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Does TTIP need investment protection provisions?

Oliver Sauer & Matthias Kullas

A particularly controversial issue in TTIP is the protection of foreign investors. Investment protection principally includes protection against expropriation, national treatment and most-favoured-nation (MFN) treatment. Normally, investor-state arbitral tribunals are set up for the purposes of implementation. cep's requirements:

- TTIP should not contain protection against expropriation without compensation. Laying down national treatment and MFN treatment is sufficient.
- Arbitral tribunals as a means of enforcing investment protection should be rejected. We advocate genuine judicial settlement of investment disputes by an international court.
- Its judges must be independent and, in particular, remunerated independently of the cases to be decided.
- For reasons of legal certainty, there should be an appeals system.
- We advocate giving the investor an immediate right of action against the host state under TTIP.

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1 TTIP under discussion

TTIP and investment protection is a hot topic at the moment.[1] TTIP stands for the "Transatlantic Trade and Investment Partnership" between the EU and the U.S. and is first and foremost a free trade agreement. Free trade refers to the removal of tariff and non-tariff barriers. As the name already indicates, however, there is more to it than that: It addresses not only "free trade" but also "investment protection". TTIP will contain provisions to that effect; this is part of the negotiating mandate given to the European Commission by the Council of the European Union.[2] Investment protection in particular is the subject of heated debate.

So far, there have been ten official negotiating rounds, the first in July 2013, the tenth and most recent in July 2015. On the European side, the European Commission is negotiating alone rather than together with the Member States. Leading the negotiations on the American side is the Office of the United States Trade Representative (USTR). The highly controversial question of investor-state arbitration was once again left out of the recently completed ninth round of negotiations[3] as well as in the tenth round which has just ended[4]. The European Commission had held a consultation on investment protection in TTIP in 2014, the results of which were published in a comprehensive report at the beginning of 2015.[5] Negotiations on this point are said to have been in abeyance since February 2014.[6]

The European Parliament (EP), for its part, adopted an own-initiative report on TTIP by the EP Trade Committee (INTA) on 8 July 2015. The version of the report adopted by the EP generally supports investment protection and rejects the existing investor-state arbitral procedures.[7] The plenary vote on the INTA Report was originally fixed for 10 June but had been postponed due to differences of opinion.

Since even the Commission's Transparency Initiative[8], launched under President Jean-Claude Juncker and the Commissioner for Trade Cecilia Malmström, has not succeeded in unearthing a draft chapter of TTIP on investment protection, - only accompanying documents[9] and recently a concept paper[10] have so far been published - here and in the following, we will also refer to the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada for the purposes of the analysis[11].

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[1] See e.g. Handelsblatt of 10, 11, 12 April 2015, No. 69 entitled "TTIP: Free trade or submission" (p. 1) and a 12-page special report (p. 48-59); 19 readers' comments in: Handelsblatt of 15 April 2015, No. 72, p. 12-13.

[2] See Council Document No. 11103/13 of 17 June 2013, Directives for the negotiation on the Transatlantic Trade and Investment Partnership between the European Union and the United States of America, para. 22 et seq.

[3] European Commission's Representation in Germany, Press Release of 16 April 2015, http://ec.europa.eu/deutschland/press/pr_releases/13240_de.htm (last accessed 19 July 2015).

[4] European Commission's Representation in Germany, Press Release of 17 July 2015, http://ec.europa.eu/deutschland/press/pr_releases/13511_de.htm (last accessed 19 July 2015).

[5] European Commission, Report SWD(2015) 3 of 13 January 2015, Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP), 140 pages.

[6] Kafsack (2015).

[7] European Parliament resolution of 8 July 2015 containing the European Parliament's recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP) (2014/2228(INI)) [Provisional edition], para. S. 2. (d) (xiii) et seq. = p. 18 et seq.

[8] See European Commission, Communication C(2014) 9052 final of 25 November 2014 concerning transparency in TTIP negotiations. The Commission's transparency initiative is not restricted to TTIP.

[9] Available at: http://trade.ec.europa.eu/doclib/press/index.cfm?id=1230 (last accessed 19 July 2015).

[10] European Commission, Concept Paper of May 2015, Investment in TTIP and beyond – the path for reform, http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF (last accessed 19 July 2015).

[11] The basis is the final draft published by the European Commission, dated: 26 September 2014, http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf (last accessed 19 July 2015).

2 Investment protection provisions: Subject and objective

Investment protection provisions relate to the protection of foreign investors from state - i.e. regulatory or statutory - intervention which reduces the value of the investment. Investment protection provisions are both in the domestic and in the foreign interest.

Foreign investors may, under domestic law, have less protection than domestic investors or may not even have sufficient protection at all. What is seen by foreign investors as a deficit in the national legal situation will be balanced out at international level by investment protection provisions placing investments by foreign investors under a separate legal system.

Investment protection provisions are in the interest of of the host state because they - at least theoretically - promote direct investments. Successful direct investments result in increased domestic income because they lead to a rise in capital stock which pushes up labour productivity and therefore earned income.[12] Direct investments also promote the distribution of new technologies and business practices.[13] This so-called knowledge spill-over may, for example, arise as a result of collaboration between a foreign and a domestic company or by moving employees from a foreign to a domestic company.[14] Knowledge spill-over has a positive effect on economic growth.

Investment protection under public international law does not necessarily have to be linked to free trade agreements on the removal of trade barriers. As a rule, it is contained, or at least used to be, in separate mainly bilateral investment treaties (BITs). Under newer free trade agreements though, such as CETA and probably also TTIP, it now forms an integral component, i.e. it is part of the overall political package.

Investment protection provisions in this sense include both substantive provisions (see Section 3 below) and procedural rules on their implementation (see Section 4 below).

3 Substantive investment protection

3.1 Scope

Irrespective of the question of enforcement, substantive legal provisions on investment protection provide the material basis for shielding investments from depreciation. In line with their objective, they relate exclusively to foreign investors and their domestic investments. Domestic investors are prevented from invoking them; their domestic investments are protected by domestic law.

This is already apparent from the definitions of "investment" and "investor". Thus, for example, CETA's definitions (Ch. 10 Art. X.3 CETA) are as follows:

> "For the purpose of this Chapter:
>
> … *covered investment* means, with respect to a Party, an investment: *in its territory*; … ; directly or indirectly owned or controlled *by an investor of the other Party*; …

[12] Investment also has advantages for the foreign investor because he receives a higher return on his investment than he would in his home state, otherwise he would have no reason for investing abroad.
[13] Cf. Felbermayr (2014), p. 471.
[14] Cf. Kerner (2009), p. 75.

