Development of the Dispute Resolutions in Free Trade Agreements

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For almost twenty years, there exists a double taxation convention between the Socialistic Republic of Vietnam and the Federal Republic of Germany, which is to avoid double taxation on income and assets. [1] Such agreements often are the first steps on the way of fostering trade between states and make international trade economically more attractive, because they avoid a double taxation of a company's income in both, its home state along the world income principle and in the country where the income is generated. Of course not only double taxation is an obstacle for free international trade, but there are also other trade barriers, namely state implemented measures, that make the exchange of goods and services across borders less attractive. These are, for example, import duties and non-tariff barriers such as, for example, import- and settlement bans, but also quality-, environmental- and social standards within countries. In contrast, the liberalisation of international trade promotes the wealth of the involved states and their people. Looking at Asia, this development can be observed in many countries, as for example in China and Vietnam. Therefore, the liberalisation of international commercial trade by means of the dismantling of non-tariff trade barriers is a worldwide concern, especially pursued by the World Trade Organization (WTO).

Many trade barriers can be dismantled with unilateral, multilateral, or bilateral measures. Unilateral actions naturally are permitted in every state. For example, with regard to imported goods, a state can always recognize the technical standards of the country of origin as being equal to the national set standards. However, a unilateral approach often does not completely fulfil the requirements of a modern international trade system, because a state which is not bound by international law can withdraw trade facilitating regulations any time, without any legal consequences. Therefore, after the Second World War, there has been the attempt to enhance the liberalisation of global trade by means of multilateral measures, namely with the General Agreement on Tariffs and Trade (GATT) from 1948, which also constitutes the foundation of the World Trade Organization (WTO). After the efforts by the Doha Development Agenda to liberate global trade with multilateral means have stumbled in the

[1] Bundesgesetzblatt 1996 II, p.2622.

first half of the last decade, in 2006 the European Union[2] has started to use bilateral free trade agreements, which had already been frequently employed before 1948.

The bilateral dismantling of trade barriers is enabled through free trade agreements between states or groups of states. An example for such an international treaty is the free trade agreement between the European Union (EU) and the Republic of Korea from 2011.[3] This agreement has been the first free trade agreement between an Asian state and the European Union.[4] It has been very successful, which can also be measured with the export figures for exports from Europe to Korea that since have increased 35 percent. The policy of Vietnam also pursues the conclusion of such agreements. As an example, the country participates in the China-ASEAN free trade agreement from 2010. A new free trade agreement between Vietnam and the European Union is planned to be concluded this year.[5] Moreover, Vietnam considers participating in a free trade agreement between several Asian states and the USA (Trans Pacific Partnership [TPP]).

Occasionally, the pursue of dismantling trade barriers with free trade agreements collides with the legal introduction of new environmental- or social standards within one of the involved contract states. This can result in the financial loss of a company from a contract state which has invested in the country with the newly introduced standards. Then, the investor will attempt to receive compensation for the loss. An exemplary case is the complaint of the Swedish energy company Vattenfall against the Federal Republic of Germany at the International Centre for Settlement of Investment Disputes (ICSID) of the World Bank. The company has claimed a compensation of approximately 4.6 billion Euros for the shutdown of two nuclear plants that were done along with the German law for opting out of the nuclear energy program in 2011.[6] Such cases raise the question on the types of procedures that can be implemented for the resolution of disputes concerning investment protection.

[2] The foundation for this is the notification of the EU Commission „Ein wettbewerbsfähiges Europa in einer globalisierten Welt“ (engl. „A competitive Europe in a globalised world“) from October 4, 2006.
[3] Official Journal of the European Union L 127 from May 14, 2011, p.6 ff.
[4] A free trade agreement between the EU and Japan is planned to be concluded within 2015, the latest by 2016.
[5] Since 1993, there exists a contract between the Socialist Republic of Vietnam and the Federal Republic of Germany on the promotion and the mutual protection of capital investment (BGB1. II 1997, p. 2116) which grants investor protection and stipulates investor-state arbitration (Art.4, 11).
[6] ICSID Case No. ARB/12/12.

