

# European Parliament Hearing on Foreign Direct Investment

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In my brief presentation, I will focus on the issue of investment protection, that is, the post-establishment element of international investment agreements.

We will first look at some of the trends in the area of investment protection and dispute settlement. We will see, among other things, that Europe, like other parts of the world, is already facing a number of investment treaty arbitrations. We will then identify some of the main challenges that have become apparent in the rapidly evolving area of investment protection. We will examine issues that have arisen both in relation to the substantive rules contained in investment treaties as well as the investor-state dispute settlement mechanism. Drawing on the experience of countries like the United States and Canada, we will identify ways in which some of the main problems could be addressed in the European context.

## 1.0 Introduction

As is well known, the EU already had the competence to negotiate various investment-related issues, even before the Lisbon Treaty was ratified. Most importantly, the EU already could negotiate and has negotiated investment liberalization elements. What the EU has not done so far is negotiate post-establishment investment protection. This area remained in the hands of the member states. And they used this competence extensively, negotiating over 1,200 bilateral investment protection treaties (BITs).

Most European BITs follow a similar template, laying out broad obligations for the host state relating to the treatment of the home state's investors. Typically, the treaties require the host state to provide guarantees to the foreign investor, including national treatment and most-favoured nation treatment. They also require the host state to compensate the foreign investor in case of expropriation, to ensure fair and equitable treatment and the free transfer of capital. These obligations are typically formulated in very vague terms, making it impossible for investors and host states to predict their rights and respective obligations with any certainty whatsoever. Indeed, the imprecise language has led investment tribunals to reach entirely contradictory interpretations of the same obligations.

The most distinctive feature in investment protection treaties is the investor-state dispute settlement mechanism. This is what makes BITs different from any other treaty, in that they allow foreign investors to sue the host state before an arbitral panel, appointed on a case-by-case basis, if they believe that the BIT has been violated. The investor-state process allows the investors to challenge a wide range of governmental measures in a final and binding arbitral decision.

## 2.0 Trends

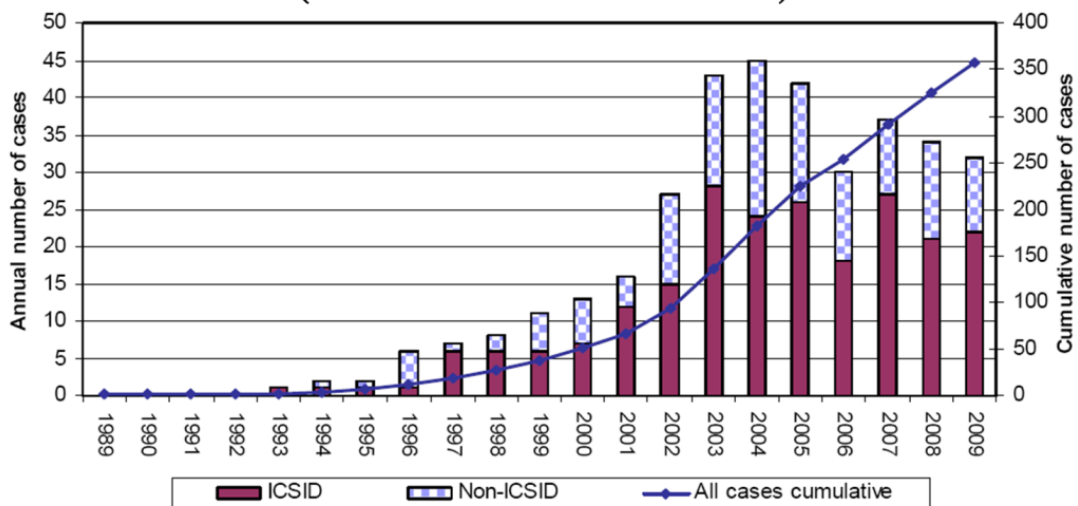
Fifteen years ago, treaty-based investor-state arbitration was largely unknown. The first case was decided in 1990, but it was only with the 1994 North American Free Trade Agreement (NAFTA)—which contains an investment chapter—that investors (or their lawyers) began to increasingly use this unique way of settling disputes. The first case under NAFTA was against Canada (*Ethyl v Canada*). It involved Canadian legislation banning the import of a gasoline additive (for health reasons), an additive that was already banned in about half the states in the U.S. As a result of the arbitration—which was settled half-way through the dispute process—Canada did three things. It paid Ethyl Corporation damages for costs and lost profits during the time the regulation was in place; repealed the health legislation; and released an official statement that noted the substance in question did not pose a health hazard. The product remains banned in many other jurisdictions.