> … *investor* means a Party, a natural person or an enterprise of a Party, other than a branch or a representative office, that seeks to make, is making or has made an *investment in the territory of the other Party*. …"
>
> [Our emphasis]

Substantive investment protection, in this sense, includes, in particular, protection against expropriation (3.1.1), national treatment (3.1.2) and most-favoured-nation (MFN) treatment (3.1.3).

3.1.1 Protection against expropriation

Protection against expropriation is a central pillar of investment protection under public international law. Although, in principle, every state has the right, on the basis of territorial sovereignty, to effect expropriation on its own territory, this is, in principle, not permitted without compensation. The question of whether and to what extent protection against expropriation constitutes customary public international law need not be considered here if and because the disputed points are explicitly regulated in investment treaties.

Thus protection against expropriation under CETA - as generally in investment treaties - includes both direct and indirect expropriation (Ch. 10 Art. X.11). Direct expropriation means official revocation of the owner's legal title by way of a state measure.[15] Indirect expropriation, on the other hand, means the de facto removal of the owner's right to dispose over property, without officially revoking ownership status.[16] In principle, both are only lawful, irrespective of the additional requirements, where there is "prompt, adequate and effective compensation" (Ch. 10 Art. X. 11 (1) d; known as the Hull Formula after the former U.S. Foreign Secretary). There is no legal consequence other than compensation or damages (cf. Ch. 10 Art. X.36 (1) CETA).

Notably, the distinction between protection against indirect expropriation, i.e. that which takes place without affecting the legal title, and mere restrictive regulatory measures, is a politically sensitive issue and has not been conclusively clarified (the problem of so-called regulatory takings).[17] CETA therefore attempts to achieve a legally binding definition by way of an Annex (Ch. 10 Annex X.11 CETA). This states that a measure does not constitute indirect expropriation inter alia where the state regulation is non-discriminatory and serves legitimate public welfare objectives, unless the measure is manifestly excessive in light of its purpose (Ch. 10 Annex X.11 (3) CETA).

3.1.2 National treatment

National treatment means that the foreign investor must be treated like a domestic investor, i.e. must be treated equally irrespective of nationality. This, by contrast with protection against expropriation, is not therefore an absolute, stand-alone standard of protection but a relative one which is inherently dependent on the domestic legal position.

The principle of national treatment is found in virtually all investment treaties, and thus also in CETA's chapter on investment protection (Ch. 10 Art. X.6 CETA). It should be borne in mind, however, that national treatment is not always strictly, i.e. formally, adhered to. First of all, a

[15] Inter alia Krajewski (2012), para. 599. Cf. also Ch. 10 Annex X. 11 (1) CETA.
[16] Cf. Dolzer/Schreuer (2012), p. 101; Krajewski (2012), para. 601 et seq. Cf. also Ch. 10 Annex X. 11 (1) CETA.
[17] See e.g. Krajewski (2012), para. 605 et seq.; Reinisch, in: Muchlinski/Ortino/Schreuer (2008), § 11 (3) (d) = p. 432 et seq.

suitable comparison must be established in order to prove discrimination, whereby it is arbitral practice to take account of the purpose of unequal treatment. Where unequal treatment has a "legitimate purpose", e.g. the protection of public security or public order, arbitral tribunals use this either to rule out unequal treatment or to justify it, thus preventing any claim for national treatment.[18] Furthermore, exceptions can also be expressly specified. Thus, CETA contains general exceptions covering the state's regulatory interests, e.g. health protection, and can therefore allow unequal treatment in this regard (Ch. 32 Art. X.2 CETA).

3.1.3 Most-favoured-nation (MFN) treatment

MFN treatment means that any foreign investor may rely on the most favourable provisions available even if the host state has only agreed these with a third country rather than with the investor's home state. Thus the investor can "cherry pick" what are for him the most favourable legal consequences.[19] There is often controversy as to precisely which provisions are covered by MFN treatment, usually in the absence of any express regulatory clarification on the point.[20]

CETA also contains the principle of MFN treatment commonly used in investment treaties (Ch. 10 Art. X.7 CETA). Noteworthy here is the fact that MFN treatment expressly does not apply to procedural rules on dispute settlement in other investment treaties or trade agreements (Ch. 10 Art. X.7 (4) 1 CETA). In other words, as far as arbitral procedures are concerned, it is clear that an investor cannot rely on the host's treaties with third party states, if and insofar as they contain more favourable procedural rules for investors. In addition to this, CETA's general exemption clauses, already referred to in relation to national treatment (3.1.2), also apply to MFN treatment so that here too, equal treatment, in this case with respect to investors from third countries, does not apply in a strict and formal sense.

3.2 Legal Assessment

Of particular interest from a legal perspective is whether the existence, or conversely the lack, of investment protection provisions, may breach the principle of equality. This applies equally to protection against expropriation (3.2.1), national treatment (3.2.2) and MFN treatment (3.2.3).

3.2.1 Protection against expropriation

Investment protection provisions apply exclusively to foreign investors.[21] This could constitute unjustified discrimination against domestic investors if, such as in the case of protection against expropriation, they granted foreign investors an absolute standard of protection, over and above questions of equality. Domestic investors may be better protected under domestic law than foreign investors so that discrimination and preferential treatment might be balanced. This is not necessarily the case, however.

[18] For more detail see Krajewski (2012), para. 628 et seq.
[19] E.g. Krajewski (2012), para. 631.
[20] Cf. Dolzer/Schreuer (2012), p. 270 et seq.; also Haltern, in: Ipsen (2014), § 34 para. 15, 103.
[21] See Sections 2 and 3.1.

A graphic example of this is provided by the dogmatic approach of the German fundamental right to property. Art. 14 Basic Law (GG) basically recognises expropriation in return for compensation and provisions defining content and limitations without compensation (in German: "Inhalts- und Schrankenbestimmung"). Indirect expropriation as such does not exist, however (any longer). Up until the Federal Constitutional Court's (BVerfG) landmark decision in the "Nassauskiesung" case[22], there was a material threshold beyond which the imposition of a charge could "tip over" into expropriation; thus, at that time, one could have called that an indirect expropriation. In any case, since then it has become passé. Provisions defining content and limitation are, at most, subject to compensation only in the exceptional case. Primarily, they can be warded off (if unlawful) or have to be accepted (if lawful).

