



MASTER THESIS

Titel der Master Thesis / Title of the Master's Thesis

**„Differences of the investor-state dispute settlement regimes
in the European Union and the Russian Federation“**

verfasst von / submitted by

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angestrebter akademischer Grad / in partial fulfilment of the requirements for the
degree of

Master of Laws (LL.M.)

Wien, 2016 / Vienna 2016

Studienkennzahl lt. Studienblatt /
Postgraduate programme code as it
appears on
the student record sheet:

A 992 628

Universitätslehrgang lt. Studienblatt /
Postgraduate programme as it appears on
the student record sheet:

International Legal Studies

Betreut von / Supervisor:

Univ.-Prof i.R. Dr. Gerhard Hafner

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Introduction

Much like international trade law has been reshaping the global economy, international investment law today has presented mankind with a handful of norms, which have significantly increased global economic growth. For instance, studies have shown that the liberalization of trade has enhanced global trade flow and hence improved living standards. “In 1948, world merchandise exports of goods, amounted to U.S. \$59 billion per year. In 2011, world merchandise exports amounted to U.S. \$17.816 billion, or almost U.S. \$18 trillion per year. World exports of commercial services, marginal in 1948, amounted in 2011 to U.S. \$4.170 billion, or almost U.S. \$4.2 trillion.”¹ It applies *mutatis mutandis* to investment flows worldwide and among other things serves as evidence of a positive influence on the economies of developing countries.² Global economy is much more efficient, open and liberalized today and therefore more fragile and demanding. Thus it needs a well-functioning and strong legal framework to monitor and protect it.

Contemporary international investment law is often criticized. The perception exists that only big multinational corporations benefit from this legal framework and foreign investors are the sole beneficiaries of this system. However, it is the ordinary consumer who benefits the most.³ Ironically, the real problem in investment law is its diversity. There are no uniform global rules on investment protection and no universally recognized standards of investment protection. Therefore, jurisdictions differ in the application of substantive law, they attract different amounts of capital and, hence, it leads to disproportionate economic development.

Another paradox is that the global character of the economy leads to the vanishing of the borders between “domestic” and “foreign”. The issue of ownership, control and management becomes central rather than the country of origin.⁴ Finally, the correlation between domestic and international law is an issue as well. State acts of expropriation have significantly scaled down in the recent years: “the number of direct expropriation acts was 136 in the 1960’s and 423 in the 1970’s, but has since

¹ Peter Van den Bossche, Werner Zdouc, “*The Law and Policy of the World Trade Organization*”, Third Edition, Cambridge, page 8

² *Ibid.*, page 9

³ Simon Lester, “*Reforming the International Investment Law System*”, Maryland Journal of International Law, Volume 30, 2015, page 70

⁴ *Ibid.*, page 75-76

declined to only 17 in the 1980's, 22 in the 1990's, and 27 instances in the 2000's, through 2006.”⁵

Despite the fact that States undertake obligations under a vast majority of bilateral and multilateral investment treaties they tend to violate them regardless of their commitments. Even a State's agreement to arbitration established under an international treaty might be overruled by State's domestic courts or simply ignored. Consequently the problem of enforcement of arbitral awards arises with it. In many cases there are no suitable mechanisms to ensure enforcement through domestic courts even if the State has prior agreed to arbitration. The issues at hand present a threat to the economic development and prosperity that are being granted by the investment law framework. Accordingly, time has come to reform this system or, perhaps, even to take revolutionary measures.

This paper will be focusing on two major economies: The European Union (hereinafter – the EU) and its member States on the one hand, and the Russian Federation (hereinafter – Russia) on the other. The website of the European Commission provides a basic picture of the Russian - EU trade and investment relations: “Russia is the third trading partner of the EU and the EU is the first trading partner of Russia. Trade between the two economies showed steep growth rates until mid-2008 when the trend was interrupted by the economic crisis and unilateral measures adopted by Russia, which had a negative impact on EU-Russia trade. Since 2010 mutual trade has resumed its growth reaching record levels in 2012...The EU is the most important investor in Russia. It is estimated that up to 75% of Foreign Direct Investment stocks in Russia come from EU Member States. The foreign direct investment statistics for the year 2013 are the following: From Russia into the EU – EUR 36.2 million and from the EU into Russia – EUR 154.8 million.”⁶ Given that the EU and Russia have always had a strong trade and investment relationship, a suitable legal framework in the service of the needs of the investors and States is a desirable goal.

This thesis aims to create an elaborate description of the abovementioned relations. The first chapter will be devoted to an overview of the respective investment norms of Russia, the European Union and its Member States. Issues of investment protection

⁵ *Ibid.*, page 73

⁶ European Commission official website, Trade policy, Countries and regions, Russia, [<http://ec.europa.eu/trade/policy/countries-and-regions/countries/russia/>]

on national and international levels will be analyzed. Particularly, this chapter will be dealing with the new investment policy of the European Union and the division of competences between the Union and its Member States regarding investment protection. The second chapter will be focusing on the notion of “investment” with regard to investor – State dispute settlement (hereinafter – ISDS). The aim of this chapter is to provide an overview of the relevant case law regarding the interpretation of the term “investment” in high-profile cases as well as in case law arising from bilateral treaties between Russia and EU Member States. The third chapter will be devoted to the ISDS regime between Russia and the EU. An analysis of substantive and procedural provisions in their bilateral and multilateral treaties will be presented. The goal of this chapter is to assess the optimal ISDS mechanism that would benefit both the European Union and the Russian Federation, to provide an elaborate analysis of existing and potential problems that may arise in the process of investment negotiations and to furnish possible guidelines for the future investment agreement. Being the major world economies and political actors, both the Russian Federation and the EU play a great role in developing of the ISDS regime as well as in fostering of the investment law as a scientific area.

Chapter I

The legal framework of investment protection in the Russian Federation and the European Union

The history of investment protection and emergence of ISDS

“The protection of foreign property has occupied a position at the core of public international law, since its very inception. Disputes between States resulting from alleged violations of a national’s property rights can be traced to the end of the 18th century.”⁷ Investment disputes became international disputes between the home State of the investor and the host State of the investment, which was the traditional method of receiving justice for violations of international law with respect to foreign investors. This approach is supported by the “Draft Articles on Diplomatic Protection” proposed by the International Law Commission in 2004, which include the following definition of the subject matter: “diplomatic protection consists of resort to diplomatic action or other means of peaceful settlement by a State adopting in its own right the cause of its national in respect of an injury to that national arising from an internationally wrongful act of another State.”⁸

However, such “diplomatic action” is being distinguished from “judicial proceedings” in a number of cases.⁹ On the other hand, scholars and lawyers do not draw such distinction and include in diplomatic protection the following actions: “consular action, negotiation, mediation, judicial and arbitral proceedings, reprisals, retorsion, severance of diplomatic relations, economic pressure and, the final resort, the use of force.”¹⁰ Therefore, investors could request their home State to espouse their claim, although, it was up to the State to decide whether it wants to do so or not.

⁷ Sachet Singh and Sooraj Sharma “Investor-State Dispute Settlement Mechanism: The Quest for a Workable Roadmap” Merkourios – Utrecht Journal of International and European Law, 2013 - Vol. 29/76, p.90

⁸ Article 1, ILC “Draft Articles on Diplomatic Protection”, 2004, UNTS A/CN.4/L.647, See also ILC “First report on diplomatic protection”, 2000, A/CN.4/506, pp. 13-15

⁹ *Panevezys-Saldutikis Railway case*, P.C.I.J. Reports, Series A/B, Nr. 76, page 16, see also *Nottebohm case*, 1955, I.C.J. Reports, page 24, and *Iran-United States Claim Tribunal*, Case Nr. A/18, 1984, 5 I.U.S. C.T.R. 251, page 261

¹⁰ P. Weiss, “*Diplomatic Protection of Nationals and International Protection of Human Rights*”, 1971, 4 Human Rights Journal, page 645, see also E.M. Borchard, “*The Diplomatic Protection of Citizens Abroad or The Law of International Claims*”, 1915, page 439

Nevertheless, the system of diplomatic protection has proven to be ineffective and coercive. “Under traditional international law, investors did not have access to international remedies to pursue claims against foreign States for violation of their rights. They depended on diplomatic protection by their home States.”¹¹ It is usually accompanied by various limitations: the investor loses power over his claim and relies entirely on the “political discretion” of the State. He also has to exhaust the local remedies in the host State, which requires time, resources and may be utterly useless. The State may even decline to accept the claim or drop the claim in the middle of the proceedings. Such actions may also disrupt international relations between countries.¹²

The situation later changed in favor of negotiations. One of the most famous cases in this respect is the *Barcelona Traction case*, where a Canadian utility firm went bankrupt due to restrictions imposed by the Spanish government. The majority of the shareholders of the Canadian *Barcelona Traction, Light, and Power Company Ltd.* originated from Belgium and therefore Belgium commenced a lawsuit against Spain in the International Court of Justice (hereinafter – ICJ), but did not succeed due to the ruling of the Court, which stated that only the State of incorporation may sue. The Court established that the actions of the Spanish government were not aimed at the Belgian shareholders, in which case it would give them the right to sue. It provided an analogy with municipal law stating that direct rights of the shareholders must have been violated.¹³ This case shows that even the means of diplomatic protection fail to secure the interests of a State’s nationals.

Hence, due to a fortunate state of the global economy and a need for changes in international economic law, investors acquired the possibility to settle their disputes on their own. Additionally, two related developments were involved in the evolution of investor-state dispute resolution from diplomatic protection: the establishment of *fora* for direct claims and the growth in the use of treaties (breaches of which could be pursued either in those *fora* or sometimes in domestic courts).¹⁴ Today, all Investor –

¹¹ Rudolf Dolzer/ Christoph Schreuer, “*Principles of International Investment law*”, Oxford University press, 2008, page 211

¹² *Ibid.*, page 212

¹³ *Belgium vs. Spain - Barcelona Traction, Light and Power Company, Limited - Judgment of 5 February 1970, ICJ 1, paras. 47-49*

¹⁴ Sachet Singh and Sooraj Sharma “Investor-State Dispute Settlement Mechanism: The Quest for a Workable Roadmap” *Merkourios - International and European Law: General Issue 2013 - Vol. 29/76*, p.90

State Dispute Settlement regimes are a democratic mechanism, where investor and State stand on the same level before the arbitrator. For example, investor-state disputes can be resolved by means of the International Center for the Settlement of Investment Disputes (hereinafter – ICSID). Since the 1980's, more and more developing countries have increasingly accepted highly protective investor-state dispute settlement mechanism in the bilateral investment agreements (hereinafter – BIT's) or free-trade agreements (hereinafter – FTA's) with both developed and developing countries.¹⁵ Article 27(1) of the ICSID Convention, for instance, even prohibits the use of diplomatic protection, but allows the usage of diplomatic channels for the “sole purpose of facilitating a settlement of the dispute”. The first investor-state arbitration under a BIT took place in 1987, and the reports¹⁶ suggest that prior to this, most of the investment disputes that referred to the international tribunals were either brought in pursuance to contractual agreements by the private parties or were State-to-State arbitrations.

A study¹⁷ conducted by United Nations Conference on Trade and Development (hereinafter – UNCTAD) shows the percentage of cases that have been decided either in favor of the State or the private investor. By the end of 2014, out of 356 cases, which have been concluded, 37% (132 cases) were decided in favor of the State, 27% (94 cases) in favor of the investor. 28% (101 cases) were settled by means of conciliation. The rest had been discontinued for various reasons. The statistics show that the percentage of cases in favor or against either party is more or less even, moreover a high number of settled cases should also be assessed as a positive sign of the effectiveness of the contemporary ISDS system. The contemporary international investment framework is rich with numerous agreements with high protection standards and a varied set of arbitration cases. This framework will be the object of the following analysis.

Multilateral treaties: ISDS sources and evolution

The sources of international investment law consist of multilateral investment treaties, such as the ICSID Convention or the Energy Charter Treaty, bilateral investment

¹⁵ Chen Huiping “The Investor-State Dispute Settlement Mechanism: Where to Go in the 21st Century?”, p.1

¹⁶ *Ibid.*, Sachet Singh and Sooraj Sharma, page 90

¹⁷ UNCTAD, *IIA issues note*, 1 February 2015

treaties, which are the most wide-spread investment instruments of all and also regional and plurilateral agreements, for example, investment chapters in free trade agreements. These instruments contain two types of norms: substantive, which harbour investment standards like non-discrimination of investors, fair and equitable treatment or regulations on expropriation, and procedural, which encompass the ISDS clauses. The *raison d'être* of the ISDS is to provide a remedy in case of a violation of the investment agreements. In most cases, the claims relate to unlawful administrative acts of States.¹⁸ Some critics believe that such provisions have the ability to challenge domestic legislation and this is the reason why many States are reluctant to adopt or accede to international investment agreements (hereinafter – IIA's) that grant extensive freedoms to private investors. However, the recent growth of ISDS cases in international arbitral institutions is evidence of the need and effectiveness of this mechanism. "ISDS was originally intended to provide investors with a depolitized, fast, neutral, cheap, and flexible method of enforcing the protection of their investments. It intended to encourage productive foreign direct investment to the benefit of both the host country and the investor."¹⁹ Unfortunately, this system is yet developing and needs fresh ideas. Despite the scepticism of the States, the ISDS system is evolving slowly. It is mostly the developing States, which place restrictions and reservations in their international investment agreements.

The criticism of this system is usually based on the following weaknesses: "...inconsistent interpretation of clauses and definitions, creative use of the ISDS system by investors, challenges against environmental and labor regulations intended for the public good, long and expensive arbitral procedures, and limited transparency and secret proceedings."²⁰

The United Nations Commission on International Trade Law (hereinafter – UNCITRAL) has already begun to reform the system. Namely, it developed the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration 2014²¹, which provides accessibility and transparency to the ISDS

¹⁸ European Commission, „ISDS: some facts and figures“, page 4, available at: [http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153046.pdf],

¹⁹ International Investment Agreement and Investor-State Dispute Settlement, Bundesverband der Deutschen Industrie, 29 April 2014, page 24, available at: [http://wahrheituebertip.at/wp-content/uploads/2015/07/bundesverband-der-deutschen-industrie-facts-and-figures-international-investment-agreements.pdf]

²⁰ *Supra* note 19, page 25

²¹ UNTS, United Nations Convention on Transparency in Treaty-based Investor-State Arbitration, New York, 10 December 2014

mechanism of UNCITRAL by incorporating new procedural rules. It is available to ISDS actors in proceedings under the UNCITRAL Arbitration Rules (hereinafter – UNCITRAL Rules)²² and *ad hoc*. UNCTAD has also published his *Investment Policy Framework for Sustainable Development 2015*.²³ This report provides for eleven core principles for new investment policies of States. The goal is to promote “sustainable growth and development” in the receiving State while at the same time to protect private investors. The principles are: investment for sustainable development, policy coherence, public governance and institutions, dynamic policymaking, balanced rights and obligations, right to regulate, openness to investment, investment protection and treatment, investment promotion and facilitation, corporate governance and responsibility, and international cooperation. All of them are aimed at providing new guidelines for future investment agreements, existing investment treaties that may be renegotiated and national legislation as well. However, it is not clear yet whether the international community will accept them. Only new investment agreements and treaty practice will reveal their success.

„Today there are more than 3000 international investment agreements containing Investor-to-State dispute settlement provisions. EU Member States account for 1400 of these. Investors from the EU Member States are the largest users of ISDS. Cases brought by investors from the European Union total 327, thus accounting for more than 50 % of ISDS cases initiated. Combined, investors from the Netherlands, the UK, Germany, France, Spain and Italy have launched 236 cases, representing 72 % of all EU based cases and 39 % of ISDS cases at global level.”²⁴ Although, most of the cases against the EU originated from EU Members, the majority of cases outside of the EU had been brought by the Russian Federation, thus making the functioning of the ISDS mechanism a very important issue of their investment regime.

Unfortunately, Russia is not party to the ICSID Convention, making it harder for Russian and European investors to resolve investment issues with the respective States. However, other institutions and means do exist. For example, the United Nations Commission on International Law has introduced its own arbitration rules. Today they exist in two versions – 2010 and 2013. Also the Stockholm Chamber of Commerce (hereinafter – SCC), which was historically preferred by the Soviet

²² § 4, Article 1, UNCITRAL Arbitration Rules 2013

²³ See full version at

[http://investmentpolicyhub.unctad.org/Upload/Documents/POLICY_FRAMEWORK_2015.pdf]

²⁴ *Ibid.*, pages 3-5

government to settle disputes with the “Western countries”²⁵ and the International Chamber of Commerce (hereinafter – the ICC), which accounts for fewer amount of cases.

The contemporary relations between the European Union and the Russian Federation with respect to investment matters are stalling. For the purpose of fostering their trade relations, both the EU and Russia should develop common goals, as well as common legal principles and guidelines. Today’s political and economic crisis presents a good turning point for revision of past mistakes, adjustment to a new economic environment and evolution of their bilateral relations on all fronts. Besides, for a better understanding of the ISDS regimes and the options they provide for foreign investors an analysis of the national legal frameworks will be the objective of the following paragraphs.

The Russian Investor – State Dispute Settlement regime

The contemporary investment concept of the Russian Federation is still affected by the Soviet economic model. Before the 1980’s the Soviet legislation did not include any investment regulations both internal and international. The first bilateral agreements were concluded in the late 80’s and early 90’s. It is noteworthy that in 1992 the Russian Federation assumed all contractual obligations of the USSR including all BIT’s concluded by the USSR.²⁶

The structure of Russian ISDS-related instruments has two levels: domestic and international. All norms, both national and international, which are aimed at enhancing the protection of foreign investors are the basis for the ISDS regime.²⁷ For the purpose of this thesis, an analysis of the legal acts of both those levels is necessary.

National legislation of the Russian Federation

²⁵ R. O. Zykov, “*The International arbitration in Sweden: law and practice*”, Moscow, STATUT, 2014, page 9

²⁶ Interstate Agreement between the former Soviet republics on the Succession of External Debts and Assets of the USSR, 4 December 1992;

²⁷ Evgueni Gloukhov Dissertation, “*Rechtlicher Schutz ausländischer Investitionen in der Russischen Föderation durch das System bilateraler Investitionsschutzverträge*”, Vienna, 2004, page 5

Russia's national legislation includes federal laws and other legal acts, which regulate investment matters and implement its international obligations. The domestic level consists of the Federal Constitution of the Russian Federation²⁸, the Civil Code, the Federal law N-160 on „Foreign investments in the Russian Federation“ 1999²⁹, the Federal law N-39 on „The investment activities in the Russian Federation in the form of capital investments“ 1999³⁰ and the Federal law N-46 on “The protection of rights and legal interests of investors on the stock market” 1999³¹.

The Constitution represents the basis of economic activities in the Russian Federation and provides legal grounds for investors to conduct business on its territory. Article 8 of the Constitution establishes the following basic economic principles:

- 1. In the Russian Federation guarantees shall be provided for the integrity of economic space, a free flow of goods, services and financial resources, support for competition, and the freedom of economic activity.*
- 2. In the Russian Federation recognition and equal protection shall be given to the private, state, municipal and other forms of ownership.*³²

Another important provision is Article 34 stating that: “*everyone shall have the right to a free use of his abilities and property for entrepreneurial and economic activities not prohibited by law*”. This provision allows foreign investors to access Russia's market freely and without any restrictions. It is also encompassed in § 3 of Article 62, which grants foreign nationals and stateless persons the same enjoyment of rights and obligations as to Russian citizens. A similar approach towards foreigners is shown in the Federal Law concerning the legal status of foreign citizens in the Russian Federation: “*foreign citizens in Russia shall enjoy rights and bear responsibilities on a par with the citizens of the Russian Federation, except as otherwise provided by federal law.*”³³

²⁸ Constitution of the Russian Federation, 12 December 1993

²⁹ Federal law N-160 on „Foreign investments in the Russian Federation“, 19 July 1999

³⁰ Federal law N-39 on „The investment activities in the Russian Federation in the form of capital investments“, 25 February 1999

³¹ Federal law N-46 on “The protection of rights and legal interests of investors on the stock market”, 5 March 1999

³² English translation of this and the following articles of the Constitution is provided by [<http://www.constitution.ru/en/10003000-01.htm>]

³³ Federal Law Nr. 115-FZ, „Concerning the Legal Status of Foreign Citizens in the Russian Federation“, 25 July 2002, available at the website of the MFA of Russia: [<http://archive.mid.ru/ns-osndoc.nsf/e03e22cee6f0c66e43256c630041f8ac/a052819e48402515c32575d9002c4486?OpenDocument>]

Also a relevant clause is Article 35 of the Constitution that grants the right to property to “everyone”, *i.e.* Russian and foreign nationals, which is protected by law. Paragraph is §3 of the same article is crucial for the internal regulation of such an investment standard as expropriation regulations. It says: “*No one may be deprived of property otherwise than by a court decision. Forced confiscation of property for state needs may be carried out only on the proviso of preliminary and complete compensation.*” This is one of the key standards in international investment law. The fact that it is implemented in the Constitution signals that Russia’s legal system runs indeed towards a free and open market.

Some scholars believe that the nature of investment activities is almost identical to all other kinds of entrepreneurship and therefore is subject to laws and regulations that deal with economic activities on the territory of the Russian Federation.³⁴ However, for the purposes of this thesis only those laws and regulations will be reviewed, which provide the necessary legal framework for ISDS.

The Civil Code of the Russian Federation provides a general rule that foreign citizens, stateless persons and foreign juridical persons are subject to the provisions in this code placing them along with Russian natural and juridical persons on the same level of treatment.³⁵ Another relevant provision in the Civil Code is Article 1069 that provides for responsibility of governmental entities for damages inflicted on natural and juridical persons, which in the light of Article 2 of the Civil Code includes aliens. It can be useful in case of an act of expropriation conducted by Russian authorities. The Treasury of the Russian Federation is carrying out restitution procedures in those cases.

