European Parliament Workshop

Investor-State Dispute Settlement Provisions in the EU's International Investment Agreements

Brussels, 01 April 2014

Mr. Chairman, ladies and gentlemen,

At the outset, allow me to thank you, Mr. Chairman, and the European Parliament for the opportunity to contribute to this workshop with some initial observations on “investor-state dispute settlement (“ISDS”)” to facilitate the following discussion.

Since the 1970s, almost any bilateral and regional investment instrument has provided for investor-state dispute settlement. On the basis of these agreements a foreign investor can commence international arbitration against its host state claiming administrative, regulatory, or judicial measures are in violation with investment protection standards.

At a global level rising numbers of investor-state disputes and newly signed investment agreements suggest the *continuous importance and* attractiveness of this dispute settlement mechanism. Yet, we also see *contestations*. A few countries did not renew or even terminated existing investment instruments while others have withdrawn from the ICSID-Convention.

What does this mean for the European Union? Simply carrying on appears no sustainable option anymore. Modern investor-state dispute settlement practice faces massive public criticism: non-transparent proceedings, hardly predictable outcomes, inappropriate interferences with democratic policy choices in host states, and considerable financial risks, just to mention a few controversial points.

What has been voiced and critically discussed in parts of academia and expert circles for some time has now turned into a noisy global debate, which has to be addressed also by the European Union. Popular opposition by civil society campaigners has helped turning the spotlight on serious deficits of investor-state dispute settlement. However, we must not throw out the champagne with the cork.

The EU in general and this Parliament in particular have the chance to provide significant impetus for correcting mistakes of the past and preserving the virtues of this dispute settlement mechanism for the future.

Speaking of virtues: investor-state dispute settlement is perceived as a forceful tool to *manage political risk* and to *promote an international rule of law*. It is said to *make substantive commitments in investment instruments credible* and, at the same time, contributes towards a *de-politicisation of individual investment disputes*.

Investor-state dispute settlement’s contribution to the promotion of an international rule of law should be stressed in particular. Bilateral and regional investment protection treaties are the extension of the century-old idea within public international law that everyone is entitled to a minimum standard of treatment abroad at any given time. Investor-state dispute settlement is the key mechanism to hold the host state accountable for conduct falling short of certain standards without having (exclusively) to rely on domestic judicial relief, which might be unavailable just in the moment when it is desperately needed.

Certainly, it is true – and regrettable at the same time – that not all elements of an international minimum standard for the treatment of aliens were developed further with equal focus and lasting success. The *grand idea* underlying these efforts should, however, not be forgotten: limiting governmental arbitrariness by stipulating *legal* standards to the benefit of foreign individuals and corporations enforceable in impartial arbitral proceedings.

It might, therefore, be almost tragic to see some of those civil society groups that have vigorously fought for human rights and an international rule of law now find themselves on the side of those states that blatantly call for weakening exactly this international rule of law.

Just to be clear on this point: investor-state dispute settlement as it currently operates is far from perfect. However, demanding to significantly weaken or even to completely renounce investor-state dispute settlement would call into question part of the achievements made with regard to an international rule of law. At the same time it is also clear that aberrations of investor-state dispute settlement practice must be cut back to the concept's initial idea: providing a *safety net* in case the *primary means of redress available in a host state* fail to prevent or remedy abuse of sovereign power. Put differently, international investment law and investor-state dispute settlement can only regain legitimacy if it does *not aim at replacing or turning into an alternative to domestic administrative and judicial safeguards*, but instead backs them up in case of failure.

The idea of providing a fallback, a last line of defence, can equally be applied to developing as well as developed legal systems if we accept that even the most advanced legal system may fall short of certain standards in exceptional cases. In principle, providing for investor-state dispute settlement also among developed countries signals that international investment law is not about "post-colonialism" or directed against developing countries, but rather about an international rule of law.

However, if not carefully designed, allowing for investor-state arbitration may come with significant political, legal, and economic costs, as its current practice demonstrates. Out of several serious concerns with regard to investor state dispute settlement, one appears particularly troubling. Current investor-state dispute settlement practice is perceived as not paying sufficient attention to legitimate public interests such as human rights, environmental protection, or public health. It is said to excessively curtail national regulatory space to implement policies directed at general welfare.

Investment tribunals have been dealing with *highly sensitive political issues*. They have been asked to rule on cigarette plain packaging in Australia and Uruguay, the nuclear power phase-out in Germany, or crisis-related financial austerity measures taken by Belgium in the course of the European financial crisis. In the past, tribunals have repeatedly faced questions of whether they are willing and able to sufficiently take into account public interests. In legal terms, what has been criticised is that decisions of tribunals seem to *not* accurately reflect the "right balance" which the state parties to the investment instrument meant to strike between private property protection and public interests in their investment treaties.

