United Nations A/CN.9/WG.III/WP.244

General Assembly

Distr.: Limited
8 July 2024

Original: English

United Nations Commission on International Trade Law
Working Group III (Investor-State Dispute Settlement Reform)
Forty-ninth session
Vienna, 23–27 September 2024

Possible reform of investor-State dispute settlement (ISDS)

Draft provisions on procedural and cross-cutting issues

Comments from the European Union and its Member States:

The European Union and its Member States refer to paragraph 126 of the report of Working Group III on the work of its 50th session (A/CN.9/1195), where delegations are invited to provide written comments on draft provisions 14* to 19 in document A/CN.9/WG.III/WP.244. The European Union and its Member States therefore submit the below comments on draft provisions 14 to 19. This is without prejudice to the position that the European Union and its Member States may take in light of the discussions in Working Group III.

Draft Provision 14: Local remedies

Prior to submitting a claim to the Tribunal, a party shall consider initiating recourse before a court or competent authority of a Contracting Party, where available.

Comments from the European Union and its Member States:

The position of the European Union and its Member States is that, as currently redrafted, the regulatory effect of this draft provision is limited and its added value questionable. It is worth considering whether it is necessary to include such provision in this paper.

Nevertheless, if the Working Group decides to keep it, this draft provision could appear in a protocol to a multilateral instrument with the view to retrofit in existing treaties and could also, depending on the outcome of the discussions, be in the rules of procedure of a standing mechanism.

Draft Provision 15: Waiver of rights to initiate dispute resolution proceeding

1. No claim may be submitted to the Tribunal unless the investor waives its right to initiate or continue any other adjudicatory dispute resolution proceeding with respect to the same subject matter or the measure alleged to constitute a breach of the Agreement.

V.24-09609 (E)
2409609

Please recycle

2. When submitting a claim to the Tribunal, the investor shall provide:

(a) A statement that it will not initiate any such adjudicatory dispute resolution proceeding; and

(b) A statement that it has withdrawn from or discontinued such adjudicatory dispute resolution proceeding, if applicable.

3. Paragraphs 1 and 2 shall not apply to proceedings where the investor seeks interim/provisional measures.

Comments from the European Union and its Member States:

The position of the European Union and its Member States is that further work is relevant on this draft provision, which could appear in a protocol to a multilateral instrument with the view to retrofit in existing treaties and could also, depending on the outcome of the negotiations, be in the rules of procedure of a standing mechanism.

The revised version of the "waiver of rights" provision is going in the right direction, in particular the addition of paragraph 3 on interim and provisional measures.

The EU approach also includes a paragraph (3 below) ensuring that the mechanism preventing parallel claims will not be thwarted by different claims brought by different but related entities. Therefore, the claimant includes, for the purpose of the provision on parallel claims, not only the investor but also, where applicable, the locally established enterprise. This is related to the definition of claimant in the agreement which, in EU agreements, includes claims on behalf of a locally established enterprise which will have to comply with the declaration and waiver requirements. The notion of claimant also includes all person who, directly or indirectly, have an ownership interest in or are controlled by the locally established enterprise or investor and claim to have suffered the same loss or damages as the investor or locally established enterprise.

The requirements of paragraphs 1 and 2(a) thus also extend to e.g. daughter/mother companies. However, for practical reasons, this is not the case for the waiver requirement under paragraph 2(b). Indeed, it would in certain cases of large groups of companies be an excessive burden to collect a waiver from all the related companies in a particular case. The difference with paragraph 2(a) is that this provision refers to proceedings that are already ongoing and therefore usually known to the claimant, so that it is less difficult to collect the necessary evidence.

See below a drafting proposal based on the EU approach:

" 1. The Tribunal shall dismiss a claim by a claimant who has submitted a claim to the Tribunal or to any domestic or international court or tribunal concerning the same treatment as that alleged to breach the provisions referred to in [the claim under consideration] unless the claimant withdraws such pending claim.

This paragraph does not apply if the claimant submits a claim to a court or tribunal seeking interim injunctive or declaratory relief.