The next level of protection is provided by lower level federal laws. The Federal law N-160 on „Foreign investments in the Russian Federation“³⁶ establishes legal grounds for foreign investments in the Russian Federation and provides guarantees for fair and equitable treatment of foreign investments, legal remedies, multiple forms of investment *etc.* Two aspects of this law are relevant to this thesis: investment provisions, *i.e.* investment protection standards and ISDS provisions. This law establishes the notion of the foreign investor, of an investment and of an FDI.

³⁴ Dissertation, page 62, see also Doronina N.G./Semiljutina N.G. “Review of the laws related to foreign investments”, *Pravo i Ekonomika*, 2003, pages 79-85

³⁵ Article 2 of the Russian Civil Code

³⁶ Official translation at the official website of the Investment portal of the Pskov oblast: [http://invest.pskov.ru/sites/default/files/ob_inostrannyh_investiciyah_v_rossiyskoy_federacii_eng_0.pdf]

A definition of an “investor” purports that either a foreign juridical person, a foreign organization, which is not a juridical person, a foreign national, a stateless person or an international organization can act as an investor on the territory of Russia. They must possess legal capacity according to their home State’s legislation. The Law incorporates two definitions of “investment”: one of “foreign investments” and the other of an FDI. A foreign investment is an injection of foreign capital, which is owned by the investor, into a business on the territory of the Russian Federation. It includes money, securities, other property, property rights, intellectual property, services and information. The list is non-exhaustive.

There are some restrictions provided by other federal laws on objects that are prohibited or restricted in distribution in Russia. An FDI is defined as a 10% ownership of shares in a commercial entity, an injection into main funds of a representation of a foreign juridical person in Russia or an equipment leasing contract in Russia of at least 1 million RUB value. These definitions are crucial for the understanding of Russia’s policy towards foreign investments. The 10% bar for an FDI is very low therefore it is quite liberal and the definition concurs with international standards of the International Monetary Fund (hereinafter – IMF). However, the notion is rather concise and is not as wide as in the Multilateral Investment Guarantee Agency Convention (hereinafter – MIGA Convention), where an FDI includes concessions, product sharing agreements, turnkey projects and licensing agreements. Some of these categories are not covered by the Federal law, which indicates that certain restrictions nevertheless do exist.³⁷

Substantive provisions of the Federal Law are very important for the Russian ISDS regime. They are the *ratione materiae* for the jurisdiction of various *fora*. The Federal law encompasses Article 4, which provides for national treatment of foreign investors: one of the most important standards in modern trade and investment law. Article 8 deals with expropriation and provides for a fair and adequate compensation in case of seizure of foreign assets. This article is closely linked to the relevant provision in the Constitution and is also one of the key standards. However, it differentiates between “requisition”, whereby only the cost of the investment is being returned, and “nationalization”, whereby the real cost and “other losses” are being restituted.

³⁷ Dissertation, page 64

As to the procedural ISDS provisions, Article 10 says: “*A foreign investor’s dispute arising in connection with the implementation of investment and entrepreneurial activities in the territory of the Russian Federation shall be resolved in compliance with international treaties of the Russian Federation and federal laws in the court or arbitration court or in an international arbitration court*”.³⁸ This provision is dispositive and therefore does not require an investor to use the local courts first in order to access international arbitration. There are also no linguistic restrictions on the type of claims and disputes, meaning that any dispute arising from a foreign investment may serve as grounds for jurisdiction. The dispute shall also be resolved on the basis of an international agreement of the Russian Federation. Access to national courts and to arbitration for foreign investors will be reviewed further in this paragraph.

The rest of the Federal Law N-160 (§§ 11-28) is devoted to various guarantees to private investors and regulates, for example, the acquisition of assets in the territory of the Russian Federation such as land or natural resources, transborder movement of assets and money, the transfer of rights and obligations *etc.*

Some special laws refer to international arbitration in case of disputes. For instance, the Federal law N-225 on “Production sharing agreements” 1995³⁹ states that “disputes between State and investor related to performance, termination or nullity of agreements are resolved according to the conditions of the agreement in a court, economic court or in an arbitration tribunal (including international arbitration institutions)”.⁴⁰ Such laws also provide the option of international arbitration without the need to exhaust local remedies. However, other norms may be applied if provided in an international treaty.

The Federal law N-39 on „The investment activity in the Russian Federation in the form of capital investments“ establishes an important definition of „investment“: „money, securities, other property, including property rights, other monetizable rights, which are injected into business activities or other activities for the purpose of receiving profits or other benefits”.⁴¹ The same article includes another definition of

³⁸ Article 10, Federal Law “On Foreign Investments in the Russian Federation”, 1999

³⁹ Federal law N-225 on “Production sharing agreements”, 30 December 1995, Available at the legal database Consultant Plus. The author provided translation of the relevant parts of the Law.

⁴⁰ *Ibid.*, Article 22

⁴¹ Article 1 of the Federal Law N-39, official translation of the Federal Law available at: [http://invest.pskov.ru/sites/default/files/ob_investicionnoy_deyatelnosti_v_rossiyskoy_federacii_eng.pdf]

“capital investment” that certainly can be seen as part of the core definition and a specification adding necessary activities related to construction.

Besides, Article 17 of the Federal Law N-39 provides for disputes to be resolved according to national legislation and international agreements of the Russian Federation. Some scholars⁴² believe that this law may be considered *lex generalis* in regard to the Federal law N-160 on „Foreign investments in the Russian Federation“ and serves the goal of „closing legal loopholes“ in the latter. Although, such an approach has been criticized since this legal act does not contain any specific regulations on foreign investments.⁴³

Earlier in this paragraph it was mentioned that a foreign investor can make use of local remedies as well as of international arbitration and there is no obligation to proceed first with domestic courts to access arbitration. However, the possibility to review an investment dispute in the national judicial system does exist. First, it is important to highlight the linguistic feature of the Russian courts. The words “arbitrazhnyj sud” refers to the domestic courts dealing with economic and entrepreneurial claims. It is easily confused with the English word “arbitration”, which in Russian is “tretejskij sud” and is represented by the International Commercial Arbitration Court at the Russian Chamber of Commerce and Industry (hereinafter – ICAC) or other *ad hoc* arbitral institutions.

Foreign investors have the right to file a claim in Russian domestic economic courts (arbitrazhnyj sud) according to the Arbitration Procedural Code of the Russian Federation (hereinafter – APC).⁴⁴ Article 27(5) of the APC establishes the jurisdiction of the arbitrazh courts and states that they shall try cases involving (besides Russian entities) “foreign organizations, international organizations, foreign citizens and stateless persons engaged in business activities, or organizations with foreign investments, if not otherwise provided for by an international treaty of the Russian Federation”. This provision covers foreign natural and juridical persons as well as Russian entities with foreign investments.

A special section (Section V of the APC) is devoted to proceedings on cases with the participation of foreign persons. Russian arbitrazh courts “shall investigate cases on

⁴² N. G. Doronina, „A commentary to the Federal law on foreign investments“, *Pravo i Ekonomika*, Vol. 4, 2000, pages 60-70

⁴³ Dissertation, page 69

⁴⁴ Article 4 of the Arbitration Procedural Code of the Russian Federation, Nr. 95-FZ, 24 July 2002, official translation available at: [<http://www.wipo.int/edocs/lexdocs/laws/en/ru/ru072en.pdf>]

economic disputes and the other cases involved in the performance of business and other economic activity...” of foreign entities.⁴⁵ It appears rather clear that investment activity is covered by this provision as well. The provision provides a non exhaustive list of cases, in which these courts have jurisdiction over the foreign person’s property and claims arising with relation to it: if the defendant resides on the territory of the Russian Federation or his property, the management body, affiliate or representation are located therein, if the dispute has arisen from an agreement whose execution shall take place on its territory, in case of damage to his or her property inflicted in its territory, in case of protection of business reputation, unjust enrichment, circulation of securities, in case a legally important fact that occurred in its territory, in cases that deal with intellectual property and other cases, where a link between a dispute and the territory of the Russian Federation exists. Article 248 provides for exclusive competence of arbitrazh courts in the following cases: disputes concerning property in state ownership of the Russian Federation, including privatization cases and cases of forcible alienation for state needs, one’s related to immovable property, one’s related to intellectual property, one’s concerning disputes on recognizing invalid entries in state registers and the one’s concerning the institution, liquidation or registration of legal entities on the territory of the Russian Federation. The APC provides for the same procedural rights for foreigners as for Russian entities and citizens.⁴⁶ Documents of foreign origin shall be accepted by the arbitrazh courts of the Russian Federation if they have been properly legalized or an apostille has been placed on them.⁴⁷

The analysis of the relevant Federal Laws and the APC shows that foreign investors have all necessary substantial and procedural rights to access the Russian domestic judicial system. The nature of their claims is covered by the arbitrazh courts jurisdiction and the enforcement of awards is ensured by the powers of the Russian Federation.

In case of an agreement between the parties to a dispute Article 4(6) of the APC allows them to refer the case to an arbitration tribunal unless and until the first instance arbitrazh court has rendered a decision terminating the reviewal of the merits of the dispute. Hence, foreign investors have also the remedy provided by ICAC. Of

⁴⁵ *Ibid.*, Article 247

⁴⁶ *Ibid.*, Article 254 of the APC

⁴⁷ *Ibid.*, Article 255 of the APC

course, the parties to a dispute may refer directly to ICAC if such a possibility has been agreed upon and layed down in an arbitration agreement between those parties. The Federal Law on ICAC⁴⁸ states that access to arbitration may be granted on the grounds of an arbitration agreement. It shall be conducted in written form and may be formulated as an arbitration clause in a contract or a separate agreement.

The Federal Law on ICAC⁴⁹ provides for the necessary jurisdiction: “Pursuant to an agreement of the parties...disputes resulting from contractual and other civil law relationships arising in the course of foreign trade and other forms of international economic relations...as well as disputes arising between enterprises with foreign investment...” may be referred to ICAC. Moreover, the Statute on the ICAC⁵⁰ covers specifically disputes arising out of investments. Parts III – VI deal with the tribunal’s competence, procedure, assignment of arbitrators *etc.*

In case either party is unsatisfied with the award rendered it may bring it before a domestic court⁵¹ for reviewal and annulment. Article 34 and 36(1) provide for the following grounds for setting aside an award: either party lacked legal capacity or the arbitration agreement was invalid; either party has not been properly notified concerning procedural matters; the award was rendered in breach of the arbitration agreement; the procedure or the arbitrators assignment process contradicted the arbitration agreement; the court will decide that the dispute is not subject to arbitration; the award contradicts the public order of the Russian Federation.

Another ground for the annulment of an award is listed in Article 233 of the APC – “if the award violates the fundamental principles of Russian law”. All those grounds coincide with the provisions of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (hereinafter – the New York Convention 1958).⁵² Nevertheless, the vague language of the “public order” and “fundamental principles” provisions present a threat to awards that might not be suitable for the any government. Since state courts tend to stick with the State’s policies a situation may arise, where these vague formulations might be used to set aside a valid award. Unfortunately, in case of Russia the area of enforcement lies within the discretion of the sovereign State.

⁴⁸ Part II of the Federal Law on International Commercial Arbitration, Nr. 5338-1, 7 July 1993

⁴⁹ Article 1(2) of the Federal Law on ICAC 1993

⁵⁰ Article 2 of the Annex 1 to the Federal Law on ICAC 1993

⁵¹ The relevant court competent to review an award is specified in Article 6(2) of the ICAC Law

⁵² Article V of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, UNCITRAL, New York, 1958

If both parties recognize an arbitration award it has to be enforced in the host country of the investment. There are two ways to do that: either the award is being enforced according to the order issued by the competent arbitration tribunal⁵³ or the competent arbitrazh court of the Russian Federation is issuing a writ of execution⁵⁴. Either way, the award will be furnished by the authority and power of the Russian Federation.

The legal system of the Russian Federation gives foreign investors an adequate remedy to protect their rights and property. Access to both arbitration and state judicial system is provided. Investors may directly bring a claim to arbitration institutions or act through local courts, which in a way may be better, since domestic courts commence enforcement measures. However, enforcement is a difficult issue and will be dealt with further in the next chapters.

International investment agreements of the Russian Federation

Besides the national remedies, the interests of foreign investors are protected by Russia's international investment treaties. For this purpose, Russia has enacted a Model BIT and concluded 74 BIT's, 5 Multilateral Investment Agreements (hereinafter – MIA's) and 20 other investement-related instruments with other countries.⁵⁵ An adequate analysis of Russia's international commitments established under BIT's will include a comparison with its Model BIT.

Russia's BIT's can be divided into two categories: the ones concluded by the Soviet Union and the ones concluded by the Russian Federation. The former entail usually more restrictions. However, minimal investment standards are encompassed in all of these treaties, except for the „umberella clause“, which appears in Russia's BIT's rather seldom⁵⁶ and is not present in the Russian Model BIT.

Arbitration clauses are incorporated in each of the Russia's investment agreements, however some of them entail restrictions. For instance, the bilateral investment agreements with Austria, Belgium – Luxemburg, Finland and Spain are limited in scope to the „amount or mode of compensation for expropriation“. ⁵⁷ The ones with Germany, the Republic of Korea, the Netherlands, Switzerland and the United

⁵³ Article 35 of the ICAC Law

⁵⁴ Articles 236-240 of the APC

⁵⁵ UNCTAD Database, [<http://investmentpolicyhub.unctad.org/IIA/CountryBits/175#iiaInnerMenu>];

⁵⁶ For instance, BIT's with China, Denmark, France and Germany

⁵⁷ Article 10(1) of the Belgium/Luxembourg – Russia BIT, Article 10(1) of the Spain – Russia BIT

Kingdom are additionally limited to disputes regarding the free transfer provision.⁵⁸ Nevertheless, Russia's Model BIT in this respect is more liberal and has broad provisions covering „investments of an investor in the territory of a Contracting party“⁵⁹. This shows the real difference between the soviet-era BIT's and the contemporary drafting. All abovementioned BIT's were concluded in the late 80's and early 90's. New Russian BIT's have a broader scope in this regard. Moreover, since the wording of the clause does not require a potential claim to involve BIT violation, it may theoretically relate to any matters as long as they relate to investments. *„If interpreted in this manner, the ISDS clause potentially enables investors to start international arbitration proceedings under the BIT with the respect to breaches of investment contracts or matters governed by domestic law of the host State or customary law on the treatment of aliens and their property...“*⁶⁰

Some fairly new issues in modern BIT's are not covered by the Russian Model BIT. For instance, the selection of arbitrators, conduct of proceedings, governing law, transparency of proceedings and *amicus curiae* submissions, consolidation of claims, or remedy available.⁶¹ Still some of the issues have been incorporated in some Russia's BIT's. For example, the Russia – China BIT 2006 contains provisions on applicable law.⁶² However, unless the parties have not negotiated additional provisions in their BIT's, it is the arbitration rules of various institutions that govern the mentioned issues.

For instance, Russia is party to international investment agreements that expressly provide procedural ISDS rules. For instance, the most important „procedural“ instrument in the Russian investment arbitration practice are the UNCITRAL Arbitration Rules. Under these Rules Russia has also established a competent authority – the International Commercial Arbitration Court at the Russian Federation Chamber of Commerce and Industry, which has been mentioned above. ICAC provides for a list of arbitrators, similar to the ICSID system, which potential claimants can benefit from.

Another option for arbitral proceedings accessible to Russian and foreign investors is the Stockholm Chamber of Commerce. It has developed its own rules of arbitration,

⁵⁸ *Ibid.*

⁵⁹ Article 8(1) Russian Model BIT 2001

⁶⁰ Chester Brown, *Commentaries on Selected Model Investment Treaties*, page 615

⁶¹ *Supra* note 60, page 616

⁶² Article 9(4) China – Russia BIT

however, UNCITRAL Rules can be also applied. The SCC is also available in the Model BIT after a mandatory 6 months period of negotiations. The listing of the abovementioned institutions also means an implied consent to arbitration, *i.e.* an investor does not, for example, need to exhaust local remedies to file a claim before an arbitration tribunal.

Russia has also signed the ICSID Convention, although, did not ratify it. This fact means that it can not benefit from the arbitration rules, provided by this Convention, but is only allowed to benefit from the Additional Facility rules. The Additional Facility Rules of ICSID administer the following categories of proceedings: „(ii) conciliation or arbitration proceedings for the settlement of investment disputes between parties one of which is not a Contracting State or a national of a Contracting State; and (iii) conciliation and arbitration proceedings between parties at least one of which is a Contracting State or a national of a Contracting State for the settlement of disputes that do not arise directly out of an investment, provided that the underlying transaction is not an ordinary commercial transaction.”⁶³ However, Russia has not made use of these Rules yet.

The following new multilateral economic treaties, which Russia is a party of, are worth discussing. A very important development in the Russian legislation is the accession to the Treaty on Eurasian Economic Union. In 2000 the Treaty on the establishment of the Eurasian economic community has been signed. In 2007, Belarus, Kazakhstan and Russia created a common customs territory and formed a customs union. In 2011 they formed another economic alliance – the single economic space. Finally, in 2014 the Treaty on Eurasian Economic Union (hereinafter – the EAEU Treaty) was signed, entering into force in 2015 and forming a common market, a territory with no tariffs and duties and ensuring the 4 basic freedoms: free movement of people, goods, capital, and services. By 2015 two other countries have joined the organization – Armenia and the Kyrgyz republic.

Among other economic areas, the Treaty also deals with investment matters. Article 27 says that for the purpose of promoting investments free (special) economic zones shall be established.⁶⁴ Such special zones provide for a more liberal investment regime in a specified region, for example, the Murmansk and the Vladivostok

⁶³ Introduction to the Additional Facility Rules, ICSID, available at: [\[https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/AFR_English-final.pdf\]](https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/AFR_English-final.pdf)

⁶⁴ Article 27, EAEU Treaty

harbours. Section IX of the Treaty deals with the foreign trade policy of the Eurasian Union. Article 34 encompasses the MFN clause states that: *„With regard to foreign trade, most favoured nation treatment shall be applied within the meaning of the General Agreement on Tariffs and Trade of 1994 (GATT 1994) in cases and under the conditions where the use of most favoured nation treatment is provided for by international treaties of the Union with a third party, as well as by international treaties of the Member States with a third party”*. According to this provision the MFN clause can be applied to foreign investments in Russia and other EAEU States with regard to existing investment agreements. A very important reference has been made to one of the core World Trade Organization (hereinafter – WTO) instruments – the General Agreement on Trade and Tariffs 1994 (hereinafter – GATT 1994). This MFN provision might be a means to refer to investment agreements with third parties to extract more favorable clauses from them. However, there is no practice within the Union to solidify this approach.

Article 67 of the Treaty refers to international principles and standards with respect to liberalization of investments: “The liberalisation of trade in services, incorporation, activities and investments shall be conducted with due account of international principles and standards...” While this is rather a declaratory provision, it does show the intention of the Union to develop its legal framework according to the contemporary investment law.

Annex 16 is the “investment chapter” of the EAEU Treaty, which is called “The Protocol on Trade in Services, Incorporation, Activities and Investments” (hereinafter – EAEU investment chapter). § 2 of the Protocol is devoted to the definitions and contains various investment-related notions, such as: „receiving State“, „activities related to investment“, „investment“ or „investor of a Contracting party“. The notion of “investment” is broadly drafted and is of non-exhaustive nature. However, all these definitions only refer to the rights of Contracting parties, hence only they are able to make use of the benefits provided in this Treaty. Nevertheless, some third-party regulations are indeed envisioned. Section VI (§ 6) of the Protocol regulates the relations of the Member States with third countries in this regard. Subparagraph 48 states that the conclusion of investment agreements with third States is in the competence of the Member States, not the Eurasian Union. *„The Member States shall be free to determine their foreign trade policy in relation to trade in services, incorporation, activities and investments with third states”*. This is a sign of vague

integration. However, it is an important step in economic integration in this region after the dissolution of the USSR.

Section VII of the Protocol deals exclusively with investment. §2 (68-70) provide the following investment standards within the Eurasian Union:

*“68. Each Member State shall ensure on its territory **fair and equitable treatment** to investments and investment-related activities conducted by investors of other Member States.*

*69. The treatment specified in paragraph 68 of this Protocol shall **not be less favourable** than the treatment accorded by the Member State **in respect of investments and investment-related activities conducted by its domestic (national) investors.***

*70. The treatment accorded by each Member State, under the same (similar) circumstances, to investors of any other Member State, their investments and investment-related activities shall be **no less favourable than the treatment accorded to investors of any third state**, their investments and activities related to such investments.”*

Subparagraphs 68-70 establish common international investment standards. The most important provision is the MFN clause, which allows drawing more favorable provisions from treaties with third States. But, as established before, there is no practice in the Eurasian Union on that issue that is why it is hard to say whether such practice will be actually established. Although, subparagraph 71 allows the investor to choose the most favorable regime himself. This could ideally allow such treaty practice. An important provision is envisaged in §3 (77), where compensation for damage inflicted during „war, revolution or other like actions on the territory of the Contracting party” shall be paid. This is an update in the legislation of the Russian Federation, since national legislation does not contain such a clause. § 4(79) condemns expropriation, however, allows Member States to resort to it in cases of „public benefit“ but for „prompt and adequate compensation“.