With regard to the resolution of similar disputes on trade agreements which have been concluded in the last years, there can be observed three levels of development. On the first level are dispute resolutions without participation of the investor. For example, the free trade agreement between the EU and the Republic of Korea provides for an arbitration court, where only the parties who participate in the agreement, namely the contracting states, take part and where the only object is the interpretation and application of the agreement.[7] Moreover, only the participating parties of the agreement are bound to the decision of the arbitration panel. Investors are not in the position to derive any rights - especially with regard to compensation claims.[8] This is because the agreement does not contain a chapter on individual investment protection.[9] As a consequence, investors have to sue at a public court or an arbitration court along with the national regulations of the country which is concerned. Generally, Germany allows the invocation of arbitration courts. Nonetheless, arbitration will only be in charge for the case if the affected state gives permission. [10]

The above mentioned permission often is not given. Occasionally, the laws of a state even deny state-owned companies to participate in arbitration courts.[11] Consequently, it is not unusual that the investor is forced to sue at a court within the state where the investor raises the claim. In some cases, the assumption exists that in some countries such as, for example, in some of the US-American States, there are deficits in the legal protection provided by public courts.[12] In addition, international arbitration tribunes usually take their decisions more quickly than public courts. Therefore, the chapter on investment protection in free trade agreements often include an investor-state dispute settlement (ISDS). As an example, the Canada-Korea Free Trade Agreement from June 2014 includes the rule that an investor can apply for arbitration, especially along with the ICSID Convention or the UNCITRAL

[7] Art. 14.1., 14.2., 14.4. of the Free Trade Agreement EU/Republic of Korea (ROK).
[8] Art. 14.17 Par. 2 of the Free Trade Agreement EU/ROK.
[9] Individual investor protection against measures and a resulting arbitration process is stipulated, for example, in Art. 4, 10 of the contract on the promotion and mutual protection of capital investment (BGBl. 2004, part II no. 2, p. 49 ff) between the Federal Republic of Germany and the Kingdom of Thailand.
[10] Compare § 1025 of the German Code of Civil Procedure.
[11] Compare the interview with Anahita Thoms in Börsen-Zeitung from May 16, 2015, p. 9.
[12] Franz C. Meyer/Ermes ZRP 2014, 237, 239. A proof for the fact that state courts work more slowly and that those of some states work exceptionally slow, is the clause in Art. 31 Abs. 2, 3 EuGVVO no. 1215/2012 in the version that is valid since 10.1.2015. This clause now prevents the all-too frequent practice to avoid contractual court agreements by filing an action for a negative declaratory judgment at an incompetent foreign, well-known slowly working court (e.g. an Italian court, compare EuGH from December 12, 2003, C 116/02) before a suit for performance is filed at the agreed court of jurisdiction.

Arbitration Rules.[13] Here, each party orders one arbitrator and together, these arbitrators determine a third party arbitrator. [14] The decision of the tribunal binds the parties in dispute.[15] It is final.

There has been growing political resistance against such arbitration clauses in Europe, especially from certain NGOs. In particular, this criticism concerns the Transatlantic Trade and Investment Partnership (TTIP) which is currently being negotiated between the United States and the European Union.[16] The criticism is founded on a fundamental distrust toward non-governmental jurisdiction or dispute resolution. This distrust is in marked contrast to the growing importance of extra-judicial dispute resolution in Europe and Germany, which commonly is considered to be quiet positive. For example, since 2013 there exists the EU Directive 2013/11/EU on alternative channels for settling consumer disputes, which enables consumers and companies to settle conflicts resulting from consumer contracts before boards of arbitration. The Directive is complementary to a legal position of Germany, which represents the basis for the existence of more than 200 conciliation-, mediation-, or arbitration boards.[17] For the resolution of international disputes, the German constitution asks the Federal Republic of Germany to participate in agreements on international arbitration. Arbitral clauses have been included in public-private-partnership agreements for many years.[18] Also political parties, including even those that fight against the conclusion of free trade agreements, use arbitration boards for the regulation of disputes within the party (§14 ParteienG).

There are no simple legal concerns against arbitration clauses in free trade agreements. According to the German general civil law, arbitration clauses can work for the benefit of third parties- here: for the benefit of investors (§ 328 BGB).[19] The contract for the benefit of third parties is also known and applied in public law (comp. § 62 S. 2 VwVfG)[20] as, albeit to a

[13] Art. 8.23. Canada-Korea Free Trade Agreement.
[14] Art. 8.25. Canada-Korea Free Trade Agreement.
[15] Art. 8.42. Canada-Korea Free Trade Agreement.
[16] A balanced description on this issue by Landfried, Frankfurter Allgemeine Zeitung from July 13, 2015, p.6. The EU Trade Commissioner expects a final draft of the agreement to be finished by the end of 2016 (Frankfurter Allgemeine Zeitung from June 24, 2015, p.17)
[17] An Example: The Bundesverband Investment and Asset Management supports an Ombudsman's Office for investment funds. Ombudsman is a former presiding judge of the XI. civil senate in the Federal Court, which is responsible for banking law. The settlement proposal of the Ombudsman is binding for the company for an amount of up to 10.000 Euros.
[18] Compare Wulff NVwZ 2012, 205.
[19] BGHZ 48, 35, 45; Zöller/Geimer, ZPO, 30. Edition. 2014, § 1031 Rn. 18.
[20] Soergel/Hadding, BGB, 13. Edition. 2010, § 328 Rn. 123.

limited degree, the settlement of arbitration hearings.[21] Therefore, private persons can acquire rights from treaties under international law when these have been adapted to domestic German law.[22] Arbitration agreements that have been concluded by public authorities for the benefit of investors are readily effective, as only arbitration agreements with consumers (§ 13 BGB) are bound to special conditions (comp. §§ 1031 Abs. 5 ZPO, 37 h WpHG).

