

## USING THE TTIP