§ 6 of this Section provides for an ISDS clause. If within 6 months the dispute has not been settled amicably, the article provides the following remedies: domestic court of a Contracting party, arbitration tribunal of the commercial chamber of a Contracting State, *ad hoc* tribunal according to the UNCITRAL Arbitration Rules or the ICSID Centre. The latter may be applied only in case if both of the Contracting parties are parties to the ICSID Convention, otherwise Additional Facilitation Rules shall be

applied. This paragraph also contains a fork-in-the-road clause, which means that if the investor has submitted his or her claim to one forum, it cannot make use of any other. Enforcement provisions have also been included in the Protocol. Unfortunately, the wording in the ISDS clauses accords favorable treatment only to investors from Contracting States. However, the wording of the “investor” in § 6(8) Section II of the Protocol refers to “any person of the Contracting State” and §6(10) defines “any person from the Contracting State” as any natural or juridical person of the Contracting State”. Since such drafting implies very vague wording, these treaty provisions may also cover foreign investors that have a favorable treatment according to domestic legislation.

Another recent instrument among international treaties of the Russian Federation is the Eurasian Union – Vietnam FTA 2015 (hereinafter – EAEU – Vietnam FTA).⁶⁵ It has a separate “investment chapter” contained in Section V of the Agreement. It provides for an extensive definition of “investments”, minimal protection standards for investors of both Parties and an adequate ISDS clause.

The treaty provides for a progressive definition of “investment”: “[it is] *any type of asset invested by the investor of a Party to this Chapter in the territory of the other Party to this Chapter in accordance with the latter Party’s laws and regulations, that has the characteristics of an investment, including such characteristics as the commitment to capital or other resources, the expectation of profit and assumption of risk...*” Despite the fact that the investment is defined as “asset invested”, which contradicts basic laws of logics, it still has unusual wording for Russian IIA’s. Not only is it broadly drafted, allowing basically all kinds of investment, but it adds the words “characteristics of an investment”, which include a link with capital or other resources, the purpose of receiving profit from this investment and the risk factor, which is also essential.

Articles 8.31-8.33 contain international investment standards like “fair and equitable treatment”, “full protection and security”, national treatment and MFN treatment. The latter standard, however, referring to ISDS provisions in this Treaty contains a rather new approach in investment law. Article 8.33(2) states that “*for greater certainty, this Article shall not apply to international dispute settlement procedures or mechanisms such as those set out in Article 8.38 of this Agreement.*” This provision is a result of

⁶⁵ Eurasian Union – Viet Nam Free Trade Agreement 29 May 2015

long lasting disputes among scholars and arbitrators on the issue, whether MFN treatment may be extended to ISDS provisions for they are not substantive, but procedural. More elaborate analysis on the subject matter will be provided in next chapters of this thesis.

The ISDS provisions in the EAEU – Vietnam FTA is similar to the one in the EAEU Treaty, although, containing a few more details. The dispute may arise in connection with an investment and contains no other restrictions. It entails a mandatory 6 months obligation to settle the dispute on amicable terms. This clause allows the parties to the dispute to use “*non-binding, third-party procedures, such as good offices, conciliation and mediation*”. Shall the negotiations fail, the parties to the dispute may choose a forum from the list provided. The only difference from the list provided in the EAEU Treaty is that it is exhaustive, while the EAEU – Vietnam FTA allows to choose any other arbitration institution the parties agree upon.

Russia’s international treaties provide for a liberal ISDS regime allowing investors to access arbitration directly and providing a very open list of arbitral institutions. Russia’s bilateral treaties incorporate high protection standards. Additionally, Russia is fostering its economic relations with the former USSR republics on the basis of the Eurasian integration, which is similar to European integration. The Eurasian Union has learned from the European Union and has established many institutions and adopted a variety of principles that coincide with the European vision of economics. Russia, as part of this integration process, has an opportunity to promote new and innovative ISDS measures and strengthen the existing one’s. Moreover, cooperation between the EAEU and the EU may strengthen ISDS regimes of both Russia and EU Member States thus leading to economic growth in the region.

The Investor – State Dispute Settlement Regime in the Member States of the European Union

A very important issue is the role of domestic law for the protection of investments. European States have well developed legal systems and adequate judicial entities. However, since all of them are members of the European Union their legal system is much more complex, than it seems.

Particular investments held by investors in the territory of a State party to an IIA are a matter for the IIA, not domestic law. Although, in order to qualify an investment as

such under an IIA one must prove its existence, which depends only on domestic law. That is why the matter of existence of an investment is a matter of national law, and not international. Some IIA's make a reference to domestic law requiring an investment to be held in accordance with host State's laws and regulations. National laws do not determine or limit the meaning of the investment under an IIA, but confirm its existence, validity, nature and scope of the rights related to the investment, whether it vests on a protected investor, determines the conditions for its operation on the territory of the host State and also investment-related government measures.⁶⁶

As it has been mentioned above, European Union Member States are the biggest economic partners of the Russian Federation. Investments are part of that trade exchange. Historically European countries and Russia have been very close and have established long lasting economic relations, which have survived disruption and disagreements and still remain on a partnership basis. Such States as Austria and Germany among other European States have the strongest economic ties to the Russian Federation. Despite the disagreements on grounds of the Ukrainian crisis, Austrian enterprises are active on the Russian market. Most of them comprise such economic sectors as timber and paper industry, construction, machinery, automobile shipments, banking *etc.* Austrian investments amount to 8 billion EURO per year.⁶⁷ German investors remain interested in the Russian market despite political disagreements.⁶⁸

Moreover, the first BIT's have been concluded between the then USSR and these countries. Also, within the European Union both States are the most economically developed and allocate most of the investments in total. Therefore, for the purpose of this thesis the author will analyze the present legal regime on the basis of their national legislation, their model investment laws and provide an overview of their BIT's.

Austria: national legislation

⁶⁶ Andrew P. Newcombe, Lluís Paradell, „*Law and Practice of Investment Treaties: Standards of Treatment*“, Kluwer Law International, 2009, pages 92-94

⁶⁷ Austrian embassy in Moscow, [<http://www.bmeia.gv.at/oeb-moskau/bilaterale-beziehungen/russische-foederation/wirtschaft/>]

⁶⁸ See Chadbourne & Parke LLP analysis, International Financial Law Review, 1 January 2014, [<http://www.iflr.com/Article/3306943/2014-FDI-Report-Russia.html>]

The Austrian Federal Constitutional Law 1930⁶⁹ deals with expropriation matters and empowers the Constitutional Court of Austria to have jurisdiction over expropriation claims.⁷⁰ Along with the Constitution the Austrian Civil code (§ 33) grants aliens the same civil rights as Austrian nationals. That serves as core grounds for third country investor activities on Austrian soil.

Federal laws related to investment, such as the Law on Investment funds 2011⁷¹, the Law on alternative investment fund managers 2015⁷², Decree on costs of investments 2008⁷³, Decree on reimbursements for investments 2012⁷⁴ *etc.* do not regulate the specific substantive investment standards or ISDS procedures. The Federal law on investment funds previously included regulations on foreign investment funds in §§ 175-185, but this chapter was terminated.

However, Austrian civil law provides extensive protection of property for foreigners, which is an adequate remedy. Foreign investors can also make use of its judicial system for the protection of their interests. Foreign investors have access to the national system of courts as well as to international arbitration. Investment claims will be classified as private law matters and will be subject to the jurisdiction of the courts of ordinary jurisdiction.⁷⁵ Moreover, a special commercial court exists in Vienna (Handelsgericht).

The Civil Procedure Code (hereinafter – CPC) provides for legal capacity of foreigners stating that even if a foreign citizen lacks capacity under the laws of its home State, he may be granted such capacity under the Austrian laws.⁷⁶ There are no special regulations as to the participation of foreign citizens in the judicial process, hence, general rules provided for in the CPC apply.

However, special regulations do apply to arbitration. The following institutions deal with arbitration in Austria: the International Arbitral Centre of the Austrian Economic Chamber in Vienna (Internationales Schiedsgericht der Wirtschaftskammer Österreich in Wien), which operates according to its own “Vienna rules”⁷⁷ and the Court of

⁶⁹ Bundesverfassungsgesetz 1930, BGBl. Nr. 1/1930

⁷⁰ *Ibid.*, Article 144

⁷¹ Investitionsfondsgesetz 2011, BGBl. I Nr. 77/2011

⁷² Alternatives Investmentfonds Manager-Gesetz, BGBl. I Nr. 117/2015

⁷³ Investitionskostenverordnung, BGBl. II Nr. 320/2008

⁷⁴ Investitionskostenersatzverordnung, BGBl. II Nr. 107-2012

⁷⁵ The Jurisdiction Act (Jurisdiktionsnorm), RGBl. Nr. 111/1895

⁷⁶ Para. 3, Part 1 “Legal capacity” CPC

⁷⁷ The new Vienna Rules 2013, available at: [<http://www.viac.eu>]

Arbitration of the International Chamber of Commerce, which operates under the ICC rules.

The CPC contains a reference to the „arbitration clause“, which is the basis for party referral to this CPC chapter.⁷⁸ The assignment of arbitrators is up to the parties as well as the procedure, which they have to agree upon before the arbitration proceedings. The arbitration award is final unless challenged in domestic courts on the grounds provided in the CPC⁷⁹, which are similar to the one's established under Article V of the New York Convention and also include „ordre public“ exceptions. Enforcement of an award that is recognized by the parties is based on a writ of execution provided under § 614.

Besides, Austria is party to the Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (hereinafter – Lugano Convention) that ensures enforcement among EU and EFTA Members and also an EC Council Regulation Nr. 44/2001⁸⁰ with the same title entered into force in 2002. This Regulation provides for an elaborate procedure for recognition and enforcement of awards among EU Member States and furnishes common rules in this respect for the purpose of strengthening of the common market.

Austria provides quality arbitration and accessible national judicial systems. The participation in the EU's common market and a strong judicial system make investments in its economy easy and secure.

Germany: national legislation

The German „Constitution“ or „Das Grundgesetz“, which by literal translation means „Basic law“, sets out many economic freedoms. Article 14 protects property and does not limit its possession only to Germans, but to aliens as well. Article 3(1) states that everyone is equal before the law. This means that nationals and aliens can enjoy the same economic rights on German soil. Investment-related regulations are also present in the German Basic law. For instance, norms on expropriation correspond with international standards in this regard and entail obligations for compensation.⁸¹

⁷⁸ §§ 581-618 of the Civil Procedure Code (Zivilprozessordnung), RGBI. Nr. 113/1895

⁷⁹ Para. 611(2) of the CPC

⁸⁰ Council Regulation (EC) on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, Nr. 44/2001, 22 December 2000

⁸¹ Article 14(3) of the German Basic law

Other federal laws, for instance, the German civil code,⁸² provides for a definition of „entrepreneur“⁸³, where no limitations as to nationality or statehood are implied. In case of a dispute between an investor and a State based on an IIA, the former is entitled to all benefits granted by this law.

German procedural law⁸⁴ is also available in case of an investment-related dispute. § 1029 provides for arbitration clauses in contracts, and § 1030 states that „any property-related claim may give rise to arbitration“, *i.e.* these provisions are the basis for arbitration according to this law.

Some German industries are accorded special treatment with respect to foreign direct investments. For instance, the Ordinance on external economic relations places restrictions on purchases of juridical entities under certain circumstances.⁸⁵ For example, such purchases may be limited in case of endangerment of public order and security. Moreover, the purchase of entities is subject to State control of the Bundeskartellamt (Federal cartel agency) and of the European Commission. Competition law, specific sectoral norms (*e.g.* in Energy sector, Telekommunikation) and other regulations relating to juridical persons not only protect competition, but also hinder misconduct by foreign investors.⁸⁶

Germany is also party to the Lugano Convention and as part of the EU is subject to the EC Regulation 44/2001. Its national judicial system and procedural norms are similar to the one's in Austria. Arbitration is available for foreign investors without any hindrances.

International investment agreements of Austria and Germany

In this paragraph a brief overview of the differences and similarities between the Austrian and German model laws and their active bilateral investment treaties will be provided. All standards and protections are proliferated on nationals from these States.

⁸² Das Bürgerliche Gesetzbuch, 2 January 2002, BGBl. I S. 42, 2909; 2003 I S. 738

⁸³ *Ibid.*, § 14

⁸⁴ Zivilprozessordnung, 5 December 2005, BGBl. I S. 3202

⁸⁵ § 52 of § 7 Aussenwirtschaftsverordnung

⁸⁶ Bundesverband der deutschen Industrie, „*Ausländische Direktinvestitionen in Deutschland*“, page 11, [http://bdi.eu/media/presse/publikationen/globalisierung-maerkte-und-handel/Auslaendische_Direktinvestitionen_in_Deutschland.pdf]

Austria:

An important issue is the place of international treaties of Austria in its legal system. Article 9, 10 (6) and 50 of the Austrian Constitution 1920 refer to its obligations under international law and the place of international treaties in the legal system of the country. International law and its generally recognized rules and principles are part of federal law. This means that EU legal acts and Austria's IIA's are part of its legal system. *"The rank of its international legal instruments within the domestic system is determined by their content. Treaties that modify or supplement existing legal acts are placed along with federal law, and all other international agreements are mere administrative regulations"*.⁸⁷ However, the application process of international treaties is ambiguous: one category of treaties may be applied directly if it conforms with Article 18 (Rule of Law) of the Austrian Constitution and represent the legal basis for the administrative procedures in the article; the other needs a national act of implementation to be adopted, *i.e.* direct application is not possible.

Moreover, a very controversial issue has always been the place of EU law in the legal system of EU Member States. *"The general view is that EU law now takes precedence over domestic Austrian law and the national constitution, but is subordinate to the fundamental principles of the constitution"*⁸⁸. The analysis of the relevant EU acts will be provided further. Nevertheless, protection of investor rights is still available at national and international levels.

Austria is party to 62 BIT's⁸⁹ and to many other IIA's.⁹⁰ Besides, one of the most important investment-related instrument is the Austrian Model BIT 2010.⁹¹ It shows the investment policy directions of the State and its intentions at possible negotiations. For the purposes of this paragraph, the Model BIT will be analysed along with Austria's international agreements.

⁸⁷ Sonja Neudorfer/ Claudia Wernig, *„Implementation of International Treaties into National Legal Orders: The protection of the Rights of the Child within the Austrian Legal System“*, Max Planck Yearbook of International Law, V. 14, 2010, page 415, [http://www.mpil.de/files/pdf3/mpunyb_10_neudorfer_14.pdf]

⁸⁸ Johannes Oehlboeck/ Immanuel Gerstner, *"The Austrian Legal System and Laws: a Brief Overview"*, June 2005: [<http://www.nyulawglobal.org/GlobaLex/Austria.html>]

⁸⁹ See website of the Federal Ministry of Science, Research and Economy: [http://www.en.bmwf.gv.at/ExternalTrade/Investment_Policy/Seiten/Bilateral-investment-protection-agreements.aspx]

⁹⁰ Full list available at UNCTAD Investment Policy Hub: [<http://investmentpolicyhub.unctad.org/IIA/CountryOtherIias/12#iiaInnerMenu>]

⁹¹ Draft Agreement for the Promotion and Protection of Investment, 2010, available at: [<http://investmentpolicyhub.unctad.org/Download/TreatyFile/2849>]

Chapter I of the Model law provides for substantive protection measures such as „fair and equitable treatment“ (hereinafter – FET) and „protection and security“ treatment. These principles are provided in each of Austria’s BIT’s without any exceptions. Direct and indirect expropriation measures are prohibited except for a number of reasons: public interest, if it is conducted on a non-discriminatory basis, in accordance with due process of law and is “accompanied by payment of prompt, adequate and effective compensation”. Compensatory measures also have requirements. It has to be paid without delay, in free transferable currency, shall amount to the fair market value of the expropriated investment and include interest. Austrian BIT’s contain expropriation clauses, but the ISDS provisions based on this standard are often limited to disputes concerning the amount and mode of compensation.

MFN and national treatment are included in the BIT’s. The most common limitations relate to membership of a customs union, monetary union, FTA’s and taxation matters. Article 3(4)(b) of the Model law expressly excludes benefits granted under EU law from the coverage of MFN treatment. As to the scope of the MFN and national treatment and their relevance to ISDS procedures, most BIT’s cover “investors and their investments”⁹². Many BIT’s relate specifically to “management, use, enjoyment, disposal, sale or liquidation of investments”⁹³, which narrows down the scope of potential claims in this regard. The BIT with Malaysia⁹⁴ even restricts MFN treatment only to the FET standard.

Such investment protection standard as “umbrella clauses” appear in most of the Austrian BIT’s with a few exceptions, *e.g.* Bulgaria, Ethiopia Hong Kong, Russia and Tunisia.⁹⁵ Article 11 of the Model BIT also contains an “umbrella clause” and stipulates that each Contracting party “shall observe any obligation” entered into with an investor specifying that “the breach of a contract between an investor and the host State or one of its entities will amount to a violation of this treaty”. The inclusion of this standard is considered to be a positive development in international investment law. According to an analysis of “umbrella clauses” around the world it can be

⁹² For example, Article 3 of the Austria – Bangladesh BIT 2000, or Article 3 of the Austria – Bulgaria BIT 1997

⁹³ Article 3(2) of the Austria – Poland BIT 1988

⁹⁴ Article 3 of the Austria – Malaysia BIT 1985

⁹⁵ Christian W. Konrad, Phillip A. Peters, Investment arbitration review (Austria), 2015, available at: [http://globalarbitrationreview.com/know-how/topics/66/jurisdictions/25/austria/#ftr_2]

concluded that Austria has a broad and inclusive standard, which means that almost all possible contractual obligations may be covered by this “umbrella clause”.⁹⁶

Chapter II of the Model BIT contains ISDS clauses. Article 14 provides for negotiations and consultations as a first step before filing a claim. In case of failure of negotiations the claimant may file before the „*competent courts or administrative tribunals of the Contracting party*“, the ICSID centre according to the ICSID Convention or the Additional Facility Rules, *ad hoc* under UNCITRAL Arbitration Rules, the ICC under its own arbitration rules or „*in accordance with any applicable previously agreed dispute settlement procedure*“. All of these options are dispersed in various Austrian BIT's. Some BIT's provide for all of them, some only few⁹⁷ or even one⁹⁸.

The Model law also provides for a 60 days “cooling-off period”, although, the duration of this period is usually 3-6 months in most Austrian BIT's. Noteworthy is that neither the Model law, nor Austrian BIT's limit MFN treatment only to substantive provisions.

Germany:

Germany's Model BIT 2008 is one of the most developed and up to date instruments in international investment law. It was the first country to conclude a BIT.⁹⁹ Germany is party to 135 BIT's and to 64 other IIA's. Expropriation provisions in German BIT's are similar to the one's in Austrian BIT's and have the same requirements of prompt and adequate compensation and public benefit. However, some of them contain additional requirements such as absence of discrimination¹⁰⁰, lawfulness¹⁰¹ or both.¹⁰² Indirect expropriation mostly relates to measures, which are “tantamount to expropriation”.¹⁰³ Compensation measures are dealt with in great detail: there are provisions relating to the form of payment and the interest rate (some refer to London Interbank Offered Rate (LIBOR) as a guideline).¹⁰⁴

⁹⁶ Katia Yannaca-Small, “*Interpretation of the Umbrella Clause in Investment Agreements*”, OECD, International Investment Law: Understanding Concepts and Tracking Innovations, 2008, page 125

⁹⁷ Austria – Cuba BIT 2000

⁹⁸ Czech Republic 1990 and Turkey 1988 BIT's

⁹⁹ Germany – Pakistan BIT 1959, renegotiated in 2009, not yet in force.

¹⁰⁰ Article 4(2) of the Germany – Peru BIT

¹⁰¹ Article 4 of the Germany – Hong Kong BIT

¹⁰² Article 4(2) Germany – USSR BIT

¹⁰³ Article 4(2) of the Germany – Barbados BIT, Protocol Nr. 4 to the Germany – Mozambique BIT

¹⁰⁴ Article 4(2) of the Germany – Kuwait BIT, Article 4(2) of the Germany – Hong Kong BIT

ISDS clauses are usually broadly drafted, but in some BIT's relate only to "amount and mode of compensation".¹⁰⁵ German BIT's have also a requirement that the legality of expropriation measures shall be reviewable in domestic courts, notwithstanding ISDS provisions.¹⁰⁶

It is not clear whether German BIT's cover procedural rights with MFN and national treatment, however, they do cover "activities associated with such investments".¹⁰⁷ BIT's with many African countries have limitations in this regard such as preferential treatment of own nationals in employment matters¹⁰⁸ or accord special advantages to domestic not-profit development organisations with foreign shareholdings.¹⁰⁹

Every German BIT includes an "umbrella clause". The Germany – India BIT contains special ISDS specifications, providing that disputes arising from "*any other obligations*" the State has assumed with regard to investments, shall be "*only redressed under the terms of the contracts underlying the obligations*".¹¹⁰ The new Germany – Pakistan BIT also states that if a contract provides a dispute resolution mechanism, the investor can resort only to that ISDS mechanism concerning issues arising in relation to this contract, but the BIT covers issues arising under the "umbrella clause".¹¹¹

German BIT's provide for various other very detailed ISDS clauses, which do not appear in Austrian or Russian BIT's, for example. The "fork-in-the-road" clause is an exception in both of the abovementioned countries, however, is common in German treaties. The Germany – China BIT provides that if an investment claim has been brought to Chinese domestic courts, arbitration proceedings may be initiated only according to Chinese law by withdrawal of the claim from local courts.¹¹² BIT's with Mexico and Paraguay have strict provisions limiting the ability to file before local courts if arbitration proceedings have already been initiated.¹¹³ Special provisions relating to "*res judicata*" are also a feature of German BIT's. Some BIT's do not

¹⁰⁵ Article 10(1) of the Germany – USSR BIT

¹⁰⁶ Article 4(2) of the Germany – China BIT

¹⁰⁷ Article 3(2) of the Germany – China BIT

¹⁰⁸ Article 2(2) of the Germany – Swaziland BIT

¹⁰⁹ Article 3 of the Germany – South Africa BIT (terminated in 2014)

¹¹⁰ Article 13(2) of the Germany – India BIT

¹¹¹ Article 10(5) of the Germany – Pakistan BIT

¹¹² *Ibid.*, Protocol 6(c)

¹¹³ *Ibid.*, Article 12(5) and Article 11(2) respectively

allow changing the forum unless a final decision has been rendered¹¹⁴, other allow swithing *fora* in case if the decision of the local court violates the treaty.¹¹⁵

Provisions requiring exhausting local remedies are common in German BIT's and a number of bilateral treaties oblige the investor to pursue local remedies for a defined period of time, for instance, in Germany – Peru BIT this period is 18 months.¹¹⁶ Some of the old BIT's do not have an ISDS mechanism, but only dispute settlement between States.¹¹⁷ The rules, regarding the venue for a potential ISDS proceeding, do not differ from the one's in Austrian BIT's and have the same listings of arbitral institutions.