2. Together with the submission of a claim the claimant shall provide:

(a) evidence that it has withdrawn any pending proceedings before any domestic or international court or tribunal under domestic or international law concerning the same treatment as that alleged to breach the provisions referred to in [the claim under consideration]; and

(b) a declaration that it will not initiate any proceedings before any domestic or international court or tribunal under domestic or international law concerning the same treatment as that alleged to breach the provisions referred to in [the claim under consideration].

3. For the purposes of this Article, the term "claimant" includes the investor and, if applicable, the locally established enterprise. In addition, for the purposes of paragraphs 1 and 2(a), the term "claimant" also includes:

(a) if the claim is submitted by an investor acting on its own behalf, all persons who, directly or indirectly, have an ownership interest in or are controlled by the investor and claim to have suffered the same loss or damage as the claimant; or

(b) if the claim is submitted by an investor acting on behalf of a locally established enterprise, all persons who, directly or indirectly, have an ownership interest in or are controlled by the locally established enterprise, and claim to have suffered the same loss or damage as the locally established enterprise. (Footnote: For greater certainty, the same loss or damage referred to in this paragraph means loss or damage flowing from the same treatment which the person seeks to recover in the same capacity as the claimant. For example, if the claimant sues as a shareholder, this provision would cover a related person also pursuing recovery as a shareholder.)"

Draft Provision 16: Limitation period

No claim may be submitted for resolution if [3] years have elapsed since the investor first acquired, or should have first acquired, knowledge of the alleged breach of the Agreement and knowledge that it has incurred loss or damage.

Comments from the European Union and its Member States:

The position of the European Union and its Member States is that further work is relevant on this draft provision, which could appear in a protocol to a multilateral instrument with the view to retrofit in existing treaties and could also, depending on the outcome of the negotiations, be in the rules of procedure of a standing mechanism.

Draft provision 16 is going in the right direction in terms of posing a general rule for limitation periods, but the wording could be slightly adjusted for instance to refer to "*knowledge of the* ***treatment alleged to breach the Agreement and of the loss or damage alleged to have been incurred thereby****"*.

Also, according to the EU approach, it is not the claim that should be submitted within 3 years but the request for consultations.

Furthermore, in the EU approach, where domestic remedies are pursued, a request for consultations may be submitted later than the afore-mentioned three years, in order to give enough time for domestic court proceedings and to avoid forcing the investor to stop those domestic proceedings after three years so as not to be time-barred for the international claim. However, once domestic proceedings are exhausted or terminated, investors must act within two years if they still want to request consultations, and in any event no later than 10 years after they acquired or should have acquired knowledge of the alleged breach. The 10 years introduce thus an absolute time-limit: if domestic proceedings take longer, the investor will lose its right to turn to dispute settlement, unless he terminates the domestic proceedings and lodges the claim before expiry of the 10 years.

Finally, even if the time-periods have not been respected, a claimant can still submit a claim if the non-respect of the time-limits is due to the claimant's inability to act as a result of the actions taken by the respondent. This would normally only occur in exceptional circumstances, for example, where the claimant is imprisoned or denied their civil rights by the respondent and therefore not in a position to submit its claim. In such cases, the claimant has to act as soon as reasonably possible after it is again able to act.

The draft proposal is reproduced here for simplicity:

"[The request for consultations][The claim] shall be submitted:

(a) within three years after the date on which the claimant or, as applicable, the locally established enterprise, first acquired or should have first acquired, knowledge of the treatment alleged to breach the provisions referred to in [the claim under consideration] and of the loss or damage alleged to have been incurred thereby; or

(b) within two years after the date on which the claimant or, as applicable, the locally established enterprise, ceases to pursue proceedings before a tribunal or court under

the law of a Party, and, in any event no later than 10 years after the date on which the claimant or, as applicable, the locally established enterprise, first acquired or should have first acquired, knowledge of the treatment alleged to breach the provisions referred to in [the claim under consideration] and of the loss or damage alleged to have been incurred thereby.

The time periods shall not render a claim inadmissible if the claimant can demonstrate that the failure to request consultations or to submit a claim is due to the claimant's inability to act as a result of actions taken by the other Party, provided that the claimant acts as soon as reasonably possible after it is able to act."

