



Who is Afraid of Investor-State Arbitration? Or Comparative Law?

Jan Kleinheisterkamp

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The Trans-Atlantic Trade and Investment Partnership (TTIP) has been creating expectations and stirring fears ever since it was [announced](#) by EU Commission President Barroso and US President Obama in mid-2013.

The promise to boost trans-Atlantic economic exchange in the world's largest free-trade area came along with the [aim](#) to "include investment... protection provisions based on the... highest standards of protection that both sides have negotiated to date". This [mandate](#) for the EU negotiators is in line with that defined previously by the EU member states for the negotiations of a Comprehensive Economic Trade Agreement (CETA) with Canada, as well as for trade agreements Singapore and India, all of which shall [provide](#) for "the highest possible level of legal protection and certainty for European investors ... built upon the Member States' experience and best practices regarding their bilateral investment treaties". Indeed, with the entry into force of the Lisbon Treaty, it is now for the European Union to legislate on foreign direct investments and therefore also to substitute the 1,500 or so bilateral investment treaties that the EU Member States have concluded so far with uniform EU agreements with third countries.

These bilateral investment treaties (BITs) are mostly modelled after an OECD blueprint whose origin dates back to 1952. They provide very basic and rather simplistic provisions on investment protection standards, such as national treatment and non-discrimination, fair and equitable treatment and a prohibition on

expropriation without adequate compensation. Most notably, the vast majority of these BITs grant foreign investors direct rights of action for damages against their host state before international arbitral tribunals when they feel that the host state has not respected the rights accepted in the BIT. As for their bilateral or reciprocal character, already F.A. Mann noted in 1981 that it was "rather a matter of prestige ... than reality." The reality is that no such BIT has ever been concluded between two "first world" countries. So far the clear assumption has been that these treaties would provide for protection to investors from traditional capital exporting countries doing business in countries with poor rule of law records – and poor altogether. In 1965 the World Bank sponsored a multilateral convention for establishing an institutional framework for these investor-state-arbitrations with the official aim to provide for sufficient legal certainty so that investors would not be put off by "political risk" in developing countries, and so as to help these countries to develop.

How, then, does this development-led approach square with a deal between the world's two most developed economic blocks? Given the huge size of US investments in Europe and the litigious attitude of US firms and especially law firms, considerable fears have emerged

concerning the dangers that such unchecked investor-state arbitration might entail for our own policy space. [George Monbiot](#) has polemicized in The Guardian that TTIP, with its investor-state dispute settlement (ISDS) provisions, would be a "full-frontal assault on democracy", pointing to Philip Morris' claim for billions against Australia after its Parliament passed plain packaging legislation, and to Eli Lilly's half-a-billion dollar claim against Canada after Canadian federal courts had invalidated some of the US company's pharmaceutical's patents. International law luminary [Martti Koskenniemi](#), the current LSE Centennial Professor in Law, has warned that the ISDS provisions in TTIP would be "a transfer of power from public authorities to an arbitration body, where a handful of people would be able to rule whether a country can enact a law or not and how the law must be interpreted". Koskenniemi points not only to Philip Morris' claim, but also to the multi-billion claim by the Swedish energy company Vattenfall against Germany for its accelerated phasing out of nuclear power after Fukushima, based on the Energy Charter Treaty (which was hardly designed for investment in the EU Internal Market). More recently, the [French Minister of Foreign Trade](#) has expressed France's opposition to the inclusion of ISDS in TTIP, echoing fears that US investors could challenge French anti-fracking laws. A rather clear "Nein" also has come from the [German Minister of Economy, reiterated](#) recently also for CETA. In a debate in the UK House of Commons, a backbencher for the Conservative Party, Zac Goldsmith, has asked his government: "Why do we need these tribunals for a country where the rule of law is adhered to, more or less across the board?" And the [House of Lords](#) has most recently concluded that "proponents of investment protection provisions enforced by an ISDS mechanism have yet to make a

compelling case for their inclusion in TTIP or to convincingly dispel public concerns”.