Since *Ethyl v Canada*, there have been over 66 arbitrations filed against the three NAFTA states, Canada, the United States, and Mexico, challenging a wide range of measures, including environmental measures such as environmental impact assessments, health measures (relating to chemicals and pesticides), tax laws, forest, waste and mining management, and many other areas of government policy.

While NAFTA Chapter 11 marked the starting point for a steep increase in investor-state dispute settlement, investor-state litigation is not limited to North America. Indeed, investor-state dispute settlement has increased across the globe. We don't know the exact number of cases because most are kept secret but with well over 350 known arbitrations we can assume the total is well over 400. The number of investor-state cases is rising by at least 30 to 40 per year. In fact, if we compare the number of known treaty-based investment-state cases initiated in the past decade to the number of cases over the same period at the International Court of Justice and the World Trade Organization (WTO), the number of investor-state cases is astonishing (see Figures 1 and 2 below).

Figure 1:

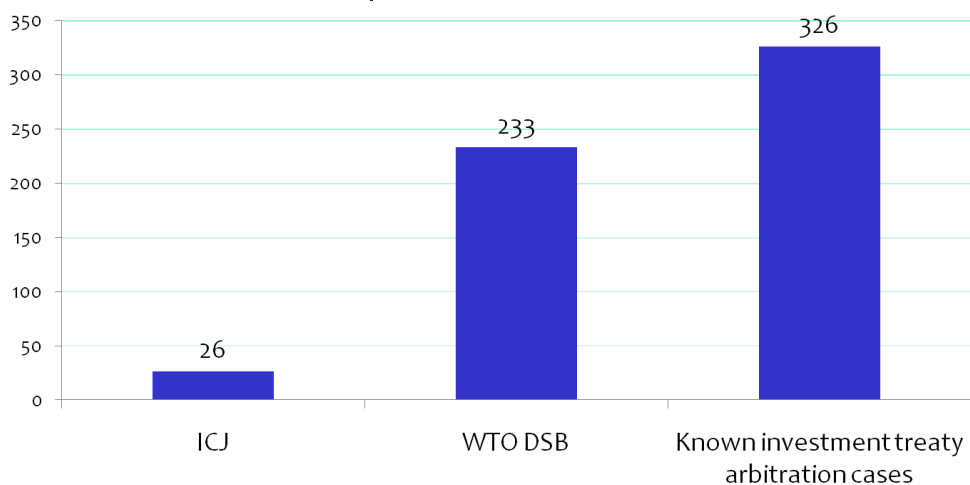
Known investment treaty arbitrations, 1989–2009  
(based on the date of initiation)



Source: UNCTAD

Figure 2:

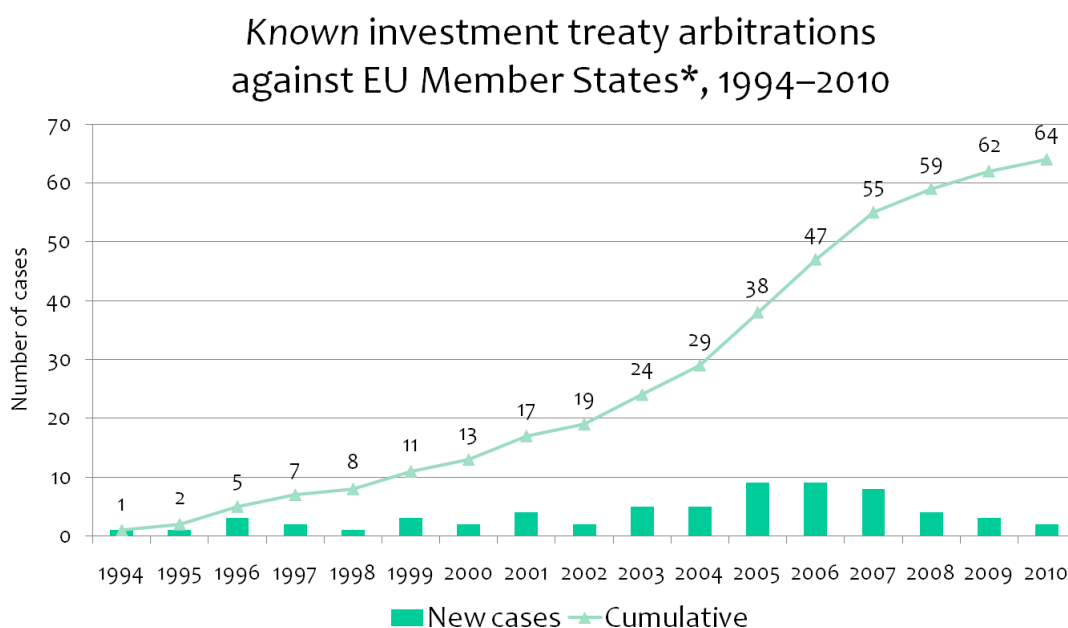
International dispute settlement cases, 2000–2010