Securing the "right balance" between private and public interests will also be central for the European Union in its unfolding international investment policy. Striking the "right balance" does not only mean securing an acceptable outcome in treaty negotiations with other states. The EU must also ensure that the *balance* struck will *not subsequently* be *distorted in dispute settlement*.

Regardless of the controversy of whether there might be incentives in the structure of investor-state dispute settlement which work in favour of private interests, or whether a re-balancing in favour of private interest is merely the consequence of some arbitrators "merely" wanting to strike some sort of equitable compromise in the particular case, state parties are constantly threatened with losing power over the ultimate determination of the content of their investment instrument.

One phenomenon observed in current investor-state arbitration practice seems to be particularly risky in this respect: the so-called system of "de facto precedent". A significant number of investment tribunals tend to justify their interpretation of a treaty provision exclusively or largely by referring to the interpretation of similar-worded provisions adopted in previous awards rendered on the basis of different investment instruments. What these tribunals basically engage in is "cherry-picking" previous awards allegedly supporting a tribunal's reading of a certain treaty provision. In doing so, they sidestep the binding methodology of interpreting international treaties found in the Vienna

Convention on the Law of Treaties. Nevertheless these "Vienna rules" are not merely a technicality. They secure a transparent interpretative process and a legitimate result most close *to the intention of the state parties to the treaty*.

Arbitrarily choosing from a selection of interpretations of similarly worded provisions previously developed in different, usually incomparable, bilateral contexts carries the risk that the state parties' intentions with regard to the substantive standards in a specific investment instrument might be replaced by other, extrinsic intentions. It lurks exactly here: the threat that tribunals would free themselves from the bonds of their masters, the state parties to the investment treaty.

An effective instrument which lends itself to preventing such distortions of the "right balance" between public and private interests is the power of authoritative interpretation of an investment instrument vested by the state parties. Authoritative interpretation means here nothing other than that the state parties have the "last word" on the meaning given to the provisions of a treaty. However, they have yet to make use of these powers more proactively.

NAFTA experience is telling that a treaty committee stuffed with representatives from the respective state parties and charged with the power to authoritatively interpret the substantive standards contained in the treaty can help hedge in (to some extent) power-seizure processes inherent to treaty interpretation by ad-hoc tribunals in the course of dispute resolution. At least in this respect it is to be welcomed that the EU seems to be following the NAFTA path when negotiating with Canada and the USA.

If one wishes to tie tribunals even closer to the intentions of the state parties an investment instrument could provide for a mandatory review process of draft awards by the state parties or a treaty committee. If the state parties conclude that the interpretation of the investment instrument does not mirror their mutual intentions they could refer the draft award, along with interpretative guidance, back to the tribunal.

The activation of the power of authoritative interpretation by the state parties is just one of many tools to secure the "right balance" between private and public interests. Others relate to more clearly defining substantive standards or restricting or delaying access to investor-state arbitration. In particular, applying fresh thinking to a flexible exhaustion of local remedies rule appears to be central to preserving the "right balance" between private and public interests. Another tool some states have deemed appropriate to better preserve their policy space is to limit remedies in investor-state dispute settlement to monetary remedies. However, whether this instrument is indeed effective or rather counterproductive has yet to be critically assessed. Furthermore, since the interpretation of an investment instrument in investor-state arbitration, especially when containing novel clauses, can hardly be predicted, it is decisive to preserve some flexibility for future correctives and changes without having to renegotiate the whole agreement. Review periods and termination clauses specific to investment provisions and investor-state dispute settlement could bring this flexibility.

In any event, the EU and its institutions are well advised to carefully evaluate each of the inadequacies of investor state arbitration, thoroughly verify whether and to which extent they can be mitigated in a specific investment instrument and weigh them against the perceived virtues before subscribing to a particular model of adjudication; legacy alone should be no argument.

However, one illusion is to be warned against right from the outset: due to the current fragmented state of international investment law there is neither an easy nor a quick solution to the challenges posed. Rather, it will take years – if not decades – to address them properly. Nonetheless, the EU as a major new player entering the "great game" of investment treaty making is presented with the unique opportunity to lay the foundations for a more predictable and balanced approach to protecting foreign investment and preserving sufficient policy space with the view to adequately addressing the puzzling regulatory questions of the future in a common interest. Thank you.