The investment protection provisions under public international law diverge from this by granting compensation even in case of indirect expropriation (3.1.1). The question of whether and to what extent one type of protection can generally be considered better or worse than the other, and whether there are any valid criteria for such a comparison, need not be considered here.[23] Anyhow, it may, in the individual case, result in foreign investors receiving preferential treatment since they can "accept and take the cash". Domestic investors, on the other hand, have to try and get the charge withdrawn. The former is both a legal and an economic advantage - especially since return on investments is what matters to the investor. In this respect there is therefore discrimination against domestic investors. This is particularly true where the foreign investor enjoys protection under both public international *and* domestic law; i.e. he can cumulate the protection provided under both legal systems.

German case law[24] – unlike Austrian[25] – has so far refrained from objecting, on grounds of equality, to discrimination against local nationals arising under Union law. The background to this presumably is the idea that the national legislature's scope for discretion should not be weakened further; it should be able to regulate purely domestic matters on its own authority. In accordance with this case law, a breach of the principle of equality due to commitments under public international law must certainly be ruled out all the more.

3.2.2 National treatment

If and insofar as foreign investors are worse off under national law than domestic investors, the question arises whether this already constitutes a breach of the principle of equality which could, at the least, result in national treatment being claimed as of right in order to compensate for the domestic legal situation.

In fact, however, the question of whether foreign investors are at a disadvantage without investment protection provisions and have thus suffered a breach of their fundamental right to equality, does not arise at all in relation to liberties and fundamental freedoms. Without going into the merits, justification arises on the technical basis of the hierarchy of norms: Liberties under

[22] Federal Constitutional Court (BVerfG), Order of 15 July 1981 – 1 BvL 77/78, BVerfGE 58, 300.
[23] Cf. in this regard, on the one hand Schill (2014), p. 2 et seq. and passim; on the other hand Krajewski (2014), p. 2.
[24] Cf. e.g. BVerfG, Order of 8 June 2004 – 2 BvL 5/00 [ECLI:DE:BVerfG:2004:ls20040608.2bvl000500], BVerfGE 110, 412 (439); BVerfG, Order of 13 June 2006 – 1 BvR 1160/03 [ECLI:DE:BVerfG:2006:rs20060613.1bvr116003], BVerfGE 116, 135 (159 et seq.); also Federal Administrative Court (BVerwG), Judgment of 31 August 2011 – 8 C 9/10 [ECLI:DE:BVerwG:2011:310811U8C9.10.0], BVerwGE 140, 276 para. 44; Federal Court of Justice (BGH), Order of 19 September 2013 – IX AR (VZ) 1/12, Neue Juristische Wochenschrift (NJW) 2013, 3374 para. 31.
[25] E.g. Constitutional Court of Austria (VerfGH), Judgment of 9 December 1999 – G 42/99 and G 135/99, Europäische Zeitschrift für Wirtschaftsrecht (EuZW) 2001, 219.

national and Union law as well as the fundamental freedoms under Union law, which in some cases might provide less protection for foreign investors than domestic investors, are not subordinate to but on a par with the principle of equality. Thus, e.g. the fundamental right to property and the freedom to exercise an occupation under the Basic Law or the freedom of establishment under the European treaties, do not have to meet the principle of equality if and insofar as non-Germans or non-EU citizens are not entitled to them. For this reason alone, a breach of the principle of equality can be ruled out in this regard. From this angle, therefore, the principle of equality does not give rise to any necessity for investment protection provisions, not even for the relative standard of protection provided by national treatment.

A breach of the principle of equality is difficult to establish in any other respect too, however. The permissibility of state regulation is substantially laid down by liberties and fundamental freedoms. As a result of their inherent differentiation between nationals and non-nationals, however, it is unlikely that an argument, based on the principle of equality, will succeed against an otherwise lawful regulation. In any case, unequal treatment can essentially be justified simply on objective grounds[26]. These may also be purely economic grounds[27] – which are generally not difficult to assert.

3.2.3 MFN treatment

Protection against expropriation and national treatment both involve the comparison between foreign and domestic investors. In the context of MFN treatment, on the other hand, foreign investors from different third countries are treated equally; in this case, it is the comparison between the foreign investors that is relevant. The question is whether the foreign investors have to be treated equally by domestic institutions or whether unequal treatment would be permitted by law.

There are, in this regard, a variety of foreign, security and economic policy issues, through to geo-strategic considerations and interests which, individually or as a whole, may objectively justify unequal treatment. And even if we wanted to challenge this and assume a duty of equal treatment, this would still not determine the orientation of such equal treatment: "most-unprivileged-nation treatment" for all foreign investors would, at least theoretically, also be possible.

The principle of equality is therefore irrelevant with regard to the question of MFN treatment. Whether and to what extent foreign investors will be treated equally as between each other is primarily a political question. There is no legal duty to provide for MFN treatment.

3.2.4 Conclusion

The extent to which domestic and foreign investors must be treated equally is not significantly regulated by law. The issue is a political one. In this regard, economic factors play a major role (3.3).

[26] Cf. only Jarass, in: Jarass/Pieroth (2014), Art. 3 GG para. 17, 75a; Hölscheidt, in: Meyer (2014), Art. 20 CFR para. 22; both with comprehensive references to case law.
[27] Cf. also Schill (2014), p. 5.

3.3 Economic Assessment

The following section will consider whether protection against expropriation (3.3.1), national treatment (3.3.2) and MFN treatment (3.3.3) should be included in TTIP. Thereafter, there will be an overview of empirical investigations into whether investment treaties promote investment (3.3.4).

3.3.1 Protection against expropriation

Protection against expropriation without compensation aims to combat the risk that foreign investors will refrain from investing in the country concerned, or will only do so to a limited extent. From an ordo-liberal perspective, there is, in principle, no reason to object to protection against expropriation. Two problems may arise, however, depending on the actual design of the protection.

Firstly, protection against expropriation may make state regulation more difficult; this problem generally arises where the distinction between indirect expropriation and legitimate state regulation is unclear or the definition of expropriation is too wide. In this case, high compensatory payments to a foreign investor may accrue where a customary measure, for example under health or environment policy, constitutes an indirect expropriation.

In fact, in the past, foreign investors have brought proceedings against health and environment policy measures which have reduced the value of their investments. Examples of this are the actions brought by Philip Morris Asia Limited (Hong Kong) against Australia due to the Tobacco Plain Packaging Act[28] and by Vattenfall AB against the Federal Republic of Germany due to the phasing out of nuclear power ("Vattenfall II")[29]. A country which shies away from possible compensatory payments might refrain from imposing a regulation at an early stage (so-called regulatory chill).