Source: based on data from the ICJ, UNCTAD, and WTO websites  
This includes the *known and reported* investment arbitration cases. There are likely many more.

Europe has not been spared from this trend. EU member states, too, have been, and still are, targets of foreign investors under BITs they have signed. As Figure 3 below shows, the number of cases against EU member states is steadily increasing, and more cases against Europe are to be expected. At the end of 2009, over 17 per cent of all the known investor-state disputes were initiated against EU member states (see Figure 4). These numbers are based on a situation where some EU member states have only a few investment treaties, and where most of the treaties are with states importing capital from the EU, rather than the opposite. A steep increase of cases against Europe is therefore likely if the EU agrees to investor-state dispute settlement with China, India, Canada and Mercosur countries, making all 27 member states liable under the treaties vis-à-vis investors from these countries. The outward investment strategies of the Chinese government and others are no secret. There is no doubt that investors from these countries will use all tools available against European measures they disfavour—including investor-state arbitration.

**Figure 3:**

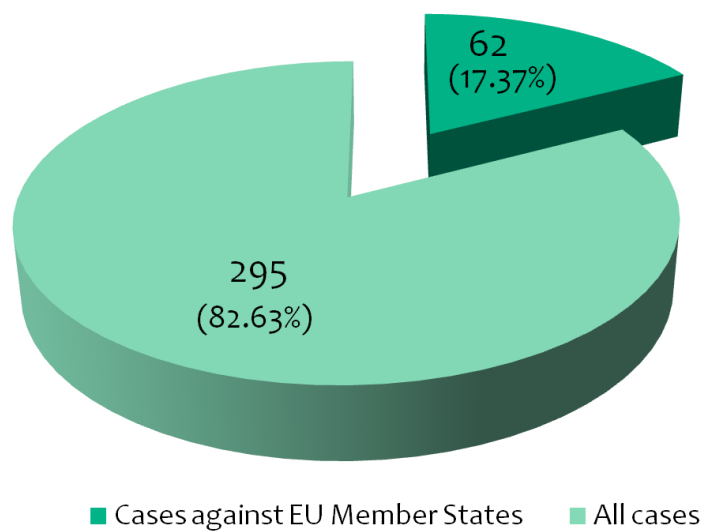


Source: based on data from the ECT, ICSID, ITA, and UNCTAD websites

\* Includes cases against states before their EU accession.

Figure 4:

## Known investment treaty arbitrations, 1989–2009



Source: based on data from the UNCTAD website



### 3.0 Taking a Fresh Look at Investment Law and Policy

The facts tell us several important things: first, investor-State disputes are rapidly increasing—faster than other areas of public international law dispute settlement; second, EU member states have not been immune and have been the target of a total number of 62 *known* investor-state claims; and third, we now have a solid block of about 10 years of experience with investor-state arbitration. During this period, a number of challenges and flaws inherent to the substantive rules and the disputes settlement process have been revealed. Given that the EU is now defining its own policy on this issue, this is the proper time to address the problems that have arisen.

When we reflect on the EU's future approach to investment protection, and considering the trends described above, we must move away from the post-colonial 1959 mind-set. At that time, European states were looking for ways to protect their investment in developing countries from expropriation, and investment flows were in large part one-directional. Our world is more complex today, and as is clear from the London School of Economics (LSE) paper and the European Commission's July communication, Europe wants to gain new markets and, at the same time, receive investment from abroad. These considerations are important as Europe negotiates investment treaties with investor-state dispute settlement. As a recipient of investment, Europe must keep in mind that it could increasingly end up defending a wide range of laws, regulations and other measures in front of arbitral tribunals. Therefore, the language and scope of future EU investment treaties will have to be crafted with this in mind.