Draft Provision 17: Denial of benefits

1. A Contracting Party may deny the benefits of the Agreement to an investor of the other Contracting Party that is an enterprise of that Contracting Party and to investments of that investor if the enterprise is owned or controlled by a person of a non-Contracting Party and:

(a) The enterprise has no substantial business activities in the territory of any Contracting Party other than the denying Contracting Party; or

(b) The denying Contracting Party adopts or maintains measures with respect to the non-Contracting Party or a person of the non-Contracting Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of the Agreement were accorded to the enterprise or to its investments.

2. A Contracting Party may deny the benefits of the Agreement to an investor of the other Contracting Party and to investments of that investor if:

(a) The investor receives third-party funding in a manner inconsistent with Draft Provision 12;

(b) The investment was made in violation of the denying Contracting Party's laws and regulations;

(c) The investment involved or was made by way of corruption, fraud, or deceitful conduct; or

(d) The claim would constitute a misuse of the Agreement and its objectives.

Comments from the European Union and its Member States:

The European Union and its Member States are not convinced that further work is necessary on a denial of benefits clause, nor that such clause should be part of a protocol to a multilateral instrument. At the same time, certain issues included in draft provision 17 are of great importance to the European Union and its Member States, for instance the issue of shell companies, or the issues covered by paragraph 2(b) and (c). As explained below, the EU approach treat these issues through jurisdictional requirements rather than through a denial of benefits clause. As a general matter, the European Union and its Member States support further disciplines to avoid the use of investment agreements by shell companies. This issue should be further discussed in the Working Group or other fora.

While the first paragraph of the denial of benefits clause in draft provision 17 is similar to language usually found in IIAs, paragraph 2 significantly departs from the treaty practice and is more far-reaching.

The EU approach to denial of benefits takes a narrower approach and would allow a Party to deny the benefits of the agreement only in circumstances where it has adopted measures related to the maintenance of international peace and security, including the protection of human rights, when such measures either require the prohibition of transactions with investors or covered investments of the other Party or to avoid the circumvention of such measures (e.g. EU Global Human Rights Sanction Regime (see Council Regulation (EU) 2020/1998 of 7 December 2020 concerning restrictive measures against serious human rights violations and abuses, enabling the freezing of

funds and economic resources). Such measures could be adopted regardless of whether the investor (enterprise of the other Contracting Party) is ultimately owned/controlled by a person of a non-Contracting Party, or not. This is because it is of no relevance whether an enterprise of a non-Contracting Party owns or control the investor, as such measures may be equally adopted vis a vis investors of the other Party.

Paragraph 1 is unnecessarily centred only around enterprises. The benefits of the agreement should be also deniable to natural persons, however the current drafting in the chapeau '*[a] Contracting Party may deny the benefits of the Agreement to an investor of the other Contracting Party that is an enterprise of that Contracting Party'* and paragraph 1(b) does not cover such situation.

Regarding paragraph 1(a), EU agreements deal with the issue of shell companies by requiring in the definition of "investor of a Party" that the juridical person has substantive business operations. As such, the matter is dealt with at the jurisdictional stage and it allows the burden of proof to remain on the claimant, which is not the case under the denial of benefits clause. The ultimate ownership as such is of no relevance so long as a certain company has substantive business operations in a Contracting party.

Regarding paragraph 1(b), the risk of allowing a party to deny the benefits of the agreement on the basis of any measures that the denying Contracting Party adopts is that this may legitimise, in certain cases, measures that would otherwise would not be justified under the exceptions of the treaty. In contrast, the narrow approach under the EU agreements provides that such measures are limited to sanctions relating to international peace and security, including human rights.

Paragraph 2 raises issues in several ways:

- On subparagraph (a), the relevance of third party funding for denial of benefits is unclear, since it is almost impossible to know before the dispute starts what is the situation of the claimant with possible third party funding. Third party funding should be regulated in this way.
- On subparagraphs (b) and (c), they relate to the substance and not to the procedure. Concerning subparagraph (b) in particular, and as far as domestic laws are concerned, the making of an investment in accordance with domestic laws is a requirement that should be present for an investment to be "covered" under the EU agreements. Therefore, it becomes a jurisdictional question.
- On subparagraph (d), it is understood as including the issue of "treaty shopping" which is addressed in EU agreements under "anti-circumvention" provisions and serves as a ground for the tribunal to decline jurisdiction.