The provisions on protection against expropriation contained in CETA do, however, leave room for state regulation as they make it clear that state measures that are non-discriminatory and serve legitimate public welfare objectives, do not in principle constitute indirect expropriation unless the legislative measure is manifestly excessive in light of its purpose (Ch. 10 Annex X.11 CETA). Thus there is no risk of regulatory chill.

Secondly, protection against expropriation may result in distortions of competition. This is the case where, due to expropriation, foreign investors are compensated but domestic investors are not (discrimination against local nationals). In Germany, there is risk of this happening particularly in the event of indirect expropriation because German law does not (any longer) recognise indirect expropriation giving rise to compensation.[30]

Since domestic investors - at least in Germany - are, in principle, not compensated in the event of indirect expropriation, it cannot be ruled out that, in individual cases, foreign investors will sometimes be placed in a better position. This would result in an unlevel playing field. Competition would consequently be distorted in favour of foreign investors.

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[28] For details see Permanent Court of Arbitration, http://www.pca-cpa.org/showpage.asp?pag_id=1494 (last accessed 14 July 2015).
[29] For details see Bernasconi-Osterwalder/Brauch (2014).
[30] See Section 3.2.1.

Against this backdrop, and taking account of the fact that both in the EU[31] and in the U.S.[32], there are already domestic provisions to protect against expropriation, it is doubtful whether rules protecting against expropriation without compensation should be incorporated into TTIP. Instead, the protection against expropriation available to domestic investors in the EU and the U.S. should also be consistently granted to foreign investors.

3.3.2 National treatment

National treatment aims to allow foreign investors to acquire, maintain and possibly extend or sell an investment under the same conditions as domestic investors.[33] This is necessary because the national legislation of some countries grants certain (protective) rights only to domestic companies.[34] An example of foreign investments receiving a lower level of protection can be found in the German Basic Law. Under the Basic Law, a distinction is made with regard to natural persons between basic rights only for Germans and basic rights for everyone. The latter, such as the right of ownership (Art. 14 GG), simply apply to everyone, the former, such as the freedom to choose and exercise a profession (Art. 12 GG), however, only apply to Germans (and, as the case may be, EU citizens[35]). With regard to legal persons, the following is true: the basic rights only apply to domestic legal persons (and, as the case may be, EU legal persons[36]) and only to the extent that the nature of such rights permits (Art. 19 (3) GG). Thus foreign investors may enjoy a lower level of protection.

Without national treatment, therefore, foreign investors might be subject to a competitive disadvantage which could deter them from investing.

Depending on how it is actually shaped and applied, national treatment can also make state regulation more difficult. This results in particular from the practice of creating (having to create) comparisons in order to determine whether there has been a breach of the principle of national treatment. Thus, for example, in the case Occidental Exploration and Production Company versus the Republic of Ecuador[37], Ecuador's refusal to refund value added tax to the company was regarded as a breach of national treatment. Although, in addition to Occidental, domestic companies in the oil industry were also affected by this regulation, the arbitral tribunal took Occidental's view that the national treatment rule also applied on the basis of a comparison with other sectors, in this case flower production. Ecuador was ordered to refund the value added tax.

The principle of national treatment guarantees that foreign companies will enjoy protection by way of the right to national treatment which otherwise only EU-domiciled companies would enjoy. CETA is not aiming to achieve full equality between foreign and domestic companies however. Instead, CETA contains exceptions which permit unequal treatment as to regulation. These exceptions are limited and only relate to certain state regulations, particularly those protecting health and safety. Such regulations are thus permitted even if they have a discriminatory effect.

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[31] See e.g. Art. 17 (1) CFR; Art. 1 (1) Protocol I ECHR; Art. 14 (3) Basic Law (GG).
[32] Fifth Amendment U.S. Constitution.
[33] Cf. Schill (2014), p. 5.
[34] Cf. European Commission, Public consultation on modalities for investment protection and ISDS in TTIP, http://trade.ec.europa.eu/doclib/html/152280.htm (last accessed 19 July 2015).
[35] Cf. BVerfG, Order of 19 July 2011 – 1 BvR 1916/09 [ECLI:DE:BVerfG:2011:rs20110719.1bvr191609], NJW 2011, 3428 para. 68 et seq., 75.
[36] BVerfG, Order of 19 July 2011 – 1 BvR 1916/09 [ECLI:DE:BVerfG:2011:rs20110719.1bvr191609], NJW 2011, 3428 para. 68 et seq., 75.
[37] London Court of International Arbitration, Final Award Case No. UN 3467, http://www.italaw.com/cases/761 (last accessed 14 July 2015).

Ch. 10 Art. X.6 CETA also contains a provision aimed at ensuring that comparisons only involve "like situations". Comparisons like that made in the case of Occidental Exploration and Production Company versus the Republic of Ecuador are thus to be avoided.[38]

Overall, the provisions contained in CETA relating to national treatment are suitable, on the one hand, for ensuring a level playing field for domestic and foreign investors and, on the other, for avoiding excessive restriction on state regulatory interests. Corresponding provisions in TTIP are recommended.

3.3.3 MFN treatment

MFN treatment protects foreign investors against discrimination as compared with other foreign investors. It is therefore complementary to national treatment which protects foreign investors from discrimination as compared with domestic investors. MFN treatment is necessary because otherwise one foreign investor might have a lower level of protection than other foreign investors.

The exceptions applicable to national treatment also apply to MFN treatment so that equal treatment - in this case compared to investors from third countries - is not strict and formal. These exceptions are appropriate for the reasons set out in Section 3.3.2.

Overall, the CETA provisions on MFN treatment largely avoid discrimination between foreign companies without excessively restricting the state's regulatory capabilities. We therefore recommend the use of identical wording in the TTIP provisions.

3.3.4 Do investment treaties result in more investment? – Empirical evidence

Economic literature contains numerous empirical studies looking at the question of whether investment treaties have resulted in more investment. The results on this are not clear-cut. Thus, for Germany, Egger/Merlo conclude that BITs do promote direct investment.[39] Kerner also comes to this conclusion.[40] Felbermayr, on the other hand, qualifies the positive link between investment treaties and direct investment. He cites an as yet unpublished study by the Ifo Institute which concludes that investment treaties only promote direct investment where courts in the host state are not independent.[41] The extent to which this is true of the EU states and the U.S. will be discussed in Section 4.