When the NAFTA states realized that each of them could be targets of the investors of the others, and they found out that arbitrators would not hesitate to interpret the obligations of host states in ways that were not intended by the treaty parties, they quickly understood that they had not given sufficient guidance to the tribunals interpreting their treaty. As a consequence, they issued an interpretative note to explain what they actually meant when they negotiated NAFTA's investment chapter, to ensure that future arbitrators would not stray from the original intent of the parties to NAFTA. Since then, both Canada and the United States, with a view to avoiding similar problems in the future, adopted model investment treaties that are much more specific than any treaty signed by an EU member state. This to some extent has allowed NAFTA states to avoid the worst surprises from tribunals deciding on their public policy measures, though litigation continues, also under the more recent, more detailed agreements.

When thinking about the future European framework on investment protection, Europe, like the NAFTA states, will need to take into account the perspective of the European investor investing abroad *as well as* the perspective of the EU as a host for foreign investment. The current framework is not satisfactory from either perspective mainly because, as the LSE study so clearly demonstrates, there is no predictability whatsoever as to how investment treaties will be interpreted, and because

the arbitration process is not only costly, but lacks the procedural safeguards other public international law dispute settlement systems provide.

Therefore, any future EU investment policy must address head-on the problems that have become apparent in relation to substance and process over the past 10 years.

## 4.0 Regaining Control of the Substance: The need for more clarity and predictability

Let us first look at the substantive obligations incorporated in the European-style post-establishment investment protection treaties we know.

The template used today by most European member states largely reflects the 1959 BIT signed between Pakistan and Germany. The typical European-style treaty then and today is short and uses broad and vague language. This may have been fine until the template was combined with a powerful and binding dispute settlement mechanism, as we know it today. The imprecision of the substantive provisions give arbitral tribunals complete liberty to interpret the terms as they wish. As mentioned earlier, the NAFTA parties learned the hard way that tribunals were straying from what the parties to NAFTA had originally intended. To get the tribunals back on track, they issued an interpretative statement and subsequently adopted model investment treaties with significantly more precise language.

Today, the models of Canada and the United States have clarified, for example, what indirect expropriation means, thereby ensuring that good faith generally applicable regulatory measures cannot be challenged. They have also clarified the scope of the “fair and equitable treatment” obligation, which, under current case law, can include just about anything. These two provisions—expropriation and “fair and equitable treatment”—are two examples where investment tribunals have taken completely opposing approaches in terms of interpretation. Therefore, unless treaty parties provide guidance, like the NAFTA parties did with their interpretative statement, for example, it is impossible for both host states and investors to predict how these two typically broadly formulated provisions will be interpreted. Even with such guidance, inconsistent decisions continue to be issued, leaving both parties to speculate about the investor’s rights and the host state’s respective obligations. The only guaranteed winners here are the lawyers and arbitrators, who generate fees from their involvement and do not have an incentive to minimize litigation or the incidence of disputes.

The European Commission’s July communication notes the need to address the far-reaching provisions on expropriation, but neglects to mention the need to clarify the fair and equitable treatment provision, which is just as important, if not more. This provision is not a colloquial provision as the phrasing might suggest, but a legally binding standard with a potentially vast scope. A good example of how widely a tribunal can interpret the fair and equitable treatment provision can be seen in this passage of a 2003 decision under the Spain-Mexico BIT (*Teemed v Mexico*)—a decision which has been referenced and built upon in a number of subsequent decisions:

*[T]his provision...requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations (para. 154).*

The July communication also states that commission intends to include in its investment treaties' provisions such as the very controversial "umbrella clause," which elevates domestic law and contract claims to the international level and subjects them to investor-state dispute settlement. This would allow an investor into Europe to bypass normal procedures of domestic administrative or judicial review and take a member state directly to international arbitration instead for virtually any complaint relating to a license, permit, contract with a state or other government acts. This issue, too, requires clarification and further debate.

We do not have the time to look at other provisions in any detail, but it goes without saying that all other provisions, such as those relating to national treatment and most favoured nation treatment, as well as the free capital transfer provisions, should also be carefully assessed in light of the evolving case law.

## 5.0 Procedural Issues:

### The need for transparency, consistency and judicial independence

Turning to the second set of issues, the procedural issues, the July communication not only indicates that commission will continue to include the substantive protection as known from the EU member states BITs, but also states that “future EU agreements including investment protection should include investor-state dispute settlement.”