The EU approach to denial of benefits also contains useful procedural elements clarifying when and how the denial of benefits clause may be triggered.

The European Union and its Member States provide below a "Denial of benefits" clause based on the EU approach:

"A Party may deny the benefits of this Agreement to an investor of the other Party or to a covered investment, if the denying Party adopts, implements, maintains or enforces measures related to the maintenance of international peace and security, including the protection of human rights, which:

a. prohibit transactions with investors of the other Party or their covered investments, or

b. would be violated or circumvented, if the benefits of this Agreement were accorded to investors of the other Party or their covered investments, including where the measures prohibit transactions with a natural or juridical person who owns or controls either of them.

For greater certainty, a Party may deny such benefits pursuant to this Article without any prior publicity or other additional formality related to its intention to exercise the right conferred by this Article."

Draft Provision 18: Shareholder claims

1. A shareholder may submit a claim on its own behalf only for direct loss or damage incurred as the result of a breach of the Agreement, which means that the alleged loss or damage is separate and distinct from any alleged loss or damage to the enterprise in which the shareholder holds shares. Direct loss or damage does not include diminution in the value of the shareholding or in the distribution of dividends to the shareholder as a result of loss or damage incurred by the enterprise. The loss of an opportunity to conduct business activities carried out or expected to be carried out by the enterprise also does not constitute direct loss or damage.

2. A shareholder may submit a claim to a Contracting Party on behalf of an enterprise of that Contracting Party, which the shareholder owns or controls, only in the following circumstances:

(a) All assets of that enterprise are directly and wholly expropriated by that Contracting Party; or

(b) The enterprise sought remedy in that Contracting Party to redress its loss or damage but has been subject to treatment akin to a denial of justice under customary international law.

3. When submitting a claim, the shareholder shall provide:

(a) Evidence of its alleged ownership or control of the enterprise;

(b) A statement that the enterprise and itself will not initiate any other adjudicatory dispute resolution proceeding with respect to the same subject matter or the measure alleged to constitute a breach of the Agreement; and

(c) A statement that the enterprise and itself has withdrawn from or discontinued such adjudicatory dispute resolution proceeding, if applicable.

4. When the Tribunal makes an award in favour of the shareholder in a proceeding pursuant to paragraph 3, the Tribunal shall award monetary damages and any applicable interest or restitutions of property to the enterprise. The award shall provide that it is made without prejudice to any right that any person may have under the applicable law in the respondent Contracting Party with respect to the relief provided therein.

Comments from the European Union and its Member States:

The European Union and its Member States support the policy concern and would not exclude exploring a formulation of draft provision 18 that reflects this concern, but that would require on an assessment of the other procedural rules that may be agreed i.e. provisions on using an "on behalf of approach". As explained below, the EU treaty practice does not contain language which explicitly addresses the issue of shareholders claims, but properly understood EU treaties containing the "on-behalf of approach" would prevent derivative claims.

EU agreements do not address directly the situation of shareholders in a detailed and specific provision. Shareholders claims are included first and foremost in the definition of "claimant" in the agreement which includes an investor submitting a claim acting either (i) on its own behalf or (ii) on behalf of a locally established enterprise which it owns or controls. EU agreements do not name "shareholders" but instead include them in the category of investors allowed to make a claim.

The European Union and its Member States wish to recall that the underlying policy rationale behind the reflective loss principle in those domestic legal systems where it exists is that shareholders should not be able to recover for reflective loss, where the company has a right to claim against the same wrongdoer. Unless a shareholder can

show that it has suffered a separate and distinct loss from that experienced by the company, it should not be able to bring a claim on its own behalf on the basis of reflective loss.

Furthermore, the rationale for providing limitations to the submission of derivative claims (i.e. claims on behalf of the enterprise) under paragraph 2 is unclear and would deserve further explanation. It questions how this provision would be reconciled with IIAs which do not limit the ability of a shareholder to bring a claim on behalf of an enterprise to specific situations.