The European Union: nature and sources of EU law

As has been mentioned above, legal systems of EU countries are today more complicated than they used to be. A new branch of legal norms has emerged within past few decades reshaping EU Member States' law and policies. The nature of EU law is unique among modern world legal systems. It certainly overrules national law, even constitutional, however, and is placed along with the rules of international law, which makes it an unusual form of integration, unlike national or international integration.

EU law is directly applicable on EU Member States territory. The direct effect of EU law means that individuals have the possibility to directly invoke provisions of certain EU acts, which has been continuously applied by the European Court of Justice (hereinafter – ECJ). EU law can be divided into “primary” and “secondary” legislation. With regard to “primary” legislation, *i.e.* founding treaties such as the Lisbon Treaty 2009, the direct effect shall be “precise, clear, unconditional and shall not call for additional measures”. This approach has been established in the Van Gend & Loos case¹¹⁸. “Secondary” legislation, *i.e.* legal acts of EU institutions on the basis of the founding agreements, can be directly applied as well. They are categorized into: regulations, directives, decisions, recommendations and opinions.

Regulations always have direct effect. Article 288 of the TFEU specifies that

¹¹⁴ Article 12(4) of the Germany – Mexico BIT

¹¹⁵ Article 10(3)(b) of the Germany Chile BIT

¹¹⁶ *Ibid.*, Article 10(3)

¹¹⁷ Germany – Syrian Arab Republic BIT

¹¹⁸ *NV Algemene Transporten Expeditie Onderneming van Gend en Loos vs. Nederlandse Administratie der Belastingen*, ECJ, 1963, case 26/62

regulations are directly applicable in EU Member States: “*A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States*”. The ECJ confirms that they have direct effect in the *Politi* judgement 1971.¹¹⁹ **Directives** are legal acts addressed to EU Member States and shall be incorporated by them into their domestic legal systems. “*However, in certain cases the Court of Justice recognises the direct effect of directives in order to protect the rights of individuals. Therefore, the Court laid down in its case-law that a directive has direct effect when its provisions are unconditional and sufficiently clear and precise and when the EU country has not transposed the directive by the deadline (Judgement of 4 December 1974, Van Duyn)*”¹²⁰. **Decisions** may as well have a direct effect¹²¹.

International agreements, such as international investment agreements, have also been acknowledged to have direct effect. “In the *Demirel* Judgement of 30 September 1987, the [ECJ] recognised the direct effect of certain agreements in accordance with the same criteria identified in the Judgement *Van Gend en Loos*.”¹²² The Judgment states the following: “*A provision in an agreement concluded by the Community with non-member countries must be regarded as being directly applicable when, regard being had to its wording and the purpose and nature of the agreement itself, the provision contains a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure.*” Otherwise, direct effect shall not be granted to international treaties. Analysis of the nature of EU law is crucial for understanding of the contemporary legal regime in the EU Member States and the EU itself.

Until 2014 the investment policies of the Member States were based on bilateral investment agreements. Today they are divided into “extra-EU BIT’s” with third States and “intra-EU BIT’s” between EU Members. “Many of these intra-EU BIT’s were agreed in the 1990s, before the EU enlargements of 2004, 2007 and 2013. They were mainly struck between existing members of the EU and those who would become the “EU 13”. The aim was to reassure investors who wanted to invest in the future “EU 13” at a time when private investors – sometimes for historical political

¹¹⁹ *Politi s.a.s. vs. Ministry for Finance of the Italian Republic*, ECJ, Case 43-71, 14 December 1971

¹²⁰ The direct effect of European Law, 14 January 2015, [<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3A114547>]

¹²¹ *Hansa Fleisch Ernst Mundt GmbH & Co. KG vs. Landrat des Kreises Schleswig- Flensburg*, ECJ, Case C-156/91, 10 November 1992

¹²² *Supra* note 120

reasons – might have felt wary about investing in those countries. The BIT's were thus aimed at strengthening investor protection, for example by means of compensation for expropriation and arbitration procedures for the settlement of investment disputes..."¹²³ At this point of time there are more than 190 „intra-EU“ BIT's.

A new tendency has emerged in the past few years. The European Commission has been taking many efforts to eliminate the abovementioned agreements. It is claiming that they overlap and conflict with EU law. However, most of them are still in force for it is not yet clear whether the powers with regard to investment agreements indeed belong to the European Union, because many member States challenge this approach. Besides, the Commission's efforts are mostly aimed at intra-EU BIT's, while extra-EU BIT's remain in force until substituted with comprehensive investment treaties concluded by the EU. The Commission has commenced proceedings against some EU Member States (Austria, the Netherlands, Slovakia, Sweden and Romania) on the grounds that these intra-EU BIT's are violating *acquis communautaire*. It has also sent information requests to other 21 Member States, which have kept their intra-EU BIT's in force. It is worth noting that two Member States – Ireland and Italy – are the only two Member States that terminated all their intra-EU BIT's in 2012 and 2013 respectively.¹²⁴

The main idea of the Commission is the following: *“In order to be effective, guarantees from third countries on the conditions of investment should come in the form of binding commitments under international law. Hence, investment negotiations with third countries, for which we can build on the body and substance of the more than 1100 BIT's, which currently exist, will enable the EU to enlarge, better define and protect the competitive space that is available to all EU investors. In the long run, we should achieve a situation where investors from the EU and from third countries will not need to rely on BIT's entered into by one or the other Member State for an effective protection of its investments”*.¹²⁵ But not all of the Members agree with this approach. Besides, scholars and even EU level authorities have expressed concerns as to the effectiveness of comprehensive agreements. *“A one-size-fits-all*

¹²³ European Commission, Pressemitteilung: Kommission fordert Mitgliedstaaten zur Beendigung ihrer EU-internen bilateralen Investitionsschutzabkommen auf, Bruxelles, 18 June 2015, [http://europa.eu/rapid/press-release_IP-15-5198_en.htm]

¹²⁴ *Supra* note 123

¹²⁵ European Commission communication, page 5-6

*model for investment agreements with 3rd countries would necessarily be neither feasible nor desirable. The Union will have to take into account each specific negotiating context”.*¹²⁶

For the abovementioned purposes, the EU Regulation Nr. 1219/2012¹²⁷ grants legal security to the existing BIT's between the Member States and third countries until they are substituted by EU-wide investment agreements. The Commission may assess the BIT's with third countries and evaluate whether one or more provisions need amendment.¹²⁸ The process of renegotiation of old BIT's and conclusion of new one's is fully supervised by the Commission. A Member State has to notify the Commission about each step of the negotiations and the latter may request to participate itself. The Commission may grant¹²⁹ such authorization to a Member State or decline¹³⁰.

The European Union: a matter of competence

As shown above, before the establishment of the European Union, European States used to conclude BIT's to regulate their bilateral investment relations and investment relations with third countries. With the introduction of the Lisbon Treaty, the European Commission has assumed powers with respect to FDI matters of all 28 Member States. It exercises its powers by means of the common commercial policy of the EU by concluding extensive multilateral investment treaties such as the Comprehensive Economic and Trade Agreement (hereinafter – CETA) or Transatlantic Trade and Investment Partnership (hereinafter – TTIP) with Canada and the U.S. respectively. These instruments will be analyzed further in greater detail.

The question whether the competence to conclude international agreements belongs to the Union or to its Member States is a widely debatable issue. There are two main arguments favouring the EU competence in this regard: first, the wording of the latest integration treaty of Europe – the Lisbon Treaty 2009 – clearly empowers organs of the Union to act on the common commercial policy and with respect to international treaties, and, secondly, the European Commission is in fact taking actions in this

¹²⁶ European Commission communication, page 7

¹²⁷ Regulation (EU) Nr. 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

¹²⁸ Article 5 Regulation 1219/2012

¹²⁹ *Ibid.*, Article 10(4)

¹³⁰ *Ibid.*, Article 10(8)

regard, thus creating an important precedent. The Treaty on the Functioning of the European Union 2009¹³¹ states that the European Union has exclusive competence in the area of the common commercial policy.¹³² Moreover, in the same article the Treaty elaborates on the conclusion of international treaties: „*The Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or in so far as its conclusion may affect common rules or alter their scope.*” Clearly, conclusion of investment treaties will affect common rules of the Union taking into account the abovementioned efforts to abolish BIT’s of its Member States, and the Union’s competence in this regard is also provided for in the Regulation Nr. 1219/2012, which is without a doubt a “legislative act” of the European Parliament and of the Council.

Particularly, investment treaties with third countries are covered by the common commercial policy as well. Article 206 of the TFEU provides for “*the progressive abolition of restrictions on international trade and on foreign direct investment*”. Article 207 specifically and in great detail regulates the issue of treaty negotiation referring to Article 218 of the Treaty, where an elaborate negotiation procedure is provided for, and also provides for transparency and accountability of European institutions.

Article 207(6) states that the execution of the Union’s competence „*shall not affect the delimitation of competences between the Union and the Member States*”. However, the Council of the European Union delegates powers to the Commission, which according to the founding documents belong to the Member States, e.g. portfolio investment, infrastructure, labour and pharmaceuticals.¹³³ One of the reasons for such an argument is the wording of the Treaty. Since only the term „foreign direct investment“ is covered by the particular articles, other investment issues should theoretically belong to the shared competence between the EU and its Member States.¹³⁴ Member States consider such agreements with third States (e.g. CETA and TTIP) as „mixed agreements“, i.e., besides the European Parliament, they shall be ratified by national parliaments of all Member States of the European Union. The

¹³¹ Treaty on the Functioning of the European Union, 1 December 2009

¹³² Article 3(1)(e) TFEU

¹³³ Bundesministerium für Wirtschaft und Energie, Q&A to Investor protection and ISDS [<http://www.bmwi.de/DE/Themen/Aussenwirtschaft/investitionsschutz,did=694176.html>]

¹³⁴ Article 4(1) of the TFEU

Commission, however, rejects narrow interpretation of the relevant articles and claims implied powers over other investment issues such as portfolio investments.¹³⁵

Moreover, the problem is that the European Union is neither a State, nor a juridical person. The legal nature of the Union is unclear, despite the fact that the Lisbon treaty has provided the EU with legal personality. Some scholars believe that it is neither an international organization, nor a State, but rather a new kind of „polity“ seen as a supranational federation.¹³⁶ Whichever the nature, the fact is that the European Union is an international actor and shapes international relations alongside with States and international organizations. This issue is very important nonetheless. For instance, the ICSID Convention states that only Members of the World Bank or parties to the Statute of the International Court of Justice (hereinafter – Statute of the ICJ) may use its ISDS rules. The European Union is neither a Member of the World Bank, nor a party to the Statute. The EU has the intention to accede to the ICSID convention as a subject of international law, although, it would require amendment of the ICSID Convention or the acquisition by the European Union of a proper form, for instance, become a federal State.¹³⁷

Despite the doctrinal criticism of EU's competence and capacity to act as sole negotiator of international investment treaties, for the purposes of this thesis the author shall assume such competence. The founding treaties of the EU clearly grant such negotiating powers to the Union and recent negotiations with multiple third States also indicate the intention of the EU to remain active as an international actor. Not only is the Union currently negotiating the abovementioned CETA and TTIP, but also a BIT with China. Besides, it is mandated to negotiate investment chapters in FTA's with India, Japan, Mercosur, Thailand, Singapore and Vietnam.¹³⁸ Russia is also one of the countries that await negotiations on investment measures with the European Union.

The European Union: Contemporary relations with the Russian Federation

¹³⁵ New York Law Journal, [<http://blogs.law.nyu.edu/transnational/2014/07/recent-developments-in-eu-investment-agreements/>]

¹³⁶ Armin von Bogdandy, “The Oxford Handbook of the European Union”: Neither an International Organization Nor a Nation State: EU as a Supranational Federation, Oxford University Press, 2012

¹³⁷ European Commission communication, page 11;

¹³⁸ Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, „Towards a comprehensive European international investment policy, Brussels, 7 July 2010,, COM(2010) 343 final, page 7

The World Investment Report 2014, prepared by the United Nations Conference on Trade and Development (hereinafter – UNCTAD) elaborates on the investment inflows and outflows in and from the Russian Federation and the European Union.

Russia, being listed in the „Transitional economies“ regional group is considered to be “the world’s third largest recipient of FDI and the world’s fourth largest investor, mostly due to a single large deal”.¹³⁹ It also lists EU countries with the most significant investment share in the Russian Federation: Austria, Finland, France, Germany, Greece, Italy, the Netherlands, Slovenia, Sweden and the United Kingdom.¹⁴⁰ As to the prospects of the EU-Russian investment relations, the World Investment Report 2014 gives the following prognosis. “The regional [Ukrainian] conflict might affect FDI flows to and from transition economies. The outlook for developed-country TNC’s investing in the region appears gloomier. For Russian TNC’s investing abroad, an important concern is the risk of losing access to foreign loans. Banks in developed countries may be reluctant to provide fresh finance. Although some Russian State banks might fill the gap left by foreign lenders, some Russian TNC’s depend on loans from developed countries”.¹⁴¹

Nevertheless, the relations between Russia and European States have always survived any kind of distress. We do belong to one European community after all, to a family one can say. This „family relationship“ is reflected historically through the same moral principles, trends and even inter-monarchistic marriages. But more importantly this relationship is reflected through a common legal framework. After the dissolution of the Soviet Union Russia has returned to the „capitalist camp“ restructuring its legal system. For example, most of the Russian civil law originated from German civil law. In the Russian Federation a tremendous civil law reform is under way and many new concepts that are being introduced come from French, German or even English law.

The contemporary relations between the EU and Russia are based on the Partnership and Cooperation Agreement 1994 (hereinafter – PCA 1994). Since 2012 the EU and Russia have also established trade relations on the WTO basis, which might significantly liberalize bilateral trade in the future. The PCA 1994 entered into force on 1 December 1997. Its duration expired in 2007. The core idea was that it would be

¹³⁹ World Investment Report 2014, page 71;

¹⁴⁰ World Investment Report 2014, page 73, figure II.16

¹⁴¹ *Ibid.*, page 75

replaced by a new investment agreement. In 2008 new negotiations commenced between the EU and Russia, however, in 2014 the EU suspended its participation due to the „Ukrainian crisis“.¹⁴²

Article 1 PCA 1994 encompasses two important objectives, which are crucial for investment relations between the EU and Russia. One of the core objectives is the promotion of trade and investment in general. The other one is the creation of “the necessary conditions for the future establishment of a free trade area between the Community and Russia covering substantially all trade in goods between them, as well as conditions for bringing about freedom of establishment of companies, of cross-border trade in services and of capital movements.”¹⁴³

Title IV of the PCA 1994 deals directly with investment. Article 23 provides for the establishment of the national treatment in both jurisdictions: „Subject to the laws, conditions and procedures applicable in each Member State, the Community and its Member States shall ensure that the treatment accorded to Russian nationals, legally employed in the territory of a Member State shall be free from any discrimination based on nationality, as regards working conditions, remuneration or dismissal, as compared to its own nationals.”¹⁴⁴ Paragraph 2 of the abovementioned article provides national treatment for EU nationals on a reciprocal basis.

Articles 28-35, Chapter II, Title IV of the PCA 1994 deals with the establishment of companies in the respective jurisdictions. The creation of companies and/or the creation of subsidiaries is considered to be an investment and is subject to certain regulations. Such regulations base themselves upon two principles: non-discrimination and the MFN clause, which are a common thread for the whole agreement.

For example, Title V, Article 52 refers to the abovementioned chapter to proliferate these principles on the movement of capital in form of FDI's: „The free movement of capital between residents of the Community and of Russia in the form of direct investment made in companies formed in accordance with the laws of the host country and investments made in accordance with the provisions of Chapter II of Title IV, and the transfer abroad of this investment, including any compensation payments arising from measures such as expropriation, nationalization or measures of

¹⁴² Official website of the Permanent Mission of the Russian Federation to the European Union, <http://www.russianmission.eu/en/negotiations-new-basic-agreement>

¹⁴³ Article 1, PCA 1994

¹⁴⁴ Article 23, PCA 1994

equivalent effect, and of any profit stemming therefrom shall be ensured.”¹⁴⁵ In a Joint declaration on Article 52 the parties have adopted a joint definition of “direct investment”: “it is an investment for the purpose of establishing lasting economic relations with an enterprise such as investments which give the possibility of exercising an effective influence on the management thereof, in the country concerned by non-residents or abroad by residents, by means of:

1. creation or extension of a wholly owned enterprise, a subsidiary or a branch, acquisition of full ownership of an existing enterprise;
2. participation in a new or existing enterprise;
3. a loan of five years or longer.”

This definition is unfortunately quite poorly drafted and defines itself through itself, however, still provides the reader with the basic concept and the elements of a common notion of investment. The main issue is that an investment is only then an investment if it allows the investor to control the decision-making process of an enterprise. The abovementioned three elements of a direct investment constitute classic forms of investment, but do not allow other forms to emerge due to the exhaustive nature of the clause.

Creating a better investment climate, by providing better conditions for investment protection and information exchange, will most certainly benefit the regional economy. It is very unfortunate that this Agreement has very vague provisions on investment protection and none on ISDS.

Further analysis of BIT's and IIA's will have the focus and primary objective of assessment of existing agreements and definitions on the subject matter and the elaboration of investment relations. The author will make proposals on the development of investment protection procedures and on ISDS mechanisms.

The European Union: negotiations on comprehensive investment treaties involving ISDS mechanisms

Thy abovementioned structural and institutional uncertainty with both law and policy of the EU creates difficulties in applying ISDS mechanisms provided for in IIA's and

¹⁴⁵ Article 52, PCA 1994

raises questions as to the financial responsibility of EU and Member States in case of arbitration. On 16 April 2014 the European Parliament approved a proposal of the Commission for the creation of a framework for administering financial responsibility linked to ISDS matters.¹⁴⁶ The idea is the proper assessment and allocation of liability for damage caused by a foreign investor. Although, it protects only inward investments on the territory of the EU.¹⁴⁷ If an investment is injured by treatment originated from acts of EU institutions then they have to bear responsibility, if originated from EU Member States bodies – responsibility shall be borne by the Member States.¹⁴⁸ If EU law requires such a treatment from a Member State, responsibility is also borne by the EU. Articles on the responsibility of international organizations of the International Law Commission (hereinafter – ILC) support this exception.¹⁴⁹ The proposal encompasses procedural ISDS rules with relation to division of responsibility. Member States, which act as host States for an investment act as respondents unless the EU assumes this role or the Member State relinquishes its claimant rights.¹⁵⁰ The whole arbitration procedure, regardless of the fact, which entity acts as the claimant, is supervised by the Commission and reported to the Parliament and Council.

The problem, however, lies with the assumption of financial responsibility. For instance, if a Member State is afforded treatment and the Union acts as respondent, but wishes to settle, or when the Union is afforded treatment and the Member State wishes to settle, special rules on cooperation and consultations¹⁵¹ require prior negotiations between these two actors. However, some lawyers believe that attribution rules do not imply the sole responsibility for “conduct” of international organizations in all circumstances: “Dual attribution of conduct normally leads to joint, or joint and several, responsibility. However, joint, or joint and several, responsibility does not necessarily depend on dual attribution. One can take as an example the so-called mixed agreements, to which both the European Community

¹⁴⁶ European Parliament legislative resolution of 16 April 2014 on the proposal for a regulation of the European Parliament and of the Council establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party, P7_TA-PROV(2014)0419, 16 April 2014

¹⁴⁷ *Ibid.*, New York Law Journal

¹⁴⁸ Article 3 of the Regulation of the European Parliament on financial responsibility, 2014

¹⁴⁹ Article 64, Draft articles on the responsibility of international organizations, GA Resolution, 9 December 2011

¹⁵⁰ *Ibid.*, Article 9

¹⁵¹ *Ibid.*, Article 6

[EC – authors remark] and its member States are parties. In case of an infringement of a mixed agreement that does not distinguish between the respective obligations of the EC and its member States – either directly, or by referring to their respective competencies – responsibility would be joint towards the non-member State party to the agreement. As the European Court of Justice said in case C-316/91, *European Parliament vs. Council of the European Union*, with regard to the Fourth ACP-EEC Convention:

In the absence of derogations expressly laid down in the Convention, the Community and its Member States as partners of the ACP States [States of Africa, the Caribbean and the Pacific] are jointly liable to those latter States for the fulfilment of every obligation arising from the commitments undertaken.