As noted, investor-state dispute settlement is the single most distinctive feature of international investment agreements, providing the right to a private party to sue a host government directly, without first having to resort to local administrative and judicial remedies. The fact that the European Commission desires to resort to this mechanism, including when its negotiating partner is a state with well-functioning administrative and judicial systems, requires close consideration. The parties to the U.S.-Australia Free Trade Agreement (FTA), for example, decided that it would be sufficient to include only a state-to-state mechanism in the FTA’s investment chapter. The investor-state mechanism was excluded.

Furthermore, even if the investor-state mechanism is included as part of investment treaties, the specific features of investor-state arbitration also need close examination and consideration.

Presently, investor-state arbitration contains problematic features that are not present in other types of international dispute resolution processes involving states.

First, the arbitration system lacks transparency at several stages of the process. When the arbitration is conducted under the United Nations Commission on International Trade Law (UNCITRAL) rules, the International Chamber of Commerce rules, or the Stockholm Chamber of Commerce rules, for instance, the arbitration may never come to light—even where the challenge is against a public policy measure or a democratically adopted law. The investor may even oppose the publication of the final award, and citizens will never know that their government was condemned for a violation of an international obligation and the payment of damages—despite the fact that claims and damages can be extremely high. Just this year, Ecuador was condemned to a payment of US\$700 million plus interest, and Germany recently faced a claim by a Swedish investor of EUR\$1.5 billion. A number of non-European states have incorporated provisions in their investment treaties to ensure transparency in proceedings.

Second, unlike other areas of international dispute settlement involving states, the adjudicators, that is, the investment arbitrators, are untenured. Arbitrators to a tribunal are generally chosen by the parties (advised by their lawyers) on a case-by-case basis, and the tribunal’s president is chosen by

these two arbitrators or an appointing authority. The arbitrators can have a dual function: they can be arbitrators in one investment case, and counsel for a party in another. This allows a counsel to appoint an arbitrator and to expect that arbitrator to appoint him or herself in a future case. The dual arbitrator-counsel role is also problematic because an arbitrator can shape investment law in a way that may be beneficial for a client he or she has as counsel. The investor-state dispute therefore lacks important institutional safeguards present in other systems.

A further characteristic of investor-state dispute settlement is that the arbitral decisions are final and binding. They can be reviewed on narrow grounds only, such as the lack of due process or the non-application of the applicable law, for instance. Arbitral decisions are generally not to be reviewed for their legal or factual accuracy. In fact, there have been decisions in the International Centre for Settlement of Investment Disputes (ICSID) context where the annulment committee acknowledged that a decision was legally wrong, or that the behaviour of an arbitrator unacceptable, but that, unfortunately, it could not do anything but uphold the decision. In other words, there is no appeal comparable to the appeals mechanism in the WTO, for example.

The European Commission's July communication acknowledged some of these problems. In particular, the communication states that the "EU should ensure that investor-state dispute settlement is conducted in a transparent manner," and that the EU should consider how to increase the consistency and predictability in the application of IIAs. It is currently unclear, however, what the commission will do to address these concerns. Ideally, the commission will adopt a policy that would also make arbitrations under existing investment treaties more transparent, just and predictable.

## 6.0 Ensuring Consistency with other Policies of the EU

Before closing, I would like to briefly note the communication's statement that "the Union's trade and investment policy has to fit with the way the EU and its Member States regulate economic activity within the Union and across our borders." The communication continues as follows:

*Investment agreements should be consistent with the other policies of the Union and its Member States, including policies on the protection of the environment, decent work, health and safety at work, consumer protection, cultural diversity, development policy and competition policy. Investment policy will continue to allow the Union, and the Member States to adopt and enforce measures necessary to pursue public policy objectives.*

*A common investment policy should also be guided by the principles and objectives of the Union's external action more generally, including the promotion of the rule of law, human rights and sustainable development (Article 205 TFEU and Article 21 TEU). In this respect, the OECD Guidelines for Multinational Enterprises, which are currently being updated, are an important instrument to help balance the rights and responsibilities of investors.*

These statements by the commission represent an important step towards a more modern type of investment treaty, which would move away from the rather one-sided character of most of the current member state BITs. In order to make this approach meaningful, the European Parliament will have to give concrete guidance how it is to be operationalized.