Draft Provision 19: Right to regulate

Nothing in the Agreement shall be construed as preventing the Contracting Parties from exercising their right to regulate and to adopt, maintain and enforce any measure that they consider appropriate to ensure that investments are made in a manner sensitive to the protection of public health, public safety, human rights, essentials security interests or the environment, the promotion and protection of cultural diversity, or [...].

When assessing the alleged breach by a Contracting Party of its obligation under the Agreement, the Tribunal shall give a high level of deference that international law accords to Contracting Parties with regard to [the development of domestic policies as well as implementation of international commitments (including compliance with the Paris Agreement or any principle or commitment contained in articles 3 and 4 of the United Nations Framework Convention on Climate Change),] the right to regulate and the right to adopt, maintain and enforce measures sensitive to the protection of public health, public safety, human rights, essential security interests or the environment, the promotion and protection of cultural diversity, or [...].

No claim may be submitted if the measure alleged to constitute a breach of the Agreement was adopted by the Contracting State to protect public health, public safety, human rights, essential security interests or the environment, to promote and protect cultural diversity, or […].

Comments from the European Union and its Member States:

As a general comment, the European Union and its Member States agree on the importance of recognition of the “right to regulate”. EU agreements contain an explicit reaffirmation of it. However, we see this issue as relating to substantial clauses which go beyond the scope of the mandate of Working Group III and its task to reforming ISDS in particular through a standing mechanism, which would in our view largely solve the problems that are sought to be addressed here.

The perceived impact of the current system of ISDS on the right to regulate is in our view largely driven by the lack of certainty, predictability and absence of appeal mechanism inherent in an ad hoc system, which means that States (and investors) cannot in advance determine with a reasonable likelihood the outcome of a potential dispute and hence States are put under pressure to curtail otherwise legitimate regulatory activities.

The position of the European Union and its Member States is accordingly that the most effective means to address this issue is the reform strand on the creation of a permanent mechanism and an appeal mechanism rather than on further clauses reaffirming States’ right to regulate. Those mechanisms would better ensure greater predictability for disputing parties and all stakeholders, because over time the decisions of those mechanisms would clarify the scope of the right to regulate and its articulation with other substantive provisions contained in the treaties.

Therefore, the European Union and its Member States does not believe that further work on this clause is necessary within Working Group III, and note that the ongoing workstream on the future of investment treaties at the OECD is discussing the right to regulate in terms of possible substantive provisions.

Nevertheless, if the Working Group wished to continue working on this provision, the European Union and its Member States have the following substantial comments:

The EU approach includes a reaffirmation of the Parties' right to regulate within their territories to achieve legitimate policy objectives and corollaries of such right, along the lines of paragraph 1. However, the right to regulate under paragraph 1 is articulated in the form of an exception. From a practical viewpoint, it means that a certain measure would be found in violation of the agreement and then it would have to be determined whether it is justifiable under paragraph 1. As such, the burden of proof falls on the state to prove that its acts are compliant with the right to regulate. But the EU approach considers that the right to regulate is inherent to the State (hence why it is a reaffirmation), not conferred by the treaty as the drafting of draft provision 19 suggests, and that any acts falling within its sphere do not constitute violation of the treaty. Under the EU approach, the burden is on the investor to prove that a certain act goes beyond the right to regulate, thus it is in violation of the treaty.

Paragraphs 2 and 3 represent a novelty compared to the provisions on the right to regulate that are usually found in IIAs:

- Paragraph 2: The European Union and its Member States assume that a tribunal, in particular in a reformed ISDS system, would not second guess policy decision of a Contracting party for all the reasons enumerated in paragraph 2. The reference to a "high level of deference" raises concerns because a tribunal should also respect and apply the applicable agreement. In addition, the reference to specific climate change agreements may raise policy issues.

- Paragraph 3: The carve out from any dispute settlement mechanisms in paragraph 3 is far-reaching. In light of what is overwhelmingly the case in IIAs and the WTO, such considerations are better served through the presence of exceptions which ensure that arbitrary or disproportionate measures or measures constituting disguised protectionism or discrimination are avoided. Rather than a complete carve-out the EU approach prefers to ensure State's policy space through the presence of exceptions and a reaffirmation of the State's right to regulate.