In this case attribution of conduct to the EC or a member State does not appear to be relevant when deciding who is responsible. Even if it was ascertained that conduct was attributable only to one of the actors, they would all be jointly responsible.”¹⁵²

The European Union has assumed a new role as an international actor. Its intention to take and/or share responsibility for investment claims is a new tendency in its policy. But this problem cannot be solved using ISDS mechanisms in existing IIA's. As mentioned above, the Union is not able to be part of arbitration proceedings under the ICSID Convention or its Additional facilitation rules. Other arbitration rules, such as UNCITRAL and SCC arbitration rules allow the EU to take part in proceedings. However, since most of the arbitration disputes are covered by the ICSID convention, the EU has been trying to develop a new ISDS mechanism.

Taking into account the abovementioned uncertainty as to the determination of the respondent in case of arbitral proceedings, it is noteworthy that CETA entails special norms on such determination of competence.¹⁵³ The claimant shall deliver a notice requesting a determination of the respondent to the EU. According to European Parliament Resolution on financial responsibility described above, the Union determines this respondent status itself. If the investor has not been informed of such determination within 50 days, he may proceed with the claim according to the

¹⁵² Special Rapporteur Giorgio Gaja, Second Report on the responsibility of international organizations, 2004, A/CN.4/541 para. 8

¹⁵³ *Ibid.*, Article X.20, *Nota bene*: The text of the CETA agreement has not been made public yet, however, a consolidated version of the agreement after the final negotiations is available. The author believes that such version will suffice for research purposes.

following rules: where the measure identified in the notice is exclusively a measure of the Member State – the Member State shall be respondent, where the measure in the notice is a measure of the European Union – the European Union shall be respondent. After either the Member State or the EU has been determined as respondent, they may not assert inadmissibility of the claim, lack of jurisdiction or otherwise object to the claim on the grounds that the respondent status has not been properly determined.

Cutting-edge ISDS clauses have been added to the agreement. For instance, the Committee on Services and Investment established under CETA has two major functions. First, it may recommend “adoption of interpretations” to the Trade Committee, which shall be binding on a tribunal established under the treaty.¹⁵⁴ Second, it “shall provide a forum for the Parties” on possible improvements of the investment chapter, including furnishing an appellate mechanism, its nature, scope and effect of its decisions.¹⁵⁵ It also shall adopt a code of conduct for arbitrators, which may replace or supplement the arbitration rules applied to a dispute under the investment chapter in this treaty.

The investment chapter in CETA comprises the most important standards of investment law. It proposes a new concept of investment protection, including amendments to the common ISDS regime established in European BIT’s. More elaborate rules might even make existing multilateral treaties, such as the ICSID Convention or UNCITRAL Arbitration Rules obsolete. The abovementioned ISDS clauses in the CETA agreement would most certainly change the established practice in international investment law, but not severely.

ISDS issues have also been raised during the TTIP negotiations with the U.S. government. Despite the fact that a comprehensive trade and investment agreement was negotiated with Canada in 2014, and it does contain special ISDS mechanisms, such as the possibility to establish an appellate body, the Agreement still remains in the paradigm of classical ISDS mechanisms. TTIP on the other hand might include a revolutionary dispute settlement mechanism – an Investment Court System (hereinafter – ICS) – proposed by the European Union. In June 2013 the European Council issued a Mandate¹⁵⁶ for these negotiations. The future agreement would be

¹⁵⁴ *Ibid.*, Article X.27

¹⁵⁵ *Ibid.*, Article X.42

¹⁵⁶ Council of Europe, Guidelines for the negotiations on the TTIP agreement between the European Union and the United States of America, 11103/13, 17 June 2013

negotiated on the basis of the highest level of liberalization and the highest level of protection.

First of all, the EU proposes¹⁵⁷ to set up four basic substantive guarantees: non-discrimination, rules on expropriation, transferability of funds and protection from unfair treatment, *e.g.* denial of justice and targeted discrimination on various grounds such as religion, gender or race. Second, traditional ISDS mechanisms shall be substituted by the ICS with appointed judges by the EU and the United States. It would comprise an Investment tribunal (first instance) consisting of 15 judges: 5 EU nationals, 5 U.S. nationals and 5 nationals from other countries. Also an Appeals Tribunal would be established: encompassing 2 EU nationals, 2 U.S. nationals and 2 nationals of other countries. These judges would have to have a clear qualification comparable to judges in other international courts, would follow a certain ethics code and would be banned from assisting with other investment disputes while acting as judges. The assignment procedure would be based on random choice to ensure impartiality and three judges would hear each case: 1 EU national, 1 U.S. national and 1 national of another country.

Innovative procedural mechanisms include a new mediation system, which would help solve disputes amicably and avoid litigation. It would include tight deadlines – disputes would be decided within 2 years, including appeals. Specific provisions for small entities would be included to make investment arbitration more available. Among the suggestions is a cap on the procedural costs a small entity would have to bear in case it would have lost the dispute and the possibility to submit the claim to a sole judge to make the procedure faster and more efficient. The European Commission has also proposed new transparency rules: all documents would be posted online on the Internet and all hearings would be open to the public. The new Court would eliminate the practice of “forum shopping” since there would only be one institution investors would have the possibility to apply for.

In this regard the new system appears to be much more developed than the existing ISDS mechanisms provided for in most of the BIT's. However, opponents of the TTIP claim that Europe does not need such regulations for they have been developed to protect investors in countries with bad investment climates and unstable political regimes. They also fear that TTIP would give excessive rights to private entities and

¹⁵⁷ European Commission's proposal on the new Investment Court System, [http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153996.5%20Investment.pdf]

undermine the role of governments in issuing necessary legislation. However, such practice would be prevented by the inclusion of the “right to regulate” into the agreement. Proponents on the other hand favour the inclusion of a new ISDS mechanism since it provides for more transparency, higher level of qualification of the judges, which would lead to a higher quality level of the awards, and significantly increase the independence of the arbitrators. Although, it does not give the answer to the question whether the “right to regulate” will indeed be included and how the issue with the competence division between the EU and its Member States will be dealt with.

Unfortunately, US Undersecretary for International Trade at the Commerce Department, Stefan Selig, rejected the European Commission’s offer on creating such a court on the grounds that this proposal does not entail safeguards for governmental measures made in the public interest, i.e. “the right to regulate” needs to be elaborated.¹⁵⁸

Following a halt in the negotiations between the EU and the U.S., the French Minister of Foreign Trade Matthias Fekl submitted in June 2015 a new proposal to the European Commission. The goal of a new draft of the investment chapter is to eradicate the public mistrust to the ISDS mechanism in TTIP and convince the U.S. government of its necessity. He proposed the following measures:

- *“provisions safeguarding States’ power to regulate, such as a clarification that general legislation changes do not amount to a breach of an investor’s legitimate expectations...*
- *provisions safeguarding States’ power to sanction foreign investors for violation of national laws or regulations, and enabling States to bring counterclaims against investors in arbitration proceedings,*
- *create a permanent court with a list of arbitrators and an appellate body and provisions aimed at enhancing the transparency, and*
- *good functioning of the arbitral process, such as the application of a code of ethics for arbitrators, punitive damages against investors bringing abusive*

¹⁵⁸ US rejects EU proposal for investment court, insists on retaining ISDS, 11 May 2015, [http://www.euractiv.com/sections/trade-society/us-rejects-eu-proposal-investment-court-insists%20-on-retaining-isds-314501]

*claims, enhanced transparency regarding third-party funding and provisions allowing the tribunal to deny jurisdiction in cases of treaty-shopping.”*¹⁵⁹

Many of these proposals are reasonable and may prove themselves quite effective, for example, „the right to regulate“, which remains the bone of contention between the EU and the U.S.

A French lawyer, Ms. Athina Fouchard Papaefstratiou disapproves of the idea of establishing such a permanent court. In her view this proposal has many flaws, for example, it mentions only a “European court”, which would be a court against the EU or its Member States and not an EU – U.S. court. Hence, it is not clear how and where European investors would file claims against the United States. The existing system established under the ICSID Convention has proven itself very effective and widely used. New rules on the permanent court would overlap with the jurisdiction of ICSID tribunals and would require amendments to the Convention, which some scholars believe to be unrealistic. She argues that the structure of the court would be unfair since it would act as an appellate body and annul awards, in issuing of which it participated. Another argument against is the length of the process of re-examination of merits, which would take more than six months and therefore would lead to additional costs.¹⁶⁰

Another point of view¹⁶¹ suggests that such a permanent court would consolidate too much power and little accountability. Moreover, it is feared that such a system will not supplement national tribunals, but replace them. The list of arbitrators would not eliminate the impartiality of the judges, but increase it. Since the Parties form the list, political ambitions might come in the way of independence of the judges.

Another concern of the Article’s authors is that more powerful nations would have more advantages over less powerful in the assignment of judges. Of course, poorer countries have fewer judges to choose from, however, a system where each State would assign one respective judge can be easily developed. The last and most persuasive argument suggested by these scholars is that the existing ISDS system “is

¹⁵⁹ Athina Fouchard Papaefstratiou, “TTIP: The French Proposal For A Permanent European Court for Investment Arbitration”, Kluwer Arbitration Blog, 22 July 2015

¹⁶⁰ *Ibid.*

¹⁶¹ Ted R. Bromund, James Roberts, Riddhi Dasgupta, “*The Proposed Investor-State Dispute Settlement (ISDS) Mechanism: U.S. Should Oppose EU Demand to Abandon It*”, 15 July 2015, [<http://www.heritage.org/research/reports/2015/07/the-proposed-investor-state-dispute-settlement-isds-mechanism-us-should-oppose-eu-demand-to-abandon-it>]

working well”. Surely, there are many imperfections in the current *ad hoc* ISDS system, for example, the lack of a consistent continuance of precedents, but it is perceived as legitimate and authoritative.

Many of the abovementioned concerns are well formulated and call for a reconsideration of the proposal of the EU. At this point of time, it is hard to deduce whether the concept of a permanent court could indicate a positive and necessary step forward. Many flaws of the current ISDS system might be avoided, such as lack of transparency and availability of the proceedings to smaller entities by reducing procedural costs *etc.*

The main point of disagreement between the parties appears to be the need for such an institution. It has divided not only the two negotiating parties, but also authorities of the European Union.¹⁶² The European Union and the United States account for the most investments in the world, have the most well developed legal systems and comprise only few ISDS cases in the array of all cases. A new round of TTIP negotiations has been set for the year 2016. Even if the final version of the Treaty will not contain the proposed ISDS mechanism, the investment relations between these two parties will most likely not be affected at all. However, such a mechanism might prove itself useful in the future investment agreement between the European Union and the Russian Federation. Particularly, it might be useful, if it were to prove itself efficient in EU – U.S. investment relations and also for some sensitive issues with Russia.

Another issue is that the main problem is not so much the flawed ISDS mechanism, but the flawed and vague definitions of “investment” and “investor”, which influence the outcome of a dispute. International practice presents clear evidence that the current ISDS system is seriously affected by the lack of comprehensive notions of “investment” and “investor”. Often tribunals are lured away from other important issues due to such a flaw. The presented issue will be dealt with in the following chapter.

¹⁶² Maxime Vaudano, “*Traité transatlantique: les 12 mots qui déchirent le Parlement européen*”, Le Monde, 12 June 2015

Chapter II

The Notion of „Investment“ and „Investor“

The most disputed issues in investments arbitrations are the vaguest definitions given in the respective instruments. For the purposes of this thesis, this chapter will be dealing only with the notion of “investment” and the investor status under various BIT’s. Arbitration practice deals with these issues not merely as with facts, but rather as with a legal concept, which needs interpretation. Unlike investment standarts, the issue of the notion of “investment” is much more complex. It requires a very thorough analysis, because the application of a treaty is basically impossible and utterly useless without a clear definition of the subject matter. No ISDS mechanism can function properly without clear definitions. Of course, for political reasons, most of the highly authoritative investment instruments, such as the ICSID Convention or the UNCITRAL Arbitration Rules, do not encompass a sufficient notion of “investment” or even none at all. However, treaty practice and doctrine have been quite useful in developing numerous notions. Clearly, due to a great number of such definitions and differences in legal approaches, a comprehensive and effective definition could not be elaborated yet. But recent agreements, such as CETA, TTIP or the Eurasian – Vietnam FTA have opened a new page in investment law. Besides, bilateral investment treaties contain certain definitions of particular interest as well. The future investment agreement between the EU and the Russian Federation may be even more elaborate and innovative. Therefore, it seems that this issue should be dealt with caution and precision.

Notion of investment: analysis of doctrinal findings

The contemporary notion of an “investment” that is used in investment agreements has emerged out of a symbiosis of a legal concept of “property, rights and interests” and the economic term “investment”. This terminology has been implemented in most BIT’s. For example, in the French language, it is “investissements”, in Spanish – “inversiones”, Russian – “инвестиции” (transliteration – [investicii]) and though in German it sounds like “Kapitalanlagen”, it still bears the same general meaning as in other languages. However, public international law does not provide a generic term

for an investment and the variety of BIT's provides such an amount of options that a common notion cannot be defined. "The absence of a traditional legal understanding of "investment", however, was not seen as an obstacle to its use. Instead, the advantage of the term was seen in its potentially wide scope and the flexibility arising from its openness. Since the legal term required a definition to specify its content, the task remained to identify the limits of the term."¹⁶³ The undefined character of the subject matter has led to a situation, where States negotiated their own notions and understandings. Although, one might rather speak in favor of such approach, the actual problems arise during the interpretation of this vast ocean of definitions and elements of the subject matter, which has always been a burden on the shoulders of the arbitrators. The notion of "investment" is closely linked to such terms as "property" or "assets", which have also their own meaning and cause misunderstanding as to their nature and plot.

Moreover, the understanding of property itself and its function has varied very much due to different views on property, possession and ownership in different societies, which led to a divergence not only on the domestic level, but also on the international level.¹⁶⁴ Some authors refer to the problem of equating of the notions "investment" and "property", which is usually the case in countries, which adopted the Anglo-Saxon legal system.¹⁶⁵ On the one hand, such equation makes sense, since for the purpose of ISDS and hence the usage of investments "on the ground" these two terms are not and should not be understood differently. The foreign character of an investment, *i.e.* property, which belongs to a national of another State, shall not serve as a reason to apply a different legal regime to it. Some authors explain that the differences arise in some legal regimes due to structural diversity of law, for instance, separation of ownership rights and property rights as in rights *in rem*. The respective notions rely on national legislation, not on international law due to a rather deficient legal framework of the latter.¹⁶⁶ Evidently it is not yet possible to elaborate a common notion of investment, however, a broad, but sufficient definition may be given to eliminate discrimination of foreign investors only on the basis of their nationality: "Foreign investments include all assets of a private person located in the host State that are owned and/or are directly or indirectly controlled by such a private

¹⁶³ Dolzer, page 60

¹⁶⁴ Wang Jing-An, "Internationaler Investitionsschutz", page 140

¹⁶⁵ Markus Peter Notter, footnote 19 dissertation

¹⁶⁶ Evgeniy Gluchov, dissertation, page 5

person”.¹⁶⁷ Nevertheless, this definition does not cover all aspects of an investment and shall be considered as one having the lesser flaws as all the other one’s.

The question nevertheless arises what does the notion of “assets” encompass. “One must therefore look to dictionaries to determine its ordinary meaning. The word “asset” in most dictionaries is defined as “anything of value” or a “valuable item that is owned”. Thus, it can be seen that the concept of “asset” is very broad indeed.

At the same time, one can identify three different approaches to employing an asset-based definition in investment treaties: (1) a broad asset definition with a non-exhaustive list of investment forms; (2) a broad-asset definition specifying substantive investment characteristics as well as investment forms; and (3) an asset-based definition with an exhaustive list of investment forms”.¹⁶⁸

Such a classification reveals the approach of States to a particular investment regime. The first approach is common for States, which are in need of investments and/or have a very liberal investment climate. It serves the purpose of attracting capital and allows investors not only to make unconventional investments, but also allows the legal system to be more flexible. According to UNCTAD¹⁶⁹, it is the most widespread form of investment definitions in the World. The other two forms are less relevant and do not provide an open investment regime, imposing restrictions in the form of characteristics or a finite list of possible assets.

Thus, practice reveals that in case of a dispute the actual question is whether a particular asset has the necessary elements of an investment and is covered by international instruments and whether this particular asset can be regarded as an investment of a particular investor. It appears reasonable to look into the bilateral practice of States to find a suitable “application regime”.

Bilateral agreements are the today’s most important source of international investment law and not only due to the quantity of such agreements, but they also represent direct sovereign will and intentions of a particular State. So, the will differs from treaty to treaty and may reflect the intention to establish lasting economic relations¹⁷⁰, rely on “characteristics of an investment”, which includes “commitment of capital and other resources, expectation of gain and profit, or the assumption of

¹⁶⁷ Richard Happ, footnote 20 dissertation

¹⁶⁸ Jeswald W. Salacuse, “The Law of Investment Treaties”, Oxford University Press, page 176

¹⁶⁹ UNCTAD, “Bilateral Investment Treaties 1995-2006” Trends in Investment Rulemaking”, 2007, pages 7-12

¹⁷⁰ BIT Ukraine – Denmark (1992)

risk”¹⁷¹, or “the possibility [of an investment] of exercising an effective influence on the management thereof”.¹⁷²

Multilateral investment treaties, such as the North Atlantic Free Trade Agreement (hereinafter – NAFTA agreement), for instance, encompass a rather meticulous definition, covering all sorts of assets and capital, all possible types of ownership, excluding some of the types of commercial activities from this definition like “commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party”.¹⁷³ The Energy Charter Treaty (hereinafter – ECT) contains a similar definition, but refers to the “Economic Activity in the Energy Sector” and is less elaborate.¹⁷⁴

Other treaties include references to “host State law”, meaning that in case of a dispute, the tribunal will have to examine domestic law of the host State and that will reveal the existence of an investment. “BIT”s frequently include the formula “in accordance with host state law” or similar formulae in their definitions of the term “investment”. Host states have argued that this meant that the concept of “investment”, and hence the reach of the protection under the treaty, had to be determined by reference to their own domestic law. Tribunals have rejected this approach. They held that the reference to the host state’s domestic law concerned not the definition of the term “investment” but solely the legality of the investment.¹⁷⁵

One of the major arbitration tribunal rulings in this regard is considered to be as definitive and most reliable. In *Salini Costruttori vs. Morocco* the so-called “Salini test” has been developed. “The Salini case revolved around two Italian companies, Salini Costruttori and Italstrade, and their dispute with the Moroccan government. The government of Morocco, through a private company, went through a bidding process for the construction of a fifty-kilometer highway. The two Italian companies jointly submitted a bid, and won the contract for construction of the highway. The two companies completed the highway thirty-six months later, going four months over the timetable laid out in their bid, which made the Moroccan government unwilling to

¹⁷¹ BIT U.S. – Chile (2003)

¹⁷² BIT EFTA – Mexico (2000)

¹⁷³ Article 1139 NAFTA

¹⁷⁴ Article 1(6) of the ECT

¹⁷⁵ Dolzer, Schreuer page 65

pay for the highway.”¹⁷⁶ After going through the domestic channels, the Italian companies submitted the dispute to ICSID arbitration.

Salini introduced a clear four-pronged test that arbitrators were to use to determine whether the two companies had in fact made an investment for the purposes of ICSID arbitration. The test requires an investment to include the following: (1) a contribution of money or assets; (2) a certain duration over which the project was to be implemented; (3) an element of risk; and (4) a contribution to the host States’ economy.”¹⁷⁷

Many arbitrators have questioned the sufficiency of the elements of the “*Salini test*” and long debates have taken place excluding some of the elements or adding other¹⁷⁸. In contemporary practice the “*Salini test*” has become the starting point of all analysis, even in cases, where it has subsequently been amended¹⁷⁹. It seems reasonable to continue to apply this test, since it practically became part of the international customary law. Some day drafters of international treaties might even codify the *Salini test*, which will in fact bring more stability and consistency to international investment arbitration.

But today this test is only applied in ICSID cases and there is no clear answer, whether it should be applied in non-ICSID cases, for example in UNCITRAL cases. In the case *Romak S.A. (Switzerland) vs. The Republic of Uzbekistan 2009*¹⁸⁰ the issue of ICSID definitions had been raised. The *Romak* tribunal has stated: “only the requirements of the BIT and of the UNCITRAL Rules shall be applicable for the purposes of determining the scope of the jurisdiction of the Arbitral Tribunal.”¹⁸¹ The Representative of Uzbekistan has expressed his position stating that the term “investment” used in ICSID arbitration shall be applied to create a common jurisprudence: “decisions of other investment arbitration tribunals interpreting the term “investment” in the context of investment treaty arbitration are relevant in the interests of the development of consistent jurisprudence in this evolving body of public international law.”¹⁸² This approach seems reasonable, at least until a new

¹⁷⁶ *Salini Costruttori S.p.A. and Italstrade S.p.A. vs. Kingdom of Morocco*, ICSID Case No. ARB/00/4

¹⁷⁷ Alex Grabowski, “The definition of investment under the ICSID Convention: A defense of *Salini*,” 1 June 2014, *Chicago Journal of International Law*, page 296

¹⁷⁸ *Ibid.*, page 300

¹⁷⁹ *Chicago journal*, footnote 131

¹⁸⁰ *Romak S.A. (Switzerland) vs. The Republic of Uzbekistan*, UNCITRAL, PCA Case No. AA280

¹⁸¹ § 167 of the *Romak Award*

¹⁸² § 168 of the *Romak Award*

notion either in ICSID arbitration, or in UNCITRAL arbitration, has been created. Nevertheless, the tribunal has clarified that arbitral awards are not a formal source of international law, but only serve as a source of reference and inspiration for arbitrators. This approach has been also applied in other cases, both ICSID and non-ICSID.¹⁸³ The tribunal does not have to rely on previous awards and is not entrusted with the task of developing investment law.¹⁸⁴ It shall not ignore the awards of the arbitrators, but shall resort to them only in case of need.

