided. Where, however, a MS is either unwilling or unable to meet its financial obligations, the provisions may not be sufficient. Especially in a situation where the Commission unilaterally decides on the financial responsibility, it may be difficult to completely secure the payment through the adoption of decisions. Also in this regard, where a breaching MS refuses to pay, it must be established that non-breaching MS will not be financially liable for those actions. However, namely Articles 258 and 259 TFEU (infringement procedures) should provide sufficient safeguard in this respect.

¹¹² UNCITRAL Convention on the recognition and enforcement of foreign arbitral awards, 1958, available at: <www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf> (visited 7 October 2012).

¹¹³ New York Convention, Art. V provides the criteria for grounds for refusal of recognition of an arbitral award.

¹¹⁴ See Art. 3(5) TEU: 'In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter.'

¹¹⁵ COM(2012) 335 final, pp. 7-8.

¹¹⁶ Art. 1 of Protocol (No 7) of the Privileges and Immunities of the European Union; see COM(2012) 335 final, p. 8.

5. FINAL CONCLUSIONS

The proposal provides a comprehensive plan for the distribution of financial responsibility. It anticipates many of the problems that may arise in investor-state disputes with the EU and MS. Thus, the scope and intent of the proposal is well-considered. Moreover, many of the problems that have been discussed in this study may never arise. However, it is important to realise that several rules of the proposed regulation legally depend on corresponding provisions in the arbitration clauses of future investment agreements or trade agreements with investment chapters of the EU with third states. Important parts of the proposed regulation will legally not be applicable if respective provisions in public international law agreements are non-existent. Further and independent of the scope of application of the external competence of the EU concerning foreign investment, MS will remain internally competent for substantial parts of actual treatment of investors, e.g. with regard to taxation. The intensity of internal regulatory competences of MS is a decisive feature which highlights certain differences between the position of a federal state and the position of the EU and its MS in international law.

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES

POLICY DEPARTMENT

Role

Policy departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

Policy Areas

Foreign Affairs
Human Rights
Security and Defence
Development
International Trade

Documents

Visit the European Parliament website: <http://www.europarl.europa.eu/studies>



ISBN 978-92-823-4015-8
doi: 10.2861/94695