Tobin/Rose-Ackerman conclude that investment treaties have at best only a minor influence on direct investment.[42] In some countries the effect can even be a negative one. Only in countries where the risk of a violation of property rights is high, do investment treaties promote direct investment. The authors conclude from this that investment treaties in general do not fulfil their purpose. This is also confirmed by Peinhardt/Allee.[43] They have found, with respect to the U.S., that American investment treaties have resulted in an increase in direct investment in fewer than ten percent of cases.

[38] Schill (2014), p. 9 et seq.
[39] Cf. Egger/Merlo (2012).
[40] Cf. Kerner (2009).
[41] Cf. Felbermayr (2014), p. 472.
[42] Cf. Tobin/Rose-Ackerman (2003).
[43] Cf. Peinhardt/Allee (2012), p. 771.

From an empirical perspective it is therefore unclear whether investment treaties do actually encourage investment. Thus one cannot rule out the possibility that the investment protection provisions in TTIP will have no or very little influence on direct investment. All the more so since the general conditions for foreign investment in many EU states are already judged to be very good. Thus the EU states scored, for instance, an average of 10.14 from a maximum of 12 points in the Investment Profile Index of the PRS Group.[44]

3.4 cep's requirements for substantive investment protection in TTIP

The considerations presented give rise to two requirements regarding the incorporation of substantive investment protection provisions into TTIP:

(1) TTIP should not contain any protection against expropriation without compensation. Laying down national treatment and MFN treatment is sufficient for the protection of foreign investors.

(2) At the same time, equal treatment should, on the one hand, be strictly implemented in principle, but on the other hand, as with the CETA provisions on national treatment and MFN treatment, there should still be room for state regulation for reasons of public interest.

4 Investor-State Dispute Settlement (ISDS)

4.1 Scope

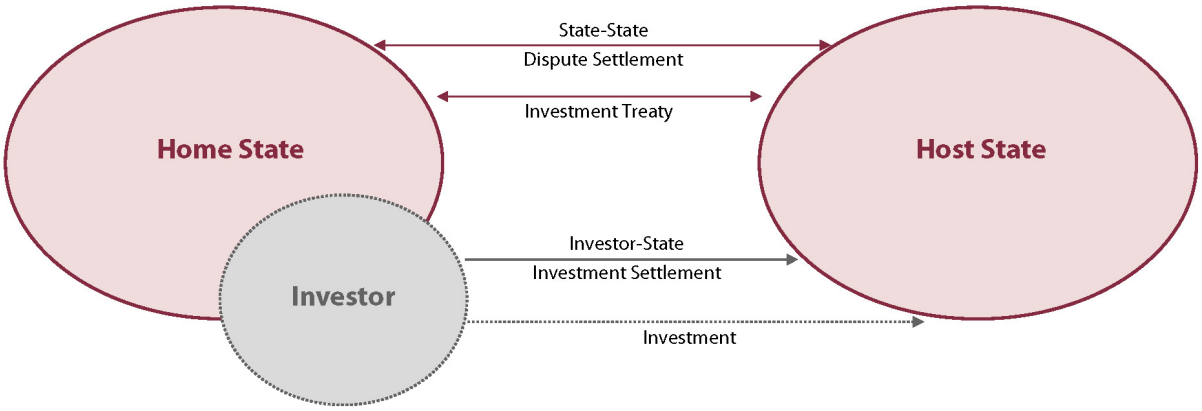
The substantive standards looked at in Section 3 will be of no help if and insofar as they cannot be enforced. Their enforcement is usually served by establishing an arbitral jurisdiction for dispute settlement between investor and state (Investor-State Dispute Settlement or ISDS).

The obligations under the investment treaty apply, at first, between the investor's home state and the state hosting the investment, i.e. at interstate level. It would therefore be possible - and quite probable - that the states involved would settle any divergences of opinion solely at interstate level as well, i.e. via a state-state arbitral tribunal, as, for instance, under the auspices of the World Trade Organisation (WTO).

Investor-state arbitration goes much further than that: by giving the foreign investor the possibility of making a direct claim based on the intergovernmental commitment between host and home state, it gives the investor a hybrid status (see Figure 1). Under this jurisdiction, foreign investors can assert their claims directly against the host state, i.e. bring arbitration proceedings directly against the host state without being reliant on their home state and its diplomatic protection.

[44] Cf. Poulsen/Bonnitcha/Yackee (2015), p. 7.

Figure 1: Investor-State Dispute Settlement (ISDS)



Source: cep

Investor-state arbitral tribunals are, as their name clearly indicates, arbitral tribunals. They proceed according to the rules of the International Centre for Settlement of Investment Disputes (ICSID), the rules of the United Nations Commission on International Trade Law (UNICTRAL) or similar rules agreed between the parties (expressly e.g. Ch. 10 Art. X.22 CETA: "any other arbitration rules on agreement of the disputing parties"). Despite claims to the contrary, investor-state arbitral tribunals are not formally institutionalised, e.g. "affiliated" to the World Bank (ICSID) or even the United Nations (UNCITRAL), but are set up on an ad hoc, case by case basis.[45] The arbitrators are generally designated by the parties from selection lists and are paid by the parties. There is no link to state or Union jurisdiction by way of appeal, and there are no regular stages of appeal either. Thus investor-state arbitral jurisdiction can be regarded as a separate private jurisdiction.

4.2. Need for a separate jurisdiction

It has been pointed out in the public debate, and not entirely without reason, that the investment treaty as an instrument was initially developed for protection in and vis-à-vis states where respect for the Rule of Law is not what it might be. It is therefore surprising that this instrument should now be applied to a relationship between states with highly developed judicial systems, i.e. between the U.S. and the EU. There is simply no need for it. The extent to which this assessment is accurate will be highlighted in Section 4.2.2. Firstly, however, Section 4.2.1 will look into the question of whether and to what extent, on the basis of legal doctrine, a separate jurisdiction is necessary.

4.2.1 Problem 1: Public international law in domestic courts

If there were no special public international law provisions for investors, no problem would exist. Foreign investors could then sue for what they were entitled to under domestic law and using the avenues open to them under domestic law. No more and no less.

[45] Krajewski (2012), para. 666; Schöbener/Markert (2006), p. 73. In the end also Griebel (2008), p. 114, 117.