During the proceedings the Claimant has stated that the notion of „investment“ may vary in case of choice between UNCITRAL and ICSID arbitration. This approach has been rejected by the Tribunal, because „this view would imply that the substantive protection offered by the BIT would be narrowed or widened, as the case may be, merely by virtue of a choice between the various dispute resolution mechanisms sponsored by the Treaty...[and]...there is no basis to suppose that this word had a different meaning in the context of the ICSID Convention than it bears in relation to the BIT.“¹⁸⁵ This approach points to the conclusion that a uniform notion of “investment” may exist without any connection to a particular investment treaty.

Analyzing the Switzerland – Uzbekistan BIT the Arbitral Tribunal came to a most important conclusion: „Indeed, as already mentioned, the categories of investments enumerated in Article 1(2) of the BIT are not exhaustive, and do not constitute an all-encompassing definition of “investment.” Both Parties agree that this is the case. Therefore, there may well exist categories different from those mentioned in the list, which, nevertheless, could properly be considered investments protected under the BIT. Accordingly, there must be a benchmark against which to assess those non-listed assets or categories of assets in order to determine whether they constitute an “investment” within the meaning of Article 1(2).

The term “investment” has a meaning in itself that cannot be ignored when considering the list contained in Article 1(2) of the BIT.”¹⁸⁶ This „meaning in itself“ points out some inherent elements of the notion, which can not be agreed or disagreed upon, denied or in any other way circumvented. They are the basic elements of any investment, which define it as one. Therefore, it seems plausible to look once again at

¹⁸³ See *Bayindir Insaat Turizm Tecaret Ve Sanayi AS vs Pakistan*, Decision on Jurisdiction, ICSID Case No ARB/03/29, 14 November 2005, § 76 and *RosInvestCo UK Ltd vs Russian Federation*, Jurisdiction Award, SCC Case No V079/2005, § 49

¹⁸⁴ §§ 170-171 of the Romak Award

¹⁸⁵ § 194 of the Romak Award

¹⁸⁶ § 180 of the Romak Award

the elements proposed by the *Salini test*. Since, first of all, those four elements have survived many amendments and critique by arbitrators and scholars and, second, became a widely used means of definition. Thus it appears reasonable to assume those elements as inherent elements.

Surely, the sole fact that those elements exist and are widely used is not sufficient to proclaim them as the inherent elements. However, they do encompass necessary characteristics, which make an investment a real investment. They make the crucial distinction between “investments” and “mere commercial transactions” that involve State actors. In the *Joy Mining* case¹⁸⁷ the Tribunal has stated the following:

“The Tribunal is also mindful that if a distinction is not drawn between ordinary sales contracts, even if complex, and an investment, the result would be that any sales or procurement contract involving a State agency would qualify as an investment.

International contracts are today a central feature of international trade and have stimulated far-reaching developments in the governing law, among them the United Nations Convention on Contracts for the International Sale of Goods, and significant conceptual contributions. Yet, those contracts are not investment contracts, except in exceptional circumstances, and are to be kept separate and distinct for the sake of a stable legal order. Otherwise, what difference would there be with the many State contracts that are submitted every day to international arbitration in connection with contractual performance, at such bodies as the International Chamber of Commerce and the London Court of International Arbitration?”

The idea behind this is that “money and assets” may constitute an investment, but in some cases not. Therefore, it is necessary to appeal to the “object and purpose” of a BIT.

It is apparent that tribunals in order to define any notion disputed before them usually refer to the Vienna Convention on the Law of Treaties 1969¹⁸⁸ (hereinafter – VCLT). Article 31 of the VCLT says the following: “A treaty shall be interpreted in good faith in accordance with the **ordinary meaning** to be given to the terms of the treaty in their context and in the light of its **object and purpose**”. The paradox lies within the ambiguity and vastness of the meanings of the words.

Unfortunately, neither arbitration practice, nor the doctrine provide a uniform

¹⁸⁷ *Joy Mining Ltd. vs Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, August 6, 2004, § 58

¹⁸⁸ UNTS, Vienna Convention on the Law of Treaties, 1969

definition. Therefore, it is reasonable to construe any disputed notion on a case-by-case basis and according to various elements and principles, which might lead to an agreeable and satisfactory definition. One of such approaches implies turning to the intent of the drafters of a treaty.¹⁸⁹

I. Buffard and K. Zemanek consider the “*purpose*” being the aim to be achieved by the treaty, while “*object*” refers to the legal position created for the parties by the provisions of the treaty as a whole, its subject-matter. Further they elaborate on this idea and conclude: “*the title and the preamble of a treaty...are the prime indicators of the purpose of a treaty...the object is defined by the treaty provisions as a whole, which means that it must be established by interpretation*”.¹⁹⁰

For instance, Russia’s bilateral investment treaties have a special designation in the title relating to its direct function¹⁹¹. At first, they were called “*treaties for investment protection*”, but later and until this very day they bear the title “*agreement concerning the promotion and reciprocal protection of investments*”. These words indicate the concrete function of the BIT, *i.e.* its purpose. This shows that the *Salini test* is the most reasonable “benchmark” for investment arbitration. Using the “object and purpose” test it becomes evident that all four elements comprise the inherent characteristics of an investment and shows that they are all necessary to distinguish an “investment” from any other “commercial contract”.

Having established that linguistical and theoretical discrepancies do exist with regard to the definition of an investment, it is now necessary to look at the BIT’s of EU Member States and Russia as well as IIA’s to highlight the differences and similarities in their legal approaches. First, bilateral agreements between Russia and some of the Member States will be analyzed. The choice of a particular Member State in relation to Russia depends on the economic significance of their trade relations, which has been shown in the previous chapter. An analysis of widely used Model BIT’s will also be provided.

Investment treaties between the EU and Russia: the notion of “investment”

¹⁸⁹ Ulf Linderfalk, On the Interpretation of the Treaties: The Modern International Law of Treaties, ch. 7, § 1, 2007

¹⁹⁰ Isabelle Buffard & Karl Zemanek, „The „Object and Purpose“ of a Treaty: An Enigma?“, 3 AUSTRIA REV. INT’L & EUR. L., 1998, p. 316

¹⁹¹ M. Boguslawski, “The regulation of investments in the former USSR States”, page 21

In this paragraph, the author will show the differences in the approach as to the subject of the notion of “investment” with respect to BIT’s concluded between Russia and some EU Member States.

For further analysis, it is important to address the provisions of the Model Investment Agreement of the Russian Federation (hereinafter – MIA). The idea of establishing such a MIA is that it stipulates the priorities of a State towards investment protection of FDI’s. Adopting a framework BIT seems to appear more effective and convenient than negotiating BIT’s individually with each State. It appears that even the latter show elements of standard provisions incorporated in MIA’s.¹⁹²

The Russian MIA has a broad-asset definition of investment and the term “investment” is very close to the German word “Kapitalanlagen”, which indicates a strong influence of the German law. Article 1 of the MIA says the following:

The term “investment” shall apply to all types of assets which an investor of one Contracting Party invests in the territory of the other Contracting Party in accordance with its legislation, in particular:

- a) Movable and immovable property;*
- b) Shares and other forms of participation in commercial enterprises and organizations;*
- c) Claims to money invested to create an economic value, or contracts, having an economic value and being connected to the investment;*
- d) Copyright, industrial property rights such as rights to inventions, including rights deriving from patents, trademarks, industrial models, trading marks of retail bodies, models, trade names, and technology and know-how;*
- e) Rights to engage in economic activity, including concessions for prospecting for, cultivating, mining or developing natural resources accorded under the legislation of the Contracting Party in whose territory the investments are made, or by virtue of a contract.*

A change of form of the investment shall not influence its qualification as an investment, unless such change contradicts the legislation of the Contracting Party in which the investment has been made.

¹⁹² Rudolf Dolzer, Margarete Stevens, “Bilateral Investment Treaties”, Martinus Nijhoff, 1995, page 14

This definition is not exhaustive and covers only such investments that are made according to the host State's law to prevent illegal investments from entering its territory. The European Union does not have a uniform MIA. Therefore, it seems plausible to proceed with analyzing the German Model BIT in connection to the BIT's between Russia and its most important European trade partners.¹⁹³

The BIT between Russia (in the original document – the then “Union of Soviet Socialist Republics”) and Germany has been concluded in 1989. Afterwards, the German Model BIT 2008 incorporated similar provisions as the USSR – Germany BIT. The German Model BIT specifies the particular movable and immovable property and adds “other rights *in rem*, such as mortgages, liens and pledges”, which in the negotiated BIT defines as: “property, and other real rights such as usufructs, mortgages and similar rights”. All other elements are basically identical in all 3 instruments and reveal a common approach to the notion of “investment”. Although, the German Model Law goes slightly further in covering indirect investments, saying that “in the case of indirect investments...[those]...shall be covered which the investor realizes via a company situated in the other Contracting State”. This provision covers a very important and problematic area of investment law and shows a very investor-friendly approach of the German government.

The BIT between the Soviet Union and Austria 1990¹⁹⁴ contains an asset-based definition of investment as well. It specifies that an “investment” is “every kind of asset owned and controlled by a national”. Although, a slightly different list of assets is presented, it still shows an open approach similar to the one with Germany.

USSR-France BIT 1989 is also similar to the one's shown earlier, but contains specific elaborations such as: all property mentioned in Article 1 of the Agreement has to be invested in accordance with the laws of the host State. The Agreement also distinguishes between the “territory” of the Contracting State and its “maritime zone”, referring evidently to the Law of the Sea Convention 1982¹⁹⁵ and the classifications therein (internal waters, territorial sea, contiguous zone, exclusive economic zone and continental shelf). It also elaborates specifically on indirect investments made by nationals of either Contracting Party or by an investor of a third State. The USSR-UK BIT differs from the presented previously in excluding the “host State legislation”

¹⁹³ See previous chapter

¹⁹⁴ USSR-Austria BIT

¹⁹⁵ UNTS, United Nations Convention on the Law of the Sea, Montego Bay, 10 December 1982

clause. BIT's between the Netherlands, Sweden, Finland, Slovenia and Russia are also similar, although the phrasing and formation of each instrument has differences, but of no particular relevance.

Investment treaties between the EU and Russia: the notion of "investor"

Another issue that is often being disputed along with the notion of "investment" is whether the particular natural or juridical person qualifies as a foreign investor. This question is crucial to establish a tribunal's jurisdiction over a case in relation to particular BIT or other instrument and whether the investor may use the benefits of the abovementioned treaties.

Investment agreements are designed to promote and protect business activities of foreign investors on the territory of another State of which the investor is not a national. This means that the foreignness of the investment is determined by the investor's nationality, and his or her nationality determines from which treaties it may benefit.¹⁹⁶

The ICSID Convention in its Article 25 provides protection for "natural" and "juridical" persons, which have the nationality of another Contracting State. Unfortunately, the Russian Federation is not a Party to ICSID and has only signed, but not ratified it. Thus, it uses only the UNCITRAL Arbitration Rules that do not provide any definitions on the subject matter. Hence, we shall address the BIT's and the notions therein.

Article 1(c) of the Germany – USSR BIT gives a special definition to the investor being a natural person: "The term "investor" with respect to Germany means "an individual having a permanent place of residence in the area covered by this Agreement..." whereas the usual definition in German BIT's refers to the "German citizen in the sense of the Basic Law of Germany". Such definition is also present only in the Germany – Poland BIT¹⁹⁷ and the Germany – Czech Republic BIT¹⁹⁸. It is connected with the special relations between Germany, USSR, Poland and the Czech Republic after World War II.¹⁹⁹

¹⁹⁶ Dolzer, Schreuer, page 46

¹⁹⁷ Art. 1(1) of the Germany – Poland BIT

¹⁹⁸ Art. 1(1) of the Germany – Czech Republic BIT

¹⁹⁹ Dipl.-Jur. Leonid Schmatenko, "Die bilateralen Investitionsschutzverträge Russlands", 2013, page 102

The UK – USSR BIT follows a more common approach stating:

the term "investor" shall comprise with regard to either Contracting Party:

(i) natural persons having the citizenship or nationality of that Contracting Party in accordance with its laws;

(ii) any corporations, companies, firms, enterprises, organisations and associations incorporated or constituted under the law in force in the territory of that Contracting Party;

provided that that natural person, corporation, company, firm, enterprise, organisation or association is competent, in accordance with the laws of that Contracting Party, to make Investments in the territory of the other Contracting Party;

The BIT's between Austria, France, Italy, Netherlands and Russia have been drafted in a similar way and all have the same two basic elements: for natural persons it's the nationality aspect, for juridical persons – incorporation according to the laws of the Contracting State.

In some cases, it might be difficult to tell how to apply the abovementioned provisions. Investors might lose or change their citizenship and then only their "active" citizenship matters²⁰⁰; they might have dual citizenship, which does not hinder them from filing a claim²⁰¹, but in the abovementioned cases, it is enough to possess the nationality of one of the Contracting States.

The situation is much more complex with juridical persons. The most common criteria for "corporate nationality" are the act of incorporation, the main seat, place of business, and the execution of effective control over the company²⁰².

A very difficult issue is the position of shareholders in an investment. They may be of different nationalities or their interests might not align with the interests of the company. Unfortunately, legal texts, especially international treaties, cannot keep up with the constant changes in economic relations. As a long-term solution the author sees once again a broadly drafted definition, which would allow the treaty to protect property of foreign juridical persons and their shareholders and tribunals to create

²⁰⁰ *Soufraki vs. United Arab Emirates*, Award, 7 July 2004, 12 ICSID Reports

²⁰¹ *Olguin vs. Paraguay*, Award, 26 July 2003, 19 ICSID Review

²⁰² *Yaung Chi Oo vs. Myanmar*, Award, 31 March 2003, 8 ICSID Reports

consistant practice, which would target the particular abovementioned questions.

Case law

Relying on the abovementioned arguments, it seems reasonable to investigate the various arbitration cases, which have dealt with interpretation issues based on the BIT's concluded by EU Members and the Russian Federation.

Germany – Russia

Mr. Franz Sedelmayer vs. The Russian Federation case deals with the issue whether Mr. Sedelmayer is an investor according to the Germany – USSR BIT. The Claimant is domiciled in Germany. The Tribunal came to the conclusion that his permanent residency in the Russian Federation does not affect his investor status (§ 3.1). The tribunal also confirmed that the source of the money or assets does not preclude the Claimant from investing and despite the incorporation status of his company, which lies outside of the covered territory, it is only “a vehicle through which [he] injected his own capital into the Russian Federation”. One of the crucial arguments of the Tribunal has been connected with the “control theory”: “This theory is based on the idea that the decisive factor is who *de facto* controls the entity which has, for example, made investments in a foreign country.” In § 3.2 the Tribunal also confirms that all of Mr. Sedelmayers investments are covered by the bilateral agreements and the intentionally broad and non-exhaustive character of the definition provides full protection to his assets.

France – Russia

In *Sergei Viktorovich Pugachev vs. The Russian Federation* the Claimant is a French citizen (since 2009) and retains dual nationality, the second of which is Russian. In his Notice of Arbitration to the PCA 1994 he explains that his investment has been expropriated by the Russian Federation and he has been continuously mistreated and discriminated by Russian authorities. His investment consisted out of the Red Square project (a real estate program to rebuild neighboring buildings to the Red Square in Moscow), the Northern shipyard, the Baltic shipyard *etc.*

In § 116-118 of the Notice of Arbitration the Claimant refers to the Article 1 of the France-USSR BIT, stating: “Each of Mr. Pugachev’s assets described in this Notice of Arbitration falls within the definition of “investments” in Article 1 of the Treaty.”²⁰³ Due to the recent character of the case, there is no award available. However, it appears clear that the issue whether those assets were an investment and whether Mr. Pugachev were in fact an investor, will be tackled during the ongoing proceedings. The Claimant is referring to Article 1(b) and (e) (French version)²⁰⁴ of the BIT, which technically does indeed cover his assets in the sense of investments. But this issue will rather depend on whether the tribunal decides if he was an investor at the time of the investment or not. The fact that he shall be considered as an investor under the France – USSR BIT has been pointed out stating that despite his dual nationality (French and Russian) he is entitiled to Treaty protection. (§ 115)

United Kingdom – Russia

In the case *RosInvestCo UK vs. The Russian Federation* the Tribunal has also dealt with the issue of defining the investment made by the Claimant. The issue at hand was that the Russian Federation did not recognize the investment made by RosInvestCo as a foreign investment. Moreover, the Claimant did not own the disputed shares and violated the laws of the host State, *i.e.* of Russia. But the Tribunal has issued its opinion on the notion: “*The rights associated with the Yukos shares created under Russian and New York law are protected under the IPPA (the UK-USSR BIT – authors remark) only if they are an “asset” of a UK investor for purposes of Article 1 (a), i.e. “something of value” to a UK investor. At a minimum, Claimant must show that under the legal position created by Russian and New York law it “would suffer financial loss if the property were damaged and destroyed.”*”²⁰⁵ This approach shows a partial application of the *Salini test*: something of value means that it is a contribution of money and/or assets and financial loss refers to the certain necessary risk the investor has to take.

Another issue that was adresssed by the Tribunal is the legal ownership of the assets, which are being invested. § 159 of the Award states that “while the Participation

²⁰³ *Sergei Viktorovich Pugachev vs. The Russian Federation, UNCITRAL*

²⁰⁴ § e) can be found only in the French version, the relevant Russian provision is available at § d)

²⁰⁵ *RosInvestCo UK Ltd. vs. The Russian Federation, SCC Case No. V079/2005*

Agreements gave Elliott International [shareholder in RosInvestCo – authors remark] an economic interest in the shares for a period of time, **they did not convey the shares themselves.**”

The asset must be in absolute and complete ownership of the investor. Nevertheless, a question might be raised: according to who’s law shall the ownership be established, *i.e.* the concept and the necessary elements. Usually States have private international law provisions in their civil codes or similar legal acts. Such provisions deal with foreign natural and juridical persons and conflict law. In case of an investment, the agreement contract with the foreign investor contains provisions on which law shall be applied in case of a dispute. But sometimes the parties to the contract do not foresee possible disputes or avoid such discussions during the negotiations. That is called the “honeymoon effect”. In that case, the arbitration tribunal can resort to the abovementioned private international laws, which allow establishing the laws of which country need to be applied in a particular case.

With regards to meeting the term “investor”, the Tribunal has confirmed the fact that the Claimant is one under the provisions of the BIT: *“The Tribunal is bound by the Article 31 VCLT when interpreting the definition. The plain meaning of the definition encompasses Claimant. Claimant’s submissions and supporting evidence bear out its qualification as an investor under the IPPA in light of this plain reading. The Tribunal is prevented from imposing a stricter interpretation on the IPPA’s definition in light of its very wide drafting.”*²⁰⁶ Here the Tribunal shows that it applies the “object and purpose” test and also confirms that the wide drafting of the treaty gives more space for interpretation.

Preliminary findings

In the author’s concluding remarks to this Chapter, he would like to state that the issue of the definition of “investments” is a huge challenge for the international investment framework. It may seem overrated, but in fact it is impossible to deal with something if there is no solid knowledge what it actually is.

The open-ended definitions provided in the given BIT’s are a very good step towards a comprehensive definition of “investment”. It is understandable that multilateral

²⁰⁶ *Supra* note 205, para. 323

treaties do not entail even a vague definition, since there is so much discussion among States on the subject matter. The PCA 1994 does not contain an investment definition and the one given in the joint declaration on Article 52 of the PCA 1994 is insufficient and lacks basic elements, which are required for proper investment relations. Moreover, the EU is now heading towards the conclusion of uniform all-EU investment agreements and since the negotiations on the PCA with Russia are currently stalling for various reasons, there is room for the reshaping of the investment part of the agreement.

The new CETA and TTIP agreements would include state-of-the-art provisions, which could lead to a re-assessment of investment protection standards worldwide, including the formulation of a comprehensive notion of “investment” and a new investor status provision. Future case law will show whether the expectations of the supporters of such comprehensive trade and investment agreements will come true. It most certainly is an important experiment for international investment law. The drafters of the new investment agreement between the EU and the Russian Federation need to learn the “do’s and don’t’s” of the EU negotiations with Canada and the U.S.

However, given the findings in this chapter, a comprehensive notion might not be the necessary solution. Major economic players like the EU, the U.S. and Russia assess the concept of property differently. It might be a good idea to create a sectoral definition. Since the new comprehensive agreements with Canada and the U.S. cover many trade-related issues and not only investments, it would be reasonable to give a definition of property related issues in each of the respective chapters and subject it to the ISDS provisions under the treaty. This way more areas would be covered and it would be easier for tribunals to establish jurisdiction. Besides, the incorporation of the elements of the *Salini test* would make a breakthrough in investment arbitration worldwide.

The goal is to grant the investors as much economic freedoms as possible. Of course, fraudulent actions need to be avoided and tackled by governments. Opening of the economy may lead to an unpredictable outflow of assets and capital. However, both the EU and Russia have strong markets and a lot to gain from each other. That’s why it is important to continue working on the new investment agreement and develop a very precise and concrete investment agreement within the PCA framework.

Chapter III

Investor – State Dispute Settlement regime between the Russian Federation and the European Union

This chapter is devoted to the investor – State dispute settlement regime between the EU and the Russian Federation. ISDS mechanisms that exist today under numerous IIA's reveal certain flaws. The lack of transparency, frivolous claims from investors, and the reluctance to enforce rendered judgments – these and many other issues must be tackled in future investment agreements between the EU and Russia. The fact that the EU has recently negotiated a comprehensive trade and investment agreement with Canada and is currently negotiating another with the United States is a clear sign that change in the global investment policy is sought. Cutting-edge proposals on new ISDS mechanisms are being raised during these negotiations. The author will explore whether changes in the ISDS regime between the EU and Russia are necessary, how this regime may look like and would such provisions benefit both parties.

