EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

In recent years, the inclusion of Investor-State Dispute Settlement (ISDS) in trade and investment agreements has become subject to increased public scrutiny and questioning. There are a number of problems that have been identified as stemming from ISDS, which is based on the principles of arbitration. These problems include the lack of or limited legitimacy, consistency and transparency of ISDS as well as the absence of a possibility of review.

To address these limitations, the Union's approach since 2015 has been to institutionalise the system for the resolution of investment disputes in EU trade and investment agreements through the inclusion of the Investment Court System (ICS). However, due to its bilateral nature, the ICS cannot fully address all the aforementioned problems. Moreover, the inclusion of ICSs in Union agreements has costs in terms of administrative complexity and budgetary impact.

The multilateral investment court initiative aims at setting up a framework for the resolution of international investment disputes[[1]](#footnote-1) that is permanent, independent and legitimate; predictable in delivering consistent case-law; allowing for an appeal of decisions; cost-effective; transparent and efficient proceedings and allowing for third party interventions (including for example interested environmental or labour organisations). The independence of the Court should be guaranteed through stringent requirements on ethics and impartiality, non-renewable appointments, full time employment of adjudicators and independent mechanisms for appointment.

This initiative will only deal with procedural issues. Matters such as the applicable law or standards of interpretation, including ensuring the consistency with other international obligations (for example from International Labour Organisation and UN Conventions) will be addressed in the underlying investment agreements to be applied by the Multilateral Investment Court.

This initiative seeks to align the Union's policy in investment dispute resolution with the Union's approach in other areas of international governance and international dispute settlement favouring multilateral solutions. This initiative is not part of the Commission's Regulatory Fitness and Performance (REFIT) programme.

• Consistency with existing policy provisions in the policy area

The May 2015 Commission concept paper "Investment in TTIP and beyond – the path for reform - Enhancing the right to regulate and moving from current ad hoc arbitration towards an Investment Court"[[2]](#footnote-2) set out a two-step approach for the reform of the traditional ISDS system. The first step was the inclusion of an institutionalised court system for the resolution of investment disputes in future Union trade and investment agreements (i.e. the ICS). As a second step, the Union was to work towards the establishment of a multilateral investment court. This multilateral court would aim at replacing all the bilateral ICSs included in the Union trade and investment agreements and allow the Union, its Member States and partner countries to replace the ISDS provisions in their existing investment agreements with access to the multilateral investment court.

• Consistency with other Union policies

The present Recommendation is in line with the Commission Communication "*Trade for all*"[[3]](#footnote-3) from October 2015 which sets out that the Commission will in parallel to its bilateral efforts "*engage with partners to build consensus for a fully-fledged, permanent International Investment Court*".

In fact, at the public release on 12 November 2015 of the EU's proposed text for the Transatlantic Trade and Investment Partnership (TTIP) on investment protection and investment dispute settlement, the Commission stated that the "*Commission will start work, together with other countries, on setting up a permanent International Investment Court. […] This would lead to the full replacement of the "old ISDS" mechanism with a modern, efficient, transparent and impartial system for international investment dispute resolution*".[[4]](#footnote-4)

The Recommendation is also consistent with the May 2017 Commission Reflection Paper on Harnessing Globalisation,[[5]](#footnote-5) which explicitly refers to this initiative when stating that "*[international investment] [d]isputes should no longer be decided by arbitrators under the so-called investor-state dispute settlement. This is why the Commission has proposed a multilateral investment court that would create a fair and transparent mechanism*".

In addition, on the occasion of the adoption by the Council of the decision authorising the signature of CETA, the Council stated that "*the Council supports the European Commission's efforts to work towards the establishment of a multilateral investment court, which will replace the bilateral system established by CETA, once established, and according to the procedure foreseen in CETA*".[[6]](#footnote-6)

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

• Legal basis

Article 218(3) of the Treaty on the Functioning of the European Union (TFEU) provides that the Commission shall submit recommendations to the Council, which shall adopt a decision authorising the opening of negotiations and nominate the Union negotiator. According to Article 218(4) of the TFEU, the Council may address directives to the negotiator.

• Subsidiarity (for non-exclusive competence)

Article 5(3) of the Treaty on European Union (TEU) provides that the subsidiarity principle does not apply to areas of exclusive EU competence.

The Union has partly exclusive and partly shared competence with regard to investment protection.