However, where a separate system under public international law is set up by way of investment protection provisions, any reference to a functioning judicial system of justice is only valid if private individuals, in this case investors, can also invoke these provisions in the domestic legal system. In order to invoke such provisions they have to be directly applicable. If this is not the case, the possibility of asserting them *at all* disappears along with the possibility of obtaining redress within the domestic legal system - because if investment protection provisions do not apply at all then they cannot be applied by domestic courts either.

Whether and to what extent public international law provisions are directly applicable in the domestic legal system is a broad subject. It primarily depends on the shape which the individual legal provisions take. With regard to provisions of the World Trade Organisation, i.e. WTO law, the European Court of Justice (ECJ) has consistently rejected direct effect[46], as a result of which, Union and national law which conflict with WTO law cannot be - consequently - tested against it. For the avoidance of any doubt right from the outset, CETA contains an express clause stating that private individuals are not permitted to invoke the provisions of the treaty in the domestic legal system (Ch. 33 Art. 14.16 CETA).[47] Thus a front-line is removed - as is, due to non-applicability, the argument that the national or Union courts could clarify any contested issues which arise. As has been shown, that is not the case. Invoking the provisions of the international treaty is excluded making jurisdiction at international level for the purpose of enforcement essential.

In the case of TTIP - by contrast with CETA - one could consider not excluding direct applicability of the investment protection law or even making deliberate efforts to include it. In the former case, the question would come up for consideration in the courts and would have to be dealt with by way of case law. In the latter case, parties to the treaty would try, by way of the wording of the provisions and/or by express stipulation, to establish direct applicability themselves.

It is almost impossible to overstate the risks involved with this method of establishing direct effect. Although legal redress could then in fact be ceded to national and Union courts, and one would no longer have to fall back or be reliant on special international courts or tribunals, the consequences of this type of implementation of the substantive provisions are virtually incalculable. Since at least parts of the treaties are subject to EU competence[48], and therefore constitute Union law, enjoying primacy over national law - and even over secondary Union law[49] -, a comprehensive transformation of the legal system is a distinct possibility.

It is, in fact, unlikely to have the same clout as that of Union law's fundamental freedoms, which the ECJ has gradually upgraded from prohibitions of discrimination to prohibitions of restriction, the constitutive impact of which is still sometimes mistakenly underestimated after over five decades of case law. Thus, Union law's closest equivalent to national treatment is probably the general prohibition of discrimination (Art. 18 TFEU). Nevertheless, extreme caution should be applied here. There even is the debate as to whether investors could derive a right, under general principles of public international law, to the re-establishment of the status quo - i.e. in case of discriminatory laws their annulment[50] - which on the basis of the primacy of Union law could possibly take effect quasi-automatically. This is certainly a doctrinal worst-case scenario. However, it would certainly be prudent to expressly exclude, not only other remedies than compensation and/or damages

[46] See e.g. ECJ, Judgment Germany v. Council, C-280/93, EU:C:1994:367, [1994] ECR I-4973; Judgment Portugal v. Rat, C-149/96, EU:C:1999:574, [1999] ECR I-8395; ECJ, Judgment in Van Parys, C-377/02, EU:C:2005:121, [2005] ECR I-1465. The American courts apparently take a similarly restrictive line, see Herdegen (2014), § 10 para. 105.
[47] Thym (2015).
[48] Cf. to that in general Mayer (2014); especially as to investment protection Bungenberg, in: von Arnauld (2014), § 13 para. 6 et seq.
[49] Cf. Art. 216 (2), 218 (11) TFEU.
[50] Cf. Schill (2014), p. 26 et seq.; Marboe, in: Bungenberg/Griebel/Hobe/Reinisch (2015), § 9 I para. 15 et seq.

(cf. Ch. 10 Art. X.36 CETA), but also the direct applicability of the provisions (Ch. 33 Art. 14.16 CETA). TTIP should also therefore contain both exclusion provisions.

4.2.2 Problem 2: Judicial systems do not work everywhere

The question of whether TTIP should contain a separate jurisdiction is also contingent upon how well the judicial systems work in the U.S. and the EU Member States. This depends in particular on the independence of the judiciary. The judiciary is not independent if judges are (can be) influenced by the national government and authorities, companies or citizens. In that case, in order to obtain an appropriate judgment it is necessary to have an independent third party who is unbiased with regard to the interests of the defendant state.

The Global Competitiveness Report of the World Economic Forum contains a ranking of judicial independence.[51] Many EU countries have been awarded almost the maximum number of 7 points. These are e.g. Finland (6.6 points and ranked 2nd out of 144), Ireland (6.3 points/ranked 6th) and the United Kingdom (6.2 points/ranked 7th). The U.S., with 5.1 points and ranked 30th is only just behind Austria (5.2 points/ranked 28th). Some EU states perform relatively poorly however. Thus, Slovakia is ranked only 130th with 2.3 points and Bulgaria is not much better (2.6 points/ranked 126th).

The Rule of Law Index, published by the World Justice Project, shows that the effectiveness of civil justice[52] varies in quality between the EU Member States.[53] Whilst the Index confirms effective civil justice e.g. in the Netherlands (with 0.86 out of a maximum of one point and ranked 1st out of 102 surveyed countries) and Germany (0.82 points/ranked 5th), the effectiveness of civil justice in Italy (0.58 points/ranked 36th), Bulgaria (0.45 points/ranked 44th) and Croatia (0.54 points/ranked 45th) is deficient.

Overall it is clear that the effectiveness of the judiciary differs - sometimes significantly - between the EU states. Against this backdrop, the introduction of an unbiased arbitral jurisdiction is to be welcomed.

4.3 Advisability of investor-state arbitration?

Investor-state arbitration as generally agreed upon in investment treaties may in fact be regarded as structural compensation for a deficit of legal redress. The investment protection provisions under public international law require a mechanism for implementation and if national or Union justice is unable to offer it, an international jurisdiction is called upon to provide this implementation.

That may well be true, but what it does not specify is whether the enforcement mechanism must be an arbitral tribunal (4.3.1). A second question to be distinguished from this is whether the investor should be able to bring an action directly on his own (4.3.2).

[51] Cf. World Economic Forum (2014), p. 411.
[52] By definition, civil justice is effective when people have access to it and this is free of discrimination, corruption and government influence. In addition, there should be no unjustified delays and judgments must be enforceable. Finally, systems of alternative dispute resolution must be available.
[53] Cf. The World Justice Project (2015).