ISDS-related substantive provisions: Expropriation

The main investment-related agreement between the EU and Russia – the PCA 1994 – does not contain any regulations as to the ISDS regime. It has been concluded during a period, where the Russian economy had been undertaking structural changes. The EU did not include many Members that joined the Union afterwards and the founding treaties did not encompass necessary provisions relating to the Union's exclusive competence. Besides, political issues influenced the decision making of both parties, thus, all that hindered the parties from including efficient investment protection provisions in the Agreement. Also, bilateral investment agreements with several EU Members have been recently concluded, which was a huge step towards a market economy for the former Soviet Union and a new level of relations between Russia and the European States.

„The most palpable defect of investment protection in Russia has not been the absence of substantive protection standards but the limited investor-State arbitration clauses in the BIT's between Russia and the EU Member States. Many Russian BIT's

concluded with economically potent EU Member States such as Austria, Belgium and Luxembourg, Bulgaria, Finland, arguably France, Germany, the Netherlands, Spain and the UK contain a qualified arbitration clause limited to disputes relating to the amount or mode of payment of compensation for expropriation. In statistical terms, 9 out of 18 Russian BIT's with EU Member States curtail the right to access investor-State dispute settlement.²⁰⁷

For example, the Germany – USSR BIT in its Article 10 states:

„If a dispute relating to the amount of compensation or the method of its payment, in accordance with article 4 [expropriation – authors remark] of this Agreement, or to freedom of transfer, in accordance with article 5 of this Agreement, is not settled within six months from the time when a claim is made by one of the parties to the dispute, either party to the dispute shall be entitled to refer the matter to an international arbitral tribunal.”

Such wording, as has been fairly pointed out, means the following: „disputes relating to investment protection standards such as fair and equitable treatment (FET), most-favored nation (MFN) or national treatment (NT) and full protection and security cannot be submitted to investment arbitration by the investor and can only be dealt with by way of State-to-State dispute settlement and that disputes over the *occurrence of expropriation* are excluded from the ambit of the arbitration clause. Following this interpretation, an arbitral tribunal's jurisdiction is lacking *ratione materiae* unless a national court has affirmed the occurrence of an expropriation measure or the host State has acknowledged that an act of expropriation has occurred.”²⁰⁸ Another example of such a provision is contained in Article 10 of the Belgium/Luxemburg – USSR BIT: “any dispute between one Contracting Party and an investor of the other Contracting Party concerning the **amount or mode of compensation** to be paid...”²⁰⁹ This provision, if construed narrowly, entails that the fact of expropriation has to be proven by the State itself or by a national court of the host State first and only then an international tribunal may decide on the amount and mode of compensation. Not only

²⁰⁷ Tilman Dralle, “A Glance into the Future: The Prospective Investment Law Regime between the European Union and the Russian Federation”, Dresden Research Papers on International Economic Law, September 2013, page 13

²⁰⁸ *Ibid.*

²⁰⁹ Belgium/Luxemburg – USSR BIT

are such provisions inefficient, they are discriminatory in nature.

International tribunals in fact do agree with the given construction. In the *Berschader vs. The Russian Federation* case²¹⁰, the Tribunal has confirmed this approach: “The Tribunal is satisfied that the ordinary meaning of the provision excludes from the scope of the arbitration clause: (i) disputes concerning any of the provisions of the Treaty other than Article 5, and (ii) disputes concerning whether or not an act of expropriation actually occurred under Article 5.”²¹¹ The Tribunal goes on in elaborating on the intentions of the drafters, stating that it can only be “assumed” that the Contracting parties wanted to submit the “establishment of facts” in relation to expropriation to “dispute resolution provisions provided for under the applicable contract or alternatively to the domestic courts” of the host State.

Such a construction of the BIT provisions is more than unreasonable and creates an unfavourable situation for an investor, whereby the fact whether his assets have or have not been seized by the host State are solely up to the discretion of the latter. Unfortunately, other international tribunals have concurred with the *Berschader* tribunal: “*The Tribunal in RosInvestCo UK Ltd. vs. Russia dealt with the dispute resolution provision contained in Art. 8 of the UK-Soviet Union BIT conferring jurisdiction over “any legal disputes ... in relation to an investment of the [investor] either concerning the amount or payment of compensation ... or concerning any other matter consequential upon an act of expropriation.”*”²¹²

However, there may be cases, where the question as to the amount and mode of payment may not be of relevance. The Tribunal in *Renta 4 S.V.S.A. et al. vs. The Russian Federation* has offered an unusual approach, stating that the term “amount” also includes “no amount”, for instance, if the expropriated assets have lost any kind of value or the act of expropriation has not occurred. Therefore, the real debate is about whether the amount of compensation is due. But for any amount to be due an act of expropriation has to occur. The Tribunal allows the arbitrators to establish an act of expropriation themselves. “*That perforce entrains the power to determine*

²¹⁰ *Vladimir Berschader and Moïse Berschader vs. The Russian Federation*, SCC Case No. 080/2004

²¹¹ *Berschader vs. The Russian Federation* case, para 153

²¹² Elvira R. Gadelshina, „*Major Pitfalls for Foreign Investors in Russia: What Are Russian BITs Worth?*“, Kluwer Arbitration Blog, 1 December 2011, available at: [http://kluwerarbitrationblog.com/2011/12/01/major-pitfalls-for-foreign-investors-in-russia-what-are-russian-bits-worth/]

whether there has been a compensable event in the first place.”²¹³ Despite a very interesting and brave attempt to use semantics as a tool to rule in favor of the investor, this approach appears to be wrong. Only a previous acknowledgement of an expropriation by the host State allows the Tribunal to establish its jurisdiction. An analysis of the late Russian BIT’s with other States can easily resolve the abovementioned contention. For example, the Norway – Russia BIT 1995²¹⁴ in Article 8 called “Disputes between an investor of one Contracting party and another Contracting party” provides the following wording: “*Disputes between an investor of one Contracting Party and the other Contracting Party arising in connection with an investment in its territory...*” Identical wording has been used in Article 8 of the Indonesia – Russia BIT 2007 as well.²¹⁵ Since the provision does not require the claim to involve an alleged breach of the BIT by a Contracting party, it means that every possible violation can be a ground for a tribunal’s jurisdiction just as long as it is related to an investment. Accordingly, it appears obvious that it was the intention of the BIT drafters to exclude expropriation occurrence issues from the scope of the Treaty.

It appears nevertheless obvious that such strong and restrictive wording is a consequence of the Soviet Union’s policy. It is noteworthy that BIT’s concluded in the early period of the Russian Federation and later on, are significantly more liberal and are much broader in their scope of application.²¹⁶ Besides, the problem with disputes concerning expropriation has deeper roots. One might suggest that it does not matter whether the State considers a certain act as nationalization or expropriation. However, enforcement measures will inevitably take place in this country. Real enforcement measures are available for ICSID Contracting States. The UNCITRAL Arbitration Rules along with the New York Convention do not provide for any useful enforcement measures. Russia as has been pointed out earlier did not ratify the ICSID Convention. Consequently, unless it recognizes its own wrongdoing in a particular case, it will be protected by its sovereignty. Further elaboration on the issue of enforcement measures will be provided further in this chapter.

²¹³ Renta 4 S.V.S.A, et al vs. The Russian Federation, Award on Preliminary Objections, SCC, 20 March 2009

²¹⁴ Norway –Russia BIT

²¹⁵ Indonesia – Russia BIT

²¹⁶ Article 8 of the Denmark – Russia BIT and Article 11 of the Japan – Russia BIT

ISDS-related substantive provisions: Most-Favored Nation Treatment and National Treatment

*“Most-favoured nation clauses have formed part of international economic treaties for centuries. The simple goal of MFN clauses in treaties is to ensure that the relevant parties treat each other in a manner at least as favourable as they treat third parties. The clause may not have any practical significance if the State concerned fails to grant any relevant benefit to a third party. However, as soon as the State does confer a relevant benefit, it is automatically extended to the State that benefits from the MFN clause. The clause will operate, in principle, in relation to all matters that fall within the scope of the treaty containing the MFN clause. More particularly, the scope will be determined by the wording of the clause, and the precise benefit granted will depend upon the right granted to the third State.”*²¹⁷ The main problem with the application of MFN clauses to investment treaties is that it does not work in the same manner like in trade law. If the MFN provision is applied „as is” from another treaty it may lead to a substitution of the substance and/or the intention of the contracting parties.

Not only is it controversial whether one may apply MFN treatment to substantive provisions, but another great difficulty are ISDS provisions, to which MFN usually is not applied. For instance, in the *Plama vs. Bulgaria* case the Tribunal has addressed the MFN clause through the word “*privilege*” and pointed out that it refers only to substance, but not to jurisdiction.²¹⁸ Nevertheless, this point of view may be circumvented by applying the “*everything which is not forbidden is allowed*” principle. §(3) of Article 3 of the Germany – USSR BIT deals with the MFN clause in the following manner:

“This regime shall not apply to benefits and privileges which the Contracting Party grants:

By virtue of participation in a customs or economic union, a free trade zone or a common market,

On the basis of a convention for the avoidance of double taxation or other agreements concerning matters of taxation.”

²¹⁷ Dolzer, Schreuer, page 186

²¹⁸ *Plama vs. Bulgaria* case, Decision on Jurisdiction, 8 February 2005, 44 ILM (2005) 721, 20 ICSID Review-FILJ (2005), 262, para. 191

While expressly excluding the abovementioned areas from the operation of the MFN clause, the treaty does not preclude application with respect to other areas, for example, including ISDS mechanisms in trade related instruments. A famous ICSID case *Maffezini vs. Spain*²¹⁹ supports the “importation” of MFN-based jurisdiction from investment treaties with third parties.

„The MFN debate prompted by the inclusion of narrow ISDS clauses in Soviet-era BIT’s focuses exclusively on the import of broader subject-matter jurisdiction, whereas other case-law applying the MFN standard to procedural matters relates to waiting periods, limitations *ratione temporis* or the definition of investment.“²²⁰ For instance, in *Berschader vs. Russia* the investor tried to invoke Article 2 of the Belgium – USSR BIT and to pick the ISDS provisions from the Norway – USSR BIT and Denmark – Russia BIT.²²¹ The tribunal is seeking clarity in major investment arbitration cases²²², but in the end refuses MFN treatment to the investor on the following grounds: „...the present Tribunal will apply the principle that an MFN provision in a BIT will only incorporate by reference an arbitration clause from another BIT where the terms of the original BIT clearly and unambiguously so provide or where it can otherwise be clearly inferred that this was the intention of the contracting parties” (§ 181).

Hence, either the wording of both the disputed BIT and the one referred to, has to be similar or even identical, or by means of interpretation, the tribunal may assume that such an application does not contradict the intentions of the parties to the treaty. It appears clear that all investment treaties concluded by the Soviet Union are restrictive in nature, which can be easily seen by a linguistic and teleological analysis of investment agreements concluded by the Russian Federation. In BIT’s concluded by the USSR the intention to limit the scope of application of the ISDS clauses is apparent, however, the limitation can be seen only with respect to the expropriation provisions, but not to most-favored nation treatment.

For instance, the Tribunal in *RosinvestCo vs. Russia* has reached an opposite conclusion. The Claimant wanted to use the MFN provision in Article 3 of the UK – USSR BIT to invoke Article 8 of the Denmark – USSR BIT instead of the respective article in the former. The UK – USSR BIT contains restrictive language and relates

²¹⁹ *Emilio Augusto Maffezini vs. The Kingdom of Spain*, ICSID case, 2000

²²⁰ Tilman Dralle page 18

²²¹ *Berschader vs. The Russian Federation*, para. 159

²²² *Ibid.*, paras. 163-181

only to the amount or payment of compensation, matters consequential upon an act of expropriation or consequences of non-implementation/incorrect implementation of Article 6 [Repatriation of Investments and Returns] of the Treaty. The Tribunal assumed that the very nature of MFN treatment implies the “exportation” of protection from one treaty to another, since the latter lacks such provisions. *“While indeed the application of the MFN clause of Article 3 widens the scope of Article 8 and thus is in conflict to its limitation, this is a normal result of the application of MFN clauses, the very character and intention of which is that protection not accepted in one treaty is widened by transferring the protection accorded in another treaty.”*²²³ Another argument is that Article 7 of the UK – USSR BIT, which contains exceptions to the MFN treatment, does not list ISDS among them.²²⁴ The intentions of the Parties were the basis for non-inclusion. The Tribunal concludes by stating that if such practice exists in respect to substantive provisions it *“sees no reason not to accept it in the context of procedural clauses such as arbitration clauses”*.²²⁵ Unfortunately, the Swedish District Court set the Award on Jurisdiction aside in November 2011.²²⁶

It can be observed that the main issue, *i.e.* the access of arbitration through the usage of MFN provisions is rather uncertain. In the case of EU Member States – Russia investment disputes only once a tribunal has tried to circumvent the established practice. In international practice, many tribunals in fact granted MFN protection to investors in relation to ISDS. Mostly the cases dealt with circumventing the “local remedies” rule and applying straight to international arbitration. Despite the common approach, such accordance of MFN treatment makes sense. Likewise, the substantive provisions in investment instruments, ISDS is a crucial protection mechanism for investors and does not imply automatically different treatment only due to its nature. Finally, the ILC in its 2015 report adopted the following view: “Whether MFN clauses are to encompass dispute settlement provisions is ultimately up to the States that negotiate such clauses. Explicit language can ensure that an MFN provision does or does not apply to dispute settlement provisions. Otherwise the matter will be left to dispute settlement tribunals to interpret MFN clauses on a case-by-case basis.”²²⁷

²²³ *RosInvestCo vs. Russia*, para. 131

²²⁴ *Ibid.*, para. 135

²²⁵ *Ibid.*, para. 132

²²⁶ *RosinvestCo vs. Russia*, Default Judgment of the Swedish District Court, 9 November 2011

²²⁷ ILC Report on the work of the sixty-seventh session (2015), Chapter IV, A/70/10, para 42

Unfortunately, recent EU agreement with Canada – CETA – expressly states that MFN treatment does not cover ISDS.²²⁸ In the light of the ILC Report it might seem even inconspicuous, however, a future investment agreement between the EU and the Russian Federation should avoid discrepancies in this area and the Contracting parties should reconsider the wording of the MFN clauses and specify that MFN treatment shall be accorded not only to investments but also to arbitration. Perhaps a list of acts, which might be deemed less favorable, is in order, similar to the one in the German Model BIT.²²⁹

Sadly, the Russian position on the MFN provisions is rather restrictive and corresponds with its statement that it will not exceed its WTO commitments. The EU on the other hand has as its primary objective the inclusion of the MFN clause in all of its BIT's. Interestingly, it stated that its wording might be adjusted "allowing some flexibility in the MFN clause in order not to obstruct regional integration processes in developing countries"²³⁰ Therefore, a suitable outcome on the inclusion of the MFN clause can be assessed positively, however, complex.

Russian BIT's with European States lack national treatment provisions.²³¹ NT is a minimal investment protection standard present in BIT's of most developed countries.²³² Therefore, a suitable national treatment provision should definitely be negotiated in the future investment agreement with the same scope as in CETA and correspond with the highest level of protection in the most progressive BIT's. However, due to Russia's policy of "import substitution"²³³ and internal market safeguards, the inclusion of this norm would require heavy bargaining from the European Union.

Procedural provisions: the nature of the ISDS mechanism

The assessment of the optimal ISDS mechanism for a future investment treaty between the EU and the Russian Federation can be based on three things. First, one should assess the effectiveness of the existing ISDS mechanisms in EU Member

²²⁸ *Ibid.*, Article X.7

²²⁹ Article 3 (2), German Model BIT

²³⁰ Tilman Dralle, page 28

²³¹ See Belgium/Luxembourg, Germany, Netherlands and Switzerland BIT's with the Russian Federation

²³² See Austrian, German, UK BIT's

²³³ Decree of the Government of the Russian Federation Nr. 1044, 11 October 2014

States – Russia BIT’s. Second, one should assess the investment climate in both jurisdictions, *i.e.* the political situation and legislation as well as the effectiveness of the judicial system and its level of impartiality. Third, contemporary international practice and recent investment treaties of the EU, such as CETA and TTIP, as well as up-to-date agreements of Russia, *e.g.* EAEU–Vietnam FTA, are of the outmost importance.

Nowadays the EU is moving towards a new investment policy and its proposal regarding a new permanent investment court is a sign of change in international investment practice. However, some States like the United State of America do not agree with such a proposal, and do not recognize the need for restructuring of existing ISDS mechanisms. They are satisfied by the existing multilateral mechanisms such as ICSID. Besides, some of the Russian-era and Soviet-era BIT’s are clearly old-fashioned and are not suited for the existing international investment environment and call for re-evaluation. Therefore, a new investment agreement between EU and Russia has to encompass a balance between efficient mechanisms and the necessity of new legal institutions.

Following the analysis of the EU Commission’s proposal on a new permanent court, it is needless to say that ISDS is an inherent part of the EU – Russia investment architecture. Some scholars believe that due to a broadly drafted Russian Model BIT and BIT’s between Russia and EU Member States, a state-of-the-art ISDS mechanism will not “elicit any major resistance from the Russian side”.²³⁴ Besides, most of the Soviet-era BIT’s with restrictive ISDS wording have not been updated since their conclusion.

Therefore there may be two ways according to which the new system would be approached. First, if the new mechanisms provided for in CETA and, if agreed upon, in TTIP would prove themselves effective, a similar ISDS mechanism could be incorporated in the future EU – Russia investment agreement, combining EU’s practice in CETA and TTIP. Second, the need for such a court would not be acknowledged and the Russia and EU would stick to the ICSID Convention/Additional facilitation rules and UNCITRAL Arbitration Rules.

Taking into account the proposal of the Commission on the permanent court, many of the provisions need to be re-assessed with respect to EU – Russia relations. For

²³⁴ Tilman Dralle, page 21

example, Russia would theoretically be interested in establishing a permanent court with a list of judges it can appoint itself. For European investors this option would also be of particular interest for two reasons: they would have more confidence in their investments, since they do not have to use local remedies on the territory of the Russian Federation and apply straight to an international arbitration court, and it would theoretically lead to a higher level of compliance with the awards of such an institution. However, a fixed list of arbitrators would significantly decrease the quality of the process, exclude experienced and skilled professionals from the “pool of arbitrators” and hence affect freedom of choice of the investors.

To resolve the abovementioned issue, Prof. Jose Zamora, a Mexican attorney, has expressed an interesting idea²³⁵ to create an association of judges similar to the International Federation of Insolvency Professionals (hereinafter – INSOL), which would certainly benefit such an institution and reduce the risk of appointing unqualified judges. Moreover, if the permanent court would be established under TTIP, such association would lead to the elevation of professionalism, experience exchange and possibly to a consistent legal approach on a global level. Nevertheless, private investors would not participate in the appointment procedure of the judges, whereas the existing ISDS regime provides for this option.

Another issue is whether such a court would respect precedents. The current system does not bind tribunals to previous decisions, which allows taking flexible and fairer decisions. Besides, an appellate body within this permanent court would create more confusion than order. Since the appeals panel would be part of the permanent court, the same court would review its own rendered decisions, which would appear ill advised. The author strongly believes that similar provisions as in CETA²³⁶ with the exact same wording should be included in the future investment agreement. If such a mechanism were to prove itself effective, it would give private investors and State parties more assurances towards the legitimacy of the arbitration process.

Unfortunately, an appeals body may incur additional costs due to a lengthier process. It would limit the accessibility of arbitration for small entities. Moreover, such a court would certainly be a financial burden for the States. It also would create additional bureaucratic hindrances, whereby parties to a dispute would prolong the enforcement

²³⁵ Jose Maria Abascal Zamora, „*Enhancing dissemination of information, technical assistance and training*“, Enforcing Arbitration Awards under the New York Convention: Experience and Prospects, UNCITRAL, 1999

²³⁶ See Article X.42 CETA

of an award by appealing to this body. Further analysis of the subject matter would be possible upon the occurrence of international practice.

A highly debated subject is the State's "right to regulate". The so-called "regulatory chill" is a known fear of governmental officials.²³⁷ ISDS is said to prevent governments from "making important policy changes that would benefit social welfare, health, or the environment because governments fear paying out millions of dollars in damages to foreign investors via resultant ISDS claims".²³⁸ A case study of NAFTA and CAFTA (Central America Free Trade Agreement) shows the empirical result of ISDS influence on the legislative process in some American States. Most of the claims were brought with respect to regulatory changes in the areas of natural resources, environment, health, and food and agriculture policy. The scholars conclude: "...there are few, if any, cases to support the theory that investment arbitration has caused states to halt, curtail, or roll back regulations aimed at legitimate policy concerns."²³⁹ First, the greater share of claims target administrative acts affecting particular investors rather than regulatory acts themselves. Second, ISDS issues are hardly the sole cause in preventing progressive and protective regulation, since most of the issues dealt with during the enactment of the regulation are already subject to continuous policy debates. Third, modern IIA's involve the right of States to regulate and general exception clauses. "Regulatory chill" should not affect the inclusion of ISDS provisions in investment agreements for it "can be mitigated through careful drafting."²⁴⁰

Another two issues, which should be considered with respect to the "right to regulate" are (a) "umbrella clauses" and (b) public policy protection. "Umbrella clauses" obligate the host State to bring all investments covered by contracts with private investors under the protection of their IIA's.²⁴¹ The "umbrella clause" is considered to significantly restrict the right of States to regulate. This approach is supported by doctrine²⁴² and case law²⁴³, and allows to make the conclusion that this provision

²³⁷ See Chapter 1, analysis of TTIP

²³⁸ Prof. Dr. Christian Tietje, A study prepared for the Ministry of Foreign Affairs of the Netherlands: „*The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*“, MINBUZA-2014.78850, 26 June 2014, page 78

²³⁹ *Ibid.*, page 92

²⁴⁰ *Ibid.*, page 93

²⁴¹ Dolzer, Schreuer, page 153

²⁴² K. P. Sauvant & F. Ortino, study prepared for the Ministry of Foreign Affairs of Finland, "Improving the International Investment Law and Policy Regime: Options for the Future", 2013, pages 69-70

should be avoided in the future investment agreement between EU and Russia.