With regard to free trade agreements, the object of criticism is the fact that government decisions in arbitration courts could be cancelled, or that a financial compensation could be required. According to the opponents, this restricts the regulatory scope of democratic legislation in an inappropriate manner.[23] Moreover, it is claimed that only by the mere act of threatening with complaint in front of an international arbitration court, companies could already prevent the introduction and implementation of unwanted laws. This criticism is partly wrong and partly misses the point. Firstly, it should be noted that the basic issue here is not about the definition of democracy, in other words, about how decision-making is done within a country, but it is about the issue of national sovereignty. This question is also relevant for states that do not follow a democratic system. Naturally, national sovereignty is touched by a free trade agreement because every contract state has to take on certain obligations that restrict its scope for national legislation in a direct or indirect way. Such obligations nowadays are included in almost every international treaty, however here the international contract law is not being suspected to misfit with democracy or sovereignty. Quite the contrary, the German Constitution expressly permits international treaties
(Art. 59 GG) and equals them with simple federal law.

Moreover, it is incorrect to assume that the free trade agreement forces a state to reverse governmental decisions. In the Canada-Korea Free Trade Agreement, for example, it is regulated that a contract state which is defeated by the arbitration court, is not obliged to abolish its legislation, but can instead compensate the investor monetarily.[24] From a legal point of view, here it cannot be complained that the investor alternatively is entitled to receive compensation - otherwise a contract state would be able to violate an obligation of the free trade agreement toward an investor without any legal consequences. Furthermore, it is to consider the fact that the expected democratic deficits can also occur with a decision of a state

[21] Zöller/Geimer, ZPO, § 1030 Rn. 23.
[22] BGHZ 17, 313; Soergel/Hadding, BGB, § 328 Rn. 124.
[23] v. Frankenberg ZRP 2014, 155.
[24] Art. 8.41. Canada-Korea Free Trade Agreement.

court. If the state has adopted the regulations of the free trade agreement into its legislation, the investment protection that has been active through this agreement would also have to be enforced by a state court against the governmental legislation.[25] As a result, the criticism actually does not concern the procedural question whether a complaint should be treated at an arbitration court or a state court, but with material investment protection as such.

Moreover, it is argued that

- arbitration courts would not be controlled by the public,
- there often would occur a conflict of interest because the arbitrators mostly are lawyers from major international law firms,
- and that it would not be possible to lodge legal remedies against the decisions of arbitration courts.[26]

The first point of criticism is obsolete. In late free trade agreements such as, for example, the one between the EU and Canada, arbitration proceedings warrant full transparency. All relevant documents are available on the website of the European Union and all hearings of arbitration courts are open to the public.[27] The UNCITRAL Rules on Transparency in Treaty-based Investor State Arbitration 2014 even go as far as that NGOs and unions are allowed to make submissions[28] although kind of these organisations lack all democratic legitimization. Germany recently has approved the UNCITRAL Rules on Transparency in the Mauritius Convention, which makes these rules (public registration of arbitration proceedings, publication of all documents, participation of stakeholders, publication of the arbitral award) mandatory for all arbitration proceedings between investor and state that are based on existing[29] and upcoming investment protection agreements.

[25] As an example, the German energy firm RWE claims at the German civil court– though without a complaint for investment protection- for compensation from the Federal Republic of Germany and the land Hesse because of an unlawful order for shutdown (BVerwG 7 B 18.13 v. 20.12.2013) in the context of the so-called nuclear moratorium in 2011.

[26] The argument that legal costs for arbitration proceedings on investment protection are too expensive for small and medium-sized companies (Frankfurter Allgemeine Zeitung, issue from July 8, 2015, p.1) is unfounded, as companies also can, according to the proposals of the EU for TTIP, bring a claim before a state court instead of an arbitration court (Krajewski, on investment protection and investor-state dispute settlement in the Transatlantic Trade and Investment Partnership (TTIP), short assessment on behalf of parliamentary party in the Bundestag Bündnis 90/Die Grünen from May 1, 2014, p.11)

[27] Art. X. 33 CETA.

[28] Art. 4 2 (a) UNCITRAL Rules on Transparency.

[29] 86 out of 129 bilateral contracts for investment promotion- and protection in Germany are regulated by an investor-state arbitration .