Many of these concerns may, in part, be less objective than one would like the political debate to be. But they do carry some weight, not only because the reasons given by the EU Commission so far for a supposed need of including ISDS are weak and almost self-defeating, as I have tried to show in a separate [policy paper](#). What is more, as rightly pointed out by the HoL, “ISDS provisions are in themselves only an enforcement mechanism: the substantive protections afforded to foreign investors in the investment chapter of a TTIP agreement would matter most”. The Commission itself has acknowledged that “the decisions of arbitral tribunals are only as good as the provisions that they have to interpret and apply”. This was also my point in a report written for the EU Parliament in December 2012, recently published with modifications in the [International and Comparative Law Quarterly](#). There I tried to show how future EU investment agreements would, if framed along the lines of existing BITs and without proper safeguards, fundamentally change the current law of the Union as regards state liability, especially for legislative acts. Foreign investors in the EU would be able to obtain monetary compensation for legislative policy decisions that might be perfectly legal under EU law but are nevertheless found by an arbitral tribunal to be non-compliant with the standards of a EU investment agreement. This is true despite the fact that the [European Court of Justice](#), on the basis of the principles common to most Member States, has limited the Union’s liability for damages to private parties precisely with the aim of shielding the

democratic policy making process from the risk of “regulatory chill”.

These issues raised in my report sparked a [debate](#) in the EU Parliament that had not been foreseen by the Commission, which only wanted to pass a rather technical regulation for managing financial responsibility under future EU investment agreements. The European Parliament then [voted](#) virtually by unanimity (excepting only those parties which reject the EU altogether) for the inclusion of a crucial [recital](#), which ultimately survived the opposition from both the Commission and the Member States: “Union agreements should afford foreign investors the same high level of protection as Union law and the general principles common to the laws of the Member States grant to investors from within the Union, but not a higher level of protection. Union agreements should ensure that the Union’s legislative powers and right to regulate are respected and safeguarded.”

As highlighted in my report, this was one possible reaction to the fears that investor-state arbitration tribunals would interpret substantive protection standards expansively and beyond the level of protection that EU investors are guaranteed in the EU, whose Internal Market is, after all, the world’s most advanced economic integration project. A much more sophisticated solution would have been to do what Article 340(2) TFEU suggests, and arguably even mandates: to work out in detail, on the basis of comparative studies, the principles of state liability common to the laws of the Member States, including the rich national case law in this respect. This would lay a baseline for negotiations with third countries – rather than outdated and one-sided

treaties merely patched to contain safeguards for EU policy space. Moreover, such a thorough approach would primarily achieve what investment treaty law should be all about and what existing investment treaties hardly deliver, namely, legal certainty for both the investors and the host states. Understandably, this much more cumbersome and time-consuming (academic) solution was much less attractive in political terms than a simple “no greater rights” affirmation.

While simple political solutions may address pressing public concerns, they sometimes risk turning *ad absurdum*. This would seem to be the case here: in line with the bipartisan negotiation principles first laid down in the 2002 US Trade Act, the US Trade Representative Marantis [informed](#) US Congress in March 2013 (six days before the “no greater rights” principle was first adopted in the EU Parliament’s Committee on International Trade) that the US Government’s specific objectives for the negotiations of the TTIP included to “seek to secure for U.S. investors in the EU important rights comparable to those that would be available under U.S. legal principles and practice, while ensuring that EU investors in the United States are not accorded greater substantive rights with respect to investment protections than U.S. investors in the United States.” “No greater rights” on both sides of the Atlantic...? If taken seriously, that is a riddle which only comparative public law studies on the principles of investment protection common to the US and the EU would really be able to solve.