The other issue is the protection of public policy matters, such as widely debated public health issues or regulation concerning strategic economic sectors. The recent investment cases *Vattenfall case*²⁴⁴ and *Philip Morris case*²⁴⁵ deal with governmental regulation on atomic energy and tobacco sales respectively. While the first case is still pending, the other shows that an award has been rendered in favor of the State of Australia and its policy towards tobacco sales. However, the case has been dismissed due to lack of jurisdiction without dealing with its merits.²⁴⁶ Besides, an analysis²⁴⁷ of recent Dutch BIT's and the U.S. Model BIT 2012 states that labor and environmental issues need to be addressed in investment treaties.

It seems that such protective language should be included in the future investment treaty between Russia and the EU. It would create a positive social impact of investments, raise public support of many projects and also legally assure governments of the dominance of their sovereign rights. On the other hand, States may abuse their rights in this respect. Domestic courts often interfere on the ground of public policy protection and refuse to enforce some awards.²⁴⁸ Case law practice shows that such grounds are often very vague. In *Konditerskaya Fabrika A.V. K vs. AVK.-Jug* case the court stated that the enforcement contradicts Russian foreign exchange law and therefore recovering of the amount in U.S. dollars would violate public policy. In *United World Ltd. Inc. vs. Krasny Yakor* case an ICC award violated public policy on the grounds that it would bankrupt the Russian company and hence affect the economy of the region in which the award would have to be enforced.²⁴⁹ Those cases are proof of such abuse, however, not to include "public policy protection" clauses in investment agreements appears non-realistic. Therefore, once again, the issue of enforcement appears to be the key problem of current ISDS regimes.

It is safe to assume that enforcement is one of the most important issues in modern international investment law generally and particularly in EU – Russia relations as

²⁴³ *CMS vs. Argentina*, Award, 12 May 2005, 44 ILM (2005) 1205, para 299

²⁴⁴ *Vattenfall AB et al vs. Germany*, ICSID Case No. ARB/12/12

²⁴⁵ *Philip Morris Asia Limited vs. Australia*, UNCITRAL, PCA Case No. 2012- 12

²⁴⁶ Gareth Hutchens, The Sydney Morning Herald, "Australian government wins plain packaging case against Philip Morris Asia", 18 December 2015

²⁴⁷ *Supra* note 199, pages 104-105

²⁴⁸ Practitioner's Handbook on International Arbitration and Mediation – Third Edition

²⁴⁹ *Ibid.*, page 356

well. Given that Russia's court system often lacks necessary will-power and follows an unnecessary formalistic approach in procedural matters, and also having in mind the non-compliance with the recent Yukos award²⁵⁰, the future investment agreement between the EU and the Russian Federation has to contain clear directions on enforcement measures and consequences in case of non-compliance, which are presented below.

The establishment of a permanent court with State-appointed judges would benefit all parties: it would provide legitimacy necessary for the Russian side and the assurance of enforcement needed for private investors from the EU. Nevertheless, the public policy exception is utterly up to the domestic court's discretion. There is no internationally recognized concept of public policy though such institutions as the International Law Association have tried developing such concept.²⁵¹

If such an institution would not be considered useful, the State parties would stick to their obligations under the ICSID Convention and UNCITRAL Arbitration Rules. In case a new investment agreement would be negotiated, both ICSID and UNCITRAL arbitration rules would be an option and both conventions should be available for the parties. However, Russia is not a party to ICSID and this presents the States with the opportunity to extract some of the more favorable rules from both treaties and incorporate them in their future agreement.

Rules governing the selection and appointment of arbitrators are relevant with respect to the speed of the constitution of the tribunal. Both ICSID and UNCITRAL rules establish time limits as to the number of the arbitrators and the method of appointment. Speed of the arbitration process is crucial, however, both treaties provide for an elaborate mechanism of choice, which allows parties to the dispute to manipulate and slow down the process. Therefore, in this case, not the actual rules are important, but the time limits the parties are willing to establish for themselves. CETA, for example, provides for identical rules as in the ICSID Convention, but in case neither of the remedies can be agreed upon, the parties delegate the decision to create a list of possible arbitrators to the Committee on Services and Investment established under the treaty.²⁵² This might be a suitable mechanism for the future EU

²⁵⁰ *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227

²⁵¹ Sameer Sattar, "Enforcement of Arbitral Awards and Public Policy: Same Concept, Different Approach?", page 4

²⁵² Article X.25 CETA

– Russia investment agreement as well.

Jurisdictional matters are a lesser issue and should incorporate broad language and non-exhaustive lists of possible “investments”. As has been explained in Chapter II, the proper and comprehensive definition of “investment” and “investor” are crucial for ISDS and should incorporate the most favorable regime provided for in the relevant BIT’s and international practice.

Finally, enforcement measures shall be dealt with high caution. Russia has signed the most important instruments containing enforcement provisions. Russia mostly uses UNCITRAL Arbitration Rules when it comes to ISDS. As a continuator State to the USSR it uses the New York Convention 1958.²⁵³ Besides, it has signed the ICSID Convention, although, did not ratify it. The EU would have to accede to these conventions according to the competence requirements mentioned in Chapter I.

The UNCITRAL awards are “final and binding on the parties”²⁵⁴ and are not subject to appeal or annulment. However, there are no special mechanisms provided to make the award enforceable and therefore UNCITRAL awards are subject to review by national courts according to the New York Convention. Unfortunately, the New York Convention does not contain any effective remedies in this regard, whereas UNCITRAL Arbitration Rules do not refer to enforcement at all.

As to the ICSID Convention, it appears that it entails sufficient norms to ensure enforcement of arbitral awards. First of all Article 53 of the Convention obliges the parties to a dispute to comply with the award unless it has been stayed “pursuant to the relevant provisions of this Convention”. It has been mentioned earlier that sovereign powers of a State allow non-compliance, as it has been in case of Argentina.²⁵⁵ However, the ICSID enforcement measures appear to be adequate and effective. Article 54 of the Convention states that an award can be enforced in any Contracting State to the ICSID Convention. Freezing of assets, garnishment of property and other means to reimburse damages is an option. However, the problem is that a State may not have any assets available in foreign countries and the one’s that may be targeted by such measures may be protected by diplomatic immunity. It would be impossible to arrest property of a diplomatic mission.

²⁵³ Order of the Presidium of the Supreme Council of the USSR, 10 August 1960

²⁵⁴ Article 32(2) UNCITRAL Arbitration Rules

²⁵⁵ Ph. D. Tsai-Yu Lin, “*Systematic Reflections On Argentina’s Non-compliance With ICSID Arbitral Awards: A New Role Of The Annulment Committee At Enforcement?*”, *Contemporary Asia Arbitration Journal*, Vol. 5, Nr. 1, May 2012, page 2, available at: [<http://ssrn.com/abstract=2115553>]

There are two more remedies that may be sought by an investor. First, according to Article 27(1) of the Convention, he or she can make use of diplomatic protection. Non-compliance is the only ground to access this remedy. However, due to the arguments presented above in Chapter I this approach may fail. The other is provided for in Article 64 and is based on State vs. State arbitration. This remedy would be only effective if the State espouses the investor's claim and brings it before the ICJ. These remedies can potentially ensure compliance. Unfortunately, unless Russia ratifies the ICSID convention, these remedies are not available to investors. Moreover, even with such seemingly effective measures full compliance cannot be ensured.²⁵⁶ Therefore, the future agreement needs to contain strict rules on the subject matter and create new one's to ensure compliance and boost the attractiveness of the Russian market.

Univ. – Prof., Ph. D. Tsai-Yu Lin proposed the following improvements to the current enforcement regime. The inclusion of *ad hoc* annulment committees in the enforcement mechanism will serve as an improvement to the current ISDS regime under the ICSID Convention. “Recent developments in the stay decisions, as having been reviewed in this paper, have indicated that the annulment committees have increasingly functioned as *de facto* “compliance tribunal” under the ICSID arbitration system.”²⁵⁷ Such remedy may be effective if such annulment committee first requests a guarantee from the State as an assurance that it will comply with the award. Tsai-Yu Lin suggests that “punitive” remedies might help to ensure non-compliance. As an example he refers to a WTO case – Canada-Aircraft case.²⁵⁸ Canada stated that it had no intention of withdrawing its subsidy as required by WTO Rules. In the light of Canada's refusal to comply the panel decided to reach a level of countermeasures that will ensure such compliance and awarded Brazil the right to block \$ 248 million of Canada's exports. He concludes that a “stay with punitive conditions might serve as a possible deterrent to initiate an annulment proceeding that are motivated primarily out of delaying and avoiding compliance.”²⁵⁹

Other suggestions for the improvement of the ISDS regime have been made on the basis of national legislation. It is the national courts or a specialized domestic

²⁵⁶ Ph. D. Tsai-Yu Lin, page 7

²⁵⁷ Ph. D. Tsai-Yu Lin, page 17

²⁵⁸ Canada – Export Credits and Loan Guarantees for Regional Aircraft, WT/DS222/ARB, 17 February 2003

²⁵⁹ *Ibid.*, page 19

authority that usually enforce awards. This approach is supported by a decision of an English court in the *Ecuador vs. Occidental* case: “*although the right to commence arbitration under a BIT has its origins in public international law, the performance of that right (i.e. the arbitration procedure and tribunal) is made subject to municipal law...*”²⁶⁰

International practice has developed four ways of obtaining enforcement. In Switzerland, a party may deposit the award with a court or another State authority and hence the rendered award would become enforceable as any other judgment/ act of that court or State authority. England allows direct enforcement without such preliminary registration of the award. In the United States, the investor would have to request recognition or “exequatur” as a guarantee of enforcement. Another way to enforce an award is to sue on it as “evidence of a debt” and claim that it is “a contractual obligation to carry out the award”.

The inclusion of the abovementioned suggestions in the ISDS mechanism between Russia and the EU will improve the legal protection of foreign investors in this region, accelerate economic growth and foster investment ties between EU Member States and Russia. ISDS has proven to be a very useful legal tool for both private entities and States. While protecting the investors it gives the State the necessary prestige as a fair and equal player, thus raising the level of trust of the investor and allocating additional capital. Whichever option the parties would choose for their agreement, they will either way benefit from the inclusion of an ISDS mechanism. That statement shall be assumed true only if (a) EU and Russia were to overcome their political disagreements and (b) Russia were to steer towards a more investor friendly and ISDS favoring investment policy.

²⁶⁰ Michael Waibel, “*The Backlash Against investment Arbitration: Perceptions and Reality*”, Kluwer Law International, 2010, page 103

Conclusion

„On the occasion of the EU – Russia summit in Brussels on 20-21 December 2012, the EU –Russia Industrialists Roundtable (IRT) issued a press statement warning that under no circumstance should an EU – Russia investment agreement weaken existing investor protection. According to the IRT, the chapter on investment should be based on best practices in existing bilateral investment treaties and where possible go even beyond existing provisions.“²⁶¹

However, today the investment relations between the EU and Russia present a great concern and need constant monitoring. Russia’s trade relations with the EU are now hindered by destructive political disagreements, despite the fact that the EU has always been the biggest and most important trade partner of Russia.

On the one hand the Russian Federation is moving towards a new EU-like economic integration project – the EAEU. Free trade, respect for competition, movement of labor and capital and hence the enhancement of investment flows are now a priority of the new Eurasian Union. The recent FTA with Vietnam shows the intention of Russia to conduct an investment and trade oriented policy much like the EU.

On the other hand, the EU has commenced a new investment policy and its primary objective today is to provide investors with stable, predictable, fair and properly regulated legal framework. The EU is also seeking a better and more efficient investment protection regime. So, CETA and TTIP are state-of-the-art agreements that have many innovative provisions. The permanent court that might emerge under the TTIP agreement could, however, turn out to be a success. This new system might appear to be investor-friendly and efficient despite the feared criticism. Although, deciding now whether it will have positive or negative impact on ISDS is mere speculation. Consequently, it would be ill advised to abolish the ISDS system that exists today.

It is true that the current ISDS regime between EU and Russia, which is based mostly on BIT’s, has revealed to be flawed. However, those flaws are rather quantitative. States have negotiated investment agreements individually with each other, which lead to the exclusion of many important substantive provisions and even ISDS as a concept. The trend to conclude comprehensive trade and investment agreements may

²⁶¹ Tilman Dralle, page 5

serve as a possibility to strengthen the current investment protection regime. However, the project to create a permanent investment court is also desired by the EU and is presented by Brussels as the perfect solution to eliminate the flaws of the current ISDS system.

Nevertheless, the author believes that the establishment of a permanent investment court does not seem now as a step towards better investment protection with respect to EU – Russian relations. The goal to achieve consistency in arbitration practice would fail and even stronger competition among the investment protection entities would emerge. A permanent court would rather create more confusion than certainty. The division of the court into first instance court and appeals body appears at first glance as positive, however, it would be used as a legitimate tool to prolong the proceedings, which in the end would only damage the investment and the investor due to abuse of the right to appeal.

The appointment of arbitrators would be utterly in the hands of the States. It would certainly fail to uphold the freedoms of investors that exist today. Besides, the proposal does not mention enforcement measures since both the U.S and the EU do not see it as an issue, which in case with Russian – EU relations may be a rather serious issue.

Therefore, a permanent court is less desirable than the current investor-friendly system. Given the findings that the sovereignty of States with respect to public policy does not suffer from investment claims and current ISDS mechanisms, it would be better to remain in the existing legal framework. Therefore, it seems reasonable to uphold the current system and only correct existing flaws. Perhaps, by updating the ICSID or UNCITRAL framework.

Of course, the contemporary ISDS system needs more transparency, legitimacy and stricter enforcement norms altogether. The author believes that the future investment agreement between Russia and the EU would benefit from the inclusion of the relevant ICSID provisions.

First, a comprehensive and broadly drafted notion of “investment” is desirable to be included in the future agreement. The goal herewith is to ensure the inclusion of as many assets as possible. It would lead to extensive jurisdiction of arbitral tribunals, hence it would increase protection of investments and finally lead to a more investor-friendly environment and maybe even to reducing of the usage of offshores. ISDS provisions in this regard shall be drafted also broadly allowing coverage of all

possible investment activities. The notion of “investor” shall be tackled in the same liberal manner. The author believes that since Russia and the EU are both part of the WTO framework it is simple logic that they both intend to open their markets and economies for inflows of foreign investments.

Another question are expropriation provisions that have to include comprehensive language relating not only to the amount of payment, but to all investment related issues. The problem of occurrence of expropriation acts has to be resolved as well. It seems unjust that an arbitration tribunal will solely decide on the issue of occurrence as well as it is unfair that domestic courts decide upon it. As a possible solution to that problem a list of possible violations may be included in the agreement to limit the legal loopholes in national and international norms. This list aims at ensuring that the State will not have the possibility to claim that the act of expropriation never happened. Since it will be an agreed upon with the State investor will be assured that those exact actions will not be likely to occur.

MFN and NT clauses need to be incorporated in the future agreement as well. The author believes that MFN and NT treatment should extend to ISDS clauses and incorporate a list of possible areas upon which the parties wish to extend such treatment.

Finally, enforcement measures listed in the ICSID Convention should also be of use to the future EU – Russia investment treaty. The author strongly believes that Russia needs to ratify the ICSID Convention and join its legal framework. New enforcement measures will be a positive improvement to the current ISDS regime along with the proposal to include punitive enforcement measures in annulment proceedings. The current enforcement provisions proposed in the New York Convention are clearly insufficient. A State that has a reputation of non-compliance may lose its reputation as an investor friendly country or even lose access to international credit and other financial means. However, since investment is associated with risk, investors would most likely invest in this country in any case.

The author also believes that it is crucial to include the public in such negotiations for the purpose of generating ideas, providing transparency and learning about the needs and wishes of investors, and hence to work out a balanced ISDS system, which would benefit all parties. The future global investment framework will definitely change and become more comprehensive. Ultimately, it might become identical to the WTO system. But most of the criticism is usually based on unawareness of the advantages

and the fear of “conspiracy” of big multinational corporations against States and peoples. Therefore, it is important to provide information in educational institutions and media to calm the fears and commence public debates on investment issues. An innovative ISDS mechanism, which would balance the interests and freedoms of private investors and the sovereign rights of States, would without any doubt, create prosperity and economic growth worldwide.

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This thesis is devoted to the topic of Investor – State dispute settlement (ISDS) regimes in the European Union and the Russian Federation. The author provides description and analysis of national and international legal acts of the EU, its Member States, Austria and Germany, as well as Russia. The goal is to assess the effectiveness of investment protection remedies provided for both in the EU and Russia. As a theoretical objective of the research, suitable ISDS mechanisms for a potential future investment agreement between the EU and Russia are examined.

The first chapter is devoted to an overview of the respective investment norms of Russia, the EU and its Member States. On the national level, constitutional, civil and procedural norms are examined for the purpose of enquiring existing remedies for foreign investors. International treaties of Russia and the relevant EU Member States are analyzed with respect to availability of investment protection standards and accessibility to foreign investors. Particularly, this chapter is dealing with the division of competences between the EU and its Member States regarding investment protection. A major issue is the contemporary investment relations between Russia and the EU within the PCA framework. Finally, ISDS provisions in CETA and TTIP are being inquired since they are recent and state-of-the-art agreements. Besides, one of the central issues is the examination of the EU's proposal on the establishment of a permanent investment court.

The second chapter is focusing on the notions of “investment” and “investor” with regard to the operation of ISDS mechanisms. The author provides an overview of the relevant case law regarding the interpretation of the term “investment” in high-profile cases as well as in case law arising from bilateral treaties between Russia and EU Member States.

The third chapter is devoted to the ISDS regime between Russia and the EU. An analysis of ISDS-related substantive and procedural provisions in their bilateral and multilateral treaties is presented. The goal is to assess the optimal ISDS mechanism that would benefit both the EU and Russia, to provide an elaborate analysis of existing and potential problems that may arise in the process of investment negotiations and to furnish possible guidelines for the future investment agreement.

In the conclusion the author establishes that the existing ISDS framework based on UNCITRAL and ICSID rules is in principle sufficient and effective. However, necessary improvements to the ISDS regime between the EU and Russia are being proposed.

Diese Magisterarbeit ist dem Thema „Die Investor – Staat Schiedsverfahrenregimes (ISDS) in der Europäischen Union und der Russischen Föderation“ gewidmet. Der Autor bietet eine Beschreibung und Analyse der nationalen Gesetzgebung und der internationalen Verträge der EU, dessen Mitglieder, bzw. Österreich und Deutschland, und Russlands dar. Das Ziel ist die Wirksamkeit der Rechtsverteidigungsmittel für ausländische Investoren in der EU und in Russland einzuschätzen. Als ein theoretisches Forschungsziel wurde das potentielle zukünftige Investitionsschutzabkommen zwischen der EU und Russland gewählt.

Der erste Teil ist der Übersicht der Investitionsnormen der EU, deren Mitglieder und Russlands gewidmet. Auf dem Niveau der nationalen Gesetzgebung werden verfassungsmäßige, zivilrechtliche und verfahrensrechtliche Normen untersucht um effektive Rechtsschutzmittel für ausländische Investoren festzulegen. Die völkerrechtlichen Verträge von Österreich, Deutschland und Russland werden analysiert um festzustellen ob sie für ausländische Investoren zugänglich sind und ob sämtliche Investitionsstandarte in diesen Verträgen vorhanden sind. Insbesondere wird die Kompetenzaufteilung anlässlich der Investitionspolitik zwischen der EU und deren Mitgliederstaaten untersucht. Ein wichtiges Forschungsobjekt stellen die Investitionsbeziehungen zwischen der EU und Russland in Rahmen des PKAs dar. Zuletzt werden die Normen in CETA und TTIP erforscht da sie neuartige ISDS Bestimmungen enthalten. Außerdem wird der EU Vorschlag einen internationalen Investitionsgerichtshof zu gründen als eines der Zentralprobleme untersucht.

Der zweite Teil ist den Definitionen von „Investition“ und „Investor“ gewidmet. Das Ziel ist eine Übersicht von relevanter weltweiter und bilateraler Schiedsgerichtspraxis und die Auslegung der obengenannten Definitionen.

Der dritte Teil ist dem ISDS Regime zwischen der EU und Russland gewidmet. Eine Analyse der materiellen und verfahrensrechtlichen Normen in bilateralen und multilateralen Verträgen wird vorgeschlagen. Das Ziel ist die Bewertung der optimalen ISDS Mechanismen und die Erstellung von Richtlinien für ein zukünftiges Investitionsabkommen zwischen der EU und Russland und die Analyse der existierenden und potentiellen Herausforderungen in möglichen Investitionsverhandlungen.

Im Fazit stellt der Autor fest dass die existierenden UNCITRAL und ICSID Normen im Prinzip genügsam und effektiv erscheinen. Allerdings notwendige Verbesserungen für die ISDS Mechanismen zwischen der EU und Russland werden vorgeschlagen.