4.3.1 Question 1: Should there be an arbitral tribunal?

Arbitral tribunals differ essentially from conventional courts in that they are generally only established to decide a concrete dispute and the parties can designate both the arbitrators and the applicable law.[54]

4.3.1.1 Problem 1: Exercise of sovereign power by arbitral tribunals

Arbitral tribunals and dispute settlement are not an exotic speciality of investment protection law. They exist under national law, Union law[55] and, above all, under public international law. For that reason alone, one cannot make the general assertion that state or Union courts have the monopoly on judicial activity per se.[56]

On the other hand, this does not give us carte blanche to establish random structures of legal redress. It is mistaken to assume that the hybrid structure of investor-state arbitration is comparable to national arbitration fora such as dispute resolution mechanisms under consumer or trade law for contractual disputes. The relationship between private individuals is governed by private autonomy. Private individuals are free to determine their legal relationships. The same cannot be said with regard to the relationship between host states and private investors. In this case, the investor unilaterally decides, for economic reasons, to enter the sovereign territory of the host state which, for its part, subject to commitments under constitutional, Union and public international law (legislative) as well as ordinary law (executive; judiciary), is free to regulate unilaterally and with democratic legitimation the economic activity of those subject within its sovereign jurisdiction. By entering into commitments under public international law and thus condescending to operate at the same level as the private investors, the host state, purely for overriding political reasons, just complies with the economic interests of foreign investors.

This becomes particularly apparent where the host state submits to an independent jurisdiction, basically to the arbitral ruling of a private third party. Such an occurrence may not amount to a formal transfer of sovereign power which the Basic Law only permits to take place with respect to the EU and international organisations.[57] Characteristic for this type of transfer is the direct interference into the national legal order which has been rejected by most commentators[58], for example, in the case of compensatory payments which the European Court of Human Rights (ECtHR) can impose on Member States under the European Convention on Human Rights (ECHR)[59]. Nevertheless, arbitral tribunals do, at least de facto, exercise sovereign power via their awards since there are few if any grounds for non-enforcement[60] and, as a general rule, countries then also comply with the arbitral rulings without objection[61].

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[54] Subject to any intermediate stages or hybrid forms, this is the basic distinction between international courts and arbitral tribunals under public international law, cf. inter alia Heintschel von Heinegg, in: Epping/Hillgruber (2015), Art. 24 GG para. 46; Epping, in: Ipsen (2014), § 55 para. 32, 38.

[55] Recently e.g. Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Directive on consumer ADR).

[56] With this tendency, however, Fischer-Lescano/Horst (2014), p. 34 et seq.

[57] Cf. Art. 23 (1), 24 (1) GG.

[58] E.g. Deiseroth, in: Umbach/Clemens (2014), Art. 24 GG para. 115; Hillgruber, in: Schmidt-Bleibtreu/Hofmann/Henneke (Ed.) (2014), Art. 24 GG para. 29; probably also Streinz, in: Sachs (2014), Art. 24 GG para. 31; giving an overview Walter (1999), p. 974 et seq.

[59] Cf. Art. 41, 46 (1) ECHR.

[60] Cf. Crawford (2012), p. 743; Dolzer/Schreuer (2012), p. 300 et seq.; Schöbener/Markert (2006), p. 106 et seq.

[61] Cf. Kröll, in: Bungenberg/Griebel/Hobe/Reinisch (2015), § 11 VII para. 2 et seq.

There is then significant need for justification as to why this de facto sovereign power is to be entrusted to private individuals. Other than political considerations, no such justification is in evidence. An institutional solution, i.e. an international court, is for this reason alone clearly preferable.

4.3.1.2 Problem 2: Arbitrators lack independence

Investor-state arbitration is, to a certain extent, a one-way street: the investor can sue the host state; the reverse - by contrast with state-state arbitration - is basically not possible. One cannot, in principle, object to this since the aim of investment protection is precisely to protect investors from intervention by the host state.

What could be problematic in this regard, however, is the fact that arbitral tribunals are generally set up - as is also the case under CETA - on an ad hoc basis. Although the selection is designed to operate on the basis of parity, the arbitrators only get a turn if such arbitration proceedings take place at all. The more restrictive the case law of the arbitral tribunals, i.e. the more often they rule against companies, the less incentive companies will have to bring arbitration proceedings and thus the fewer arbitration proceedings there will tend to be. Thus the question arises whether the inherent self-interest of arbitrators in the arbitration proceedings, having regard to their remuneration, might also have a bearing on the content of the awards - in favour of claimant companies. The more imprecise the legal sources used by the arbitral tribunals as a basis for their case law, the more dangerous this bias becomes because the more scope there is for discretion by the arbitrators, including with regard to establishing case law and develop the law.

There is no doubt that arbitrators have an interest of their own in the holding of arbitration proceedings. Although, for example in CETA, their scope for discretion has been more clearly defined, and thus limited, by more precise definition of the relevant factors this is unlikely to be enough to dispel once and for all the aforementioned concerns about a conflict of interests.

On this basis too, the ad hoc creation of investor-state arbitral tribunals should be rejected in relation to TTIP. Instead, international courts should be set up with judges who are independent and who are remunerated irrespectively of the individual cases.

4.3.1.3 Problem 3: Lack of transparency of arbitral tribunals

Even if we consider arbitral tribunals to be lawful, in principle, this does not mean that, irrespective of the question of the independence of arbitrators (4.3.1.2), the procedure used will necessarily be legally sound. This applies, in particular, as regards transparency.

As far as transparency is concerned, one often hears the term "secret justice" used. The accusation being that, in addition to a lack of independence on the part of the arbitrators, proceedings in arbitral tribunals are not public and access to documentation is made difficult. Such accusations, if accurate, are serious constitutional issues but they could shortly be largely a thing of the past. In July 2013, UNCITRAL passed comprehensive new transparency rules which have been in force since

April 2014.[62] These include, in principle, the public registration of all proceedings (Art. 2), the publication of all documents and arbitral rulings (Art. 3) and public hearings (Art. 6).

The rules will in any case apply to new treaties - thus also, in principle, to TTIP and, in modified form (see Ch. 10 Art. X.33 CETA) to CETA - where claims are submitted under UNCITRAL rules (cf. e.g. Ch. 10 Art. X.22 CETA). This is not automatically the case for old treaties. In March 2015, the German Federal Government therefore signed the UN Convention on Transparency in Treaty-based Investor-State Arbitration ("Mauritius Convention")[63], which extends the UNCITRAL transparency rules to old treaties; it is currently undergoing ratification. The Commission recently submitted proposals for Council Decisions on the signing[64] and conclusion[65] of the convention by the EU. It will come into force as soon as at least three parties to the convention have ratified it. It only applies to parties that have ratified it. The new rules will a priori have no application to ongoing proceedings.