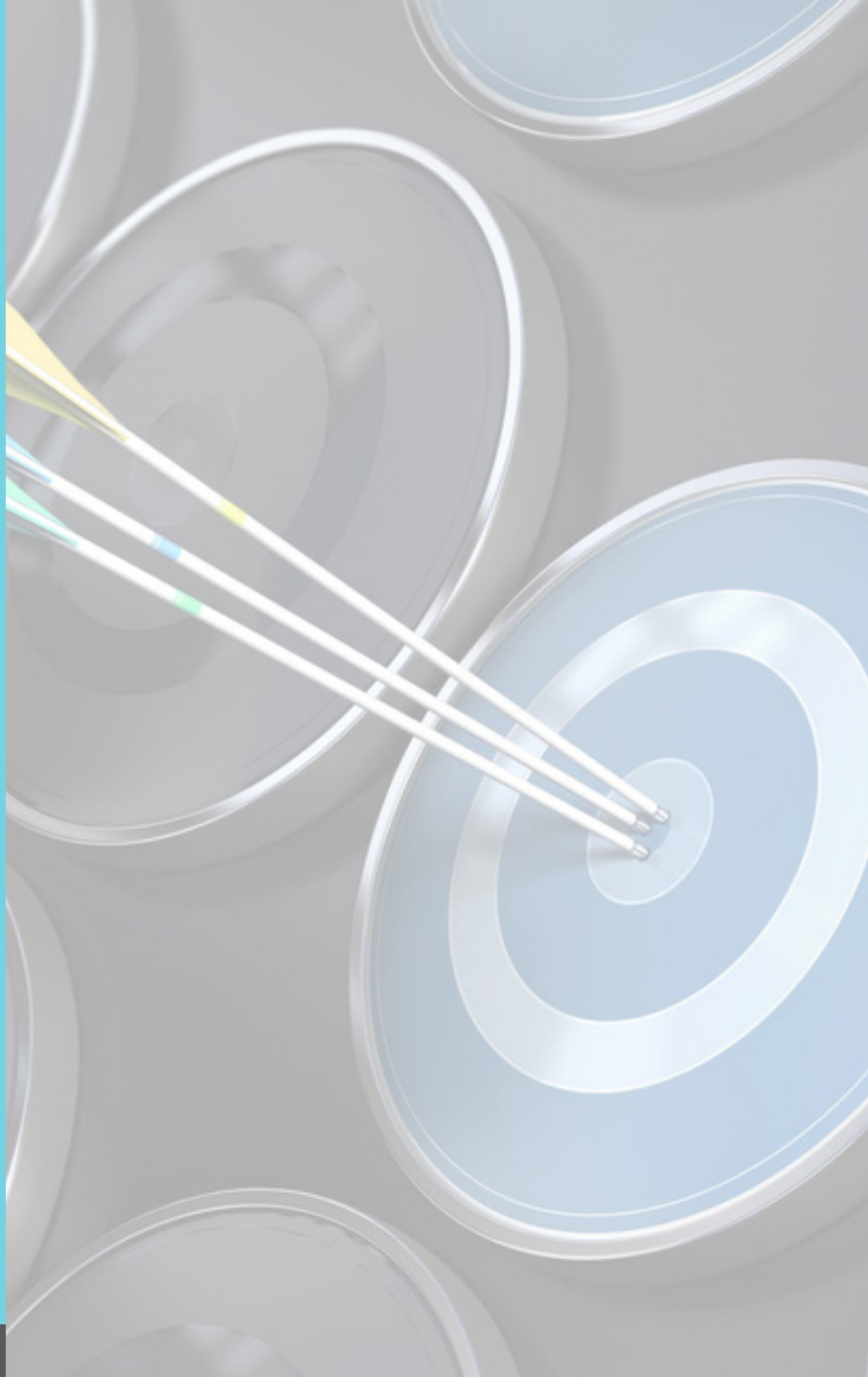
Jan Kleinheisterkamp
(Department of Law,
London School of Economics
and Political Science)

For a fuller version of this paper, please see Jan Kleinheisterkamp, ‘Financial Responsibility in European International Investment Policy’, (2014) 63:2 *International & Comparative Law Quarterly* 449-476

JAN KLEINHEISTERKAMP



Jan is Associate Professor of at LSE, where his research and teaching focuses on international arbitration, international contracts and investment treaty law. He has advised the EU Parliament and is a member of the ICC Governing Body and of the UK Government's Advisory Group on International Arbitration and has advised the EU Parliament.



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

Department of Law
The London School of Economics
and Political Science
Houghton Street
London WC2A 2AE