Furthermore, the argument there could emerge conflicts of interest for private arbitrators is not valid on closer inspection. In fact, the selection of the arbitrator is not free from the influence of the state which has been sued. Quite the contrary, each party - thus, also the sued state - chooses one arbitrator, and together these selected arbitrators determine a third one, who then becomes chairman of the arbitration court.[30] Additionally, the chosen arbitrators have to be experienced with international law and to be independent,[31] and they have to disclose conflicts of interest.[32] Moreover, each party, including the sued state, is in the position to reject an arbitrator any time there are reasonable grounds for doubting that the arbitrator is neutral and independent.[33] Recent free trade agreements also inhibit that arbitration courts interpret investment protection clauses in an undesired way. For example, CETA allows the European Union and Canada to specify binding interpretations,[34] which enables the two parties of the agreement to influence and control the way of interpretation of arbitration courts.[35] In this context, the considerations of the German minister for economic affairs are interesting and relevant. He suggests replacing common private arbitration courts with an international public legal court for investment. The parliament of the European Union has adopted these ideas and is recently calling for a new system based on democratic principles and democratic control that provides a framework in which litigation in public procedures are heard by ordered, independent professional judges.

After all, it is true that free trade agreements have not allowed lodging legal remedies against the decisions of arbitration courts yet. However, this condition does not legitimate a fundamental criticism of investment protection clauses, as recent free trade agreements already intend to establish courts of appeal.[36]

Whereas the instruments for dispute resolutions that have been discussed above serve to dissolve already existing disputes, there also exists an instrument for the preventative avoidance of conflicts which has become more and more important in more recent free trade

[30] e.g. Art. 8.25 no. 1 Canada-Korea Free Trade Agreement.
[31] e.g.. Art. 8.25 no. 2, 3 Canada-Korea Free Trade Agreement; Appendix 14-C Art. 5 Par. 1 of the Free Trade Agreement EU/ROK.
[32] Appendix 14-C Art. 3 of the Free Trade Agreement EU/ROK.
[33] Art.9 of the UNCITRAL arbitration rules (printed in: Schwab/Walter, Schiedsgerichtsbarkeit, 7th Edition 2005).
[34] Of course only, if they are not defendants on their own.
[35] Art. X.27 CETA.
[36] Art. X.42, CETA.

agreements. It is planned to embed the instrument of Regulatory Cooperation into the free trade agreement TTIP. According to the draft of the European Union, Regulatory Cooperation is defined as a closer cooperation between the participating states, with the aim to facilitate trade and investment in a way that helps to support the efforts of the states to stimulate growth and employment, but also to set up high standards for environment-, consumer-, and employee protection as well as to keep financial stability. The goal is to reduce hindering and unnecessary regulations which make trade more difficult. Therefore, the contract states shall be supposed to make planned legislative proposals publicly accessible once per year. In this context, the EU draft considers a process where the state evaluates the effects of the new laws on international trade in a first step and informs the other parties of contract about the effects in a second step. If necessary, the parties of contract then will attempt to harmonise their set of rules by aligning their national legal regulations, or the parties at least make efforts to mutually recognize the equality of the individual national regulations of each contract state.

Many NGOs have criticized the above mentioned method. They are apprehensive of democratic deficits because they assume that in the context of a regulated consultation process in TTIP, business representatives will be given exclusive influence on the regulatory cooperation as well as on the legislative procedures within the contract states. This fear is unfounded. In fact, the stakeholder consultations, which are included in Article 6 of the EU draft for TTIP, are available to all interested parties in a non-discriminatory way, thus they also include stakeholders such as NGOs and other lobbyists. Besides, such hearings are on a level of international standard. They are, for example, exercised by the European Union and are also used by many NGOs. As an example, in spring 2014 a public survey of the European Union concerning TTIP drew 150.000 answers of which around 145.000 answers had been organized by NGOs.

Furthermore, critics of the planned free trade agreement between the EU and the USA argue that a regulatory cooperation could lead to an erosion of environmental- or social standards. This critic is also unfounded as with Art. 1 (2) of the EU draft for TTIP, all contract states are explicitly granted the right to keep or to set up new regulations that serve public interest, thus that serve, for example, environmental- or consumer protection, as well as the protection of working conditions.

As we have seen, recent free trade agreements have been criticized in various ways. In this regard, there should not be ignored the fact that Europe cannot avoid globalisation, but that it can indeed shape it. If the completion of TTIP will be successful in the foreseeable future, this agreement will set new standards[37] that could also strongly influence free trade agreements from other parts of the world such as, for example, the planned Trans-Pacific Partnership (TPP) between the USA and various Asian and South American countries.

[37] „Gold standard“ for international trade agreements, said the US-American embassy counsellor for economy and trade during an event at Hanns Seidel-Stiftung on July 4, 2014.