Special transparency rules would not necessarily be required for TTIP arbitral tribunals - because and insofar they would come under the new transparency rules.

4.3.1.4 Problem 4: Lack of appeals system for private arbitral tribunals

The lack of an appeals system for arbitral tribunals is problematic in two respects: First, when it comes to rulings on disputes and obtaining redress, host state and investor are entrusted to, or in the worst case at the mercy of, the court of first (and last) instance. There is in principle no possibility of rectifying errors by way of an appeal body.[66] Self-monitoring then takes place, not as a result of the possibility of the judgment being set aside but, at best, due to the arbitrator's own interest in the holding of future proceedings, which is problematic in itself (4.3.1.2).

Second, the coherence of case law also suffers as a result. It is generally recognised that it is the task of the appeal courts and supreme courts to safeguard the consistency of case law and to develop the law. Although a judicial chamber can be orientated "sideways" to e.g. other arbitral tribunals and decisions rather than "upwards" to the appeal court, and (genuine) courts are in any case legally independent and not strictly bound by the case law of the superior court, one should in no way underestimate what this actually means. Just imagine, for example, what it would be like if civil jurisdiction were basically made up of a patchwork of regional courts without the Federal Court of Justice (and where necessary the ECJ or the Federal Constitutional Court) above them as the court of last instance. This is exactly what the existing structure looks like, however - except that the "Investment Regional Court" may rule on a much wider range of claims - in addition to which it is set up on an ad hoc basis and it is private.

In the light of the foregoing, an appeals system is crucial for consistency in the application of the law as well as for legal certainty.

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[62] UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (Effective Date: 1 April 2014), http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-2013/UNCITRAL-Arbitration-Rules-2013-e.pdf (last accessed 19 July 2015).

[63] United Nations Convention on Transparency in Treaty-based Investor-State Arbitration, http://www.uncitral.org/pdf/english/texts/arbitration/transparency-convention/Transparency-Convention-e.pdf (last accessed 19 July 2015).

[64] European Commission, Proposal COM(2015)21 of 29 January 2015 for a Council Decision on the signing, on behalf of the European Union, of the United Nations Convention on transparency in treaty-based investor-State arbitration.

[65] European Commission, Proposal COM(2015)20 of 29 January 2015 for a Council Decision on the conclusion, on behalf of the European Union, of the United Nations Convention on transparency in treaty-based investor-State arbitration.

[66] Cf. only Crawford (2012), p. 743; Dolzer/Schreuer (2012), p. 300.

4.3.1.5 Conclusion

In order to implement the substantive investment protection provisions, an international court with an appeals system is preferable to the arbitration procedure which currently exists and is also provided for by CETA.

4.3.2 Question 2: Should the investor himself be able to bring proceedings against the host state?

Rejecting arbitral jurisdiction (4.3.1) does not determine whether the affected investor himself will also be able to sue the host state, as provided for under CETA, or whether intercession by the home state will be required.

As already mentioned (4.1), arbitration based on substantive obligations under international treaties in no way has to take the form of investor-state arbitration. The WTO system, for example, also works (purely) on the basis of state-state arbitration without any apparent detriment to the interests of the (indirectly) affected companies. The hybrid construction of a claim under public international law, being brought by a private individual against a state, is inherently exceptional, in any case. State-state proceedings are also readily used in the case of institutionalised judiciary. Take, for example, infringement proceedings under the European treaties which can be initiated in the ECJ, not only by the European Commission (Art. 258 TFEU), but also by other Member States (Art. 259 TFEU), against the Member State which is actually or allegedly in breach of a treaty.

The issues of discrimination against local nationals mentioned in relation to substantive investor protection (3.2.1) arise analogously in relation to investor-state jurisdiction. The unequal treatment of foreign as compared with domestic investors arises here in that foreign investors are provided with separate, possibly additional means of redress based on the unequal substantive standard of protection conferred. The relevance of the question is shown, for example, by the Vattenfall II arbitral proceedings relating to the German nuclear phase-out: RWE, e.on and Vattenfall are bringing a claim before the German Federal Constitutional Court (BVerfG). The Swedish company Vattenfall has, in addition, brought proceedings before an ICSID arbitral tribunal under the Energy Charter Treaty - which the German companies RWE and e.on are prevented from doing due to a lack of substantive protection. Those who consider the substantive inequality to be problematic will be more likely to feel that the same problems are reinforced and reapplied when it comes to the issue of redress, as a "consolidation" of the substantive discrimination. On the other hand, those who - like the case law - take a less critical view[67] of the substantive inequality, will hardly perceive the associated provision of the means of redress as a particular problem. Doubling the means of redress then corresponds to a doubling of the substantive standards of protection.

The familiar argument that investor-state jurisdiction depoliticises disputes and should therefore be supported[68], is double-edged. If the jurisdiction itself becomes politicised, this argument comes to nothing. The politicisation will then just be shifted: it will no longer take place between the states involved but between the investor and the public of the host state.

The decentralised and thus more efficient implementation of the substantive standards of protection, however, favours investor-state jurisdiction: investors act in their own interest without

[67] Cf. before Section 3.2.2.
[68] E.g. Griebel (2008), p. 11 et seq., 119.

the intercession of the home state. In the case of TTIP, we therefore support the investor's right of action.

4.4 cep's requirements for the judicial settlement of investment disputes

Based on the consideration presented, the following requirements with regard to the judicial settlement of investment disputes should be applied to TTIP:

(1) An international jurisdiction is required for implementation because national and Union courts cannot implement substantive investment protection under public international law.

(2) This jurisdiction should not involve ad hoc arbitral tribunals as has been the case up to now. Instead, an international court should be set up with independent judges who are also remunerated irrespectively of the cases which come before them.

(3) In order to safeguard the consistency of case law and develop the law, there should be an appeals system.

(4) An immediate right of action for the investor to bring proceedings against the state hosting the investment is appropriate.

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The Authors:

Dr. Matthias Kullas heads the Department for Single Market and Competition at cep | Centre for European Policy.

RA Oliver Sauer heads the Department for Institutional Law, Justice and Consumer Protection at cep | Centre for European Policy.

cep | Centre for European Policy
Kaiser-Joseph-Strasse 266 | D-79098 Freiburg
Telephone +49 761 38693-0 | www.cep.eu