Article 3 of the TFEU provides that the Union has exclusive competence with respect to the common commercial policy. According to Article 207 of the TFEU, foreign direct investment (FDI), including the possibility to negotiate and conclude international agreements covering FDI, is part of the Union's common commercial policy.

In its Opinion 2/15 regarding the EU-Singapore Free Trade Agreement (EUSFTA) the Court of Justice has confirmed that the Union has, on the basis of Article 207 of the TFEU, exclusive competence over the substantive standards of protection usually included in investment agreements to the extent that such standards apply to FDI.[[7]](#footnote-7) In the same opinion, the Court of Justice has clarified that, in the case of non-direct investment, the competence with regard to those substantive standards is shared by the Union and the Member States.

In its Opinion 2/15, the Court has further clarified that the competence with respect to ISDS (in relation to both FDI and non-direct investment) is shared between the Union and its Member States, to the extent that the Member States are required to act as respondents in certain disputes.

The Union is a party, together with the Member States, to agreements providing for traditional ISDS (the Energy Charter Treaty - ECT) or an ICS (the EU-Canada Comprehensive Economic and Trade Agreement - CETA) and may be required to be the respondent in disputes brought under those agreements. Moreover, the Commission is negotiating several other FTAs and stand-alone investments agreements including an ICS. It is envisaged that the Union will be the respondent in at least some of the disputes brought under those agreements

The participation of the Union in the envisaged Convention is thus necessary in order to bring within its scope of application those disputes under the above mentioned agreements where the Union will be the respondent.

The existing agreements including ISDS or ICS to which the Union is a party (the ECT and CETA) provide that the Member States shall be respondents in some cases. The envisaged agreements including ICS could likewise provide that the Member States shall be respondents in certain disputes. Moreover, the Member States have been empowered by the Union under Regulation No 1219/2012[[8]](#footnote-8) to maintain or conclude almost 1400 bilateral investment treaties, which include traditional ISDS. For those reasons, the multilateral reform of investment dispute resolution envisaged by this initiative has to be subscribed by Member States in addition to the Union.

• Proportionality

The present Recommendation for a Council Decision authorising the opening of negotiations for a Convention establishing a multilateral court for the settlement of investment disputes does not go beyond what is necessary to achieve the policy objectives at stake.

In line with the principle of proportionality, all reasonable policy options were considered in order to assess the likely effectiveness of such policy intervention. They are described in detail in the Impact Assessment Report.

• Choice of the instrument

A Commission Recommendation for a Council Decision authorising the opening of negotiations is in line with Article 218(3) of the TFEU which provides that the Commission shall submit recommendations to the Council, which shall adopt a decision authorising the opening of negotiations.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

• Ex-post evaluations/fitness checks of existing legislation

A review of the ISDS is carried out periodically in the context of the ECT, where the Union and the Member States as Contracting Parties actively participate. Although modernisation of investment protection including dispute settlement remains a Union priority within the ECT review, the preferred vector for reform of investment dispute settlement is the multilateral reform embodied by this initiative.

Given its very recent introduction, no evaluation has yet been conducted on the ICS.

• Stakeholder consultations

The Commission actively engaged with stakeholders and conducted a comprehensive consultation throughout the Impact Assessment process.

Between 21 December 2016 and 15 March 2017 the Commission carried out an online public consultation which was launched on the DG TRADE website and posted on "EU survey" (i.e. the Commission's online tool for conducting public consultations). Stakeholders were invited to answer questions including on the problems and possible policy options, technical aspects of such options and possible impacts. The consultation showed overall broad support for a multilateral reform of investment dispute settlement as described in this initiative although questions remain, especially on its technical aspects.

The individual responses to the public consultation were published on the consultation website. The summary report of the online public consultation, as well as of all other activities carried out by the Commission as part of the stakeholder consultation, is annexed to the Impact Assessment Report.

• Impact assessment

An Impact Assessment on the multilateral reform of investment dispute settlement including the possible establishment of a multilateral investment court was conducted. The Impact Assessment Report and its Executive Summary Sheet, as well as the positive opinion of the Regulatory Scrutiny Board, are attached to this Recommendation.

As the multilateral investment court initiative only addresses procedural rules (i.e. dispute settlement) and not substantive rules (which are included in the underlying investment agreements), no relevant environmental or social impacts are expected to result from it.

• Regulatory fitness and simplification

The multilateral investment court will alleviate the administrative burden related to investment dispute settlement by centralising all disputes under a single set of procedural rules. It will ensure investors' access to a legitimate, independent and effective system for the resolution of international investment disputes regardless of their size and/or turnover. SMEs may benefit from additional assistance to take account of their lower turnover. Proceedings under the court are expected to be shorter and therefore less costly for investors as compared to the traditional, unreformed system. Moreover, enhanced predictability and consistency of interpretation of substantive investment provisions will contribute to fewer disputes.

• Fundamental rights

In line with article 21(1) of the TEU, the Union will be guided by the principles of democracy, the rule of law, human rights and fundamental freedoms as they relate to this initiative, including in particular Article 47 of the Charter of Fundamental Rights.

Action by the Union at multilateral level cannot compromise the level of protection of fundamental rights in the Union. The multilateral investment court is intended to create an additional remedy under international law for enforcing the obligations imposed upon States by international agreements. It is therefore without prejudice to the existing rights of foreign investors under domestic Union Law and the laws of the Member States or to the remedies for enforcing such domestic law rights.

4. BUDGETARY IMPLICATIONS

The exact financial implications of this initiative are impossible to determine at this stage insofar as the key elements of the multilateral investment court remain to be multilaterally negotiated. It is considered to be less expensive than the alternative of maintaining the ICS in agreements already negotiated or subject to negotiation and the existing system. A number of calculations have been made, based on a number of assumptions, and are included in the Impact Assessment Report.

5. OTHER ELEMENTS

• Implementation plans and monitoring, evaluation and reporting arrangements

The Commission will carry out regular monitoring once the multilateral court is operational. It will also regularly audit the Union's financial contributions to the costs of the court. An evaluation of the functioning of the multilateral investment court will be undertaken when it has been in force for a sufficient period of time allowing availability of meaningful data. The attached Impact Assessment Report contains further details on the foreseen monitoring and evaluation activities.

• Procedural aspects

The Commission welcomes the fact that the members of the Council of the European Union are increasingly engaging at an early stage with their parliaments on investment negotiations in line with their institutional practices. It encourages the members of the Council of the European Union to do the same with regard to this Recommendation for a Council Decision having due regard to Council Decision 2013/488/EU on the security rules for protecting EU classified information[[9]](#footnote-9).

The Commission makes this Recommendation and its attachment public immediately after its adoption.

The Commission recommends that the negotiating directives be made public immediately after their adoption.

Recommendation for a

COUNCIL DECISION

authorising the opening of negotiations for a Convention establishing a multilateral court for the settlement of investment disputes

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 218(3) and (4) thereof,

Having regard to the Recommendation from the European Commission,

WHEREAS negotiations should be opened with a view to concluding a Convention between the European Union and its Member States and other interested countries establishing a multilateral court for the settlement of investment disputes,

HAS ADOPTED THIS DECISION:

Article 1

The Commission is hereby authorised to open negotiations, on behalf of the Union, for a Convention establishing a multilateral court for the settlement of investment disputes.

Article 2

The negotiations shall be conducted in line with the negotiating directives set out in the Annex to this Decision.

Article 3

This Decision and its attachment will be made public immediately after their adoption.

Article 4

This Decision is addressed to the Commission.

Done at Brussels,

 For the Council

 The President

1. Disputes arising from bilateral investment treaties concluded among Member States (i.e. intra-EU BITs) and disputes between an investor of a Member State and a Member State under the Energy Charter Treaty are outside the scope of this initiative. The Commission considers this type of treaties contrary to Union law. [↑](#footnote-ref-1)
2. Available at <http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF>. [↑](#footnote-ref-2)
3. Available at <http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf>. [↑](#footnote-ref-3)
4. See <http://europa.eu/rapid/press-release_IP-15-6059_en.htm>. [↑](#footnote-ref-4)
5. Available at <https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-globalisation_en.pdf>. [↑](#footnote-ref-5)
6. Statement 36 of the Statements and Declarations entered on the occasion of the adoption by the Council of the decision authorising the signature of CETA. Brussels, 27 October 2016. [↑](#footnote-ref-6)
7. Opinion of the CJEU of 16 May 2017, C-2/15,EU:C:2017:376 pursuant to Article 218(11) TFEU on the competence of the European Union to conclude the Free Trade Agreement with Singapore. [↑](#footnote-ref-7)
8. Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries (OJ L 351, 20.12.2012, p.40). [↑](#footnote-ref-8)
9. <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013D0488> [↑](#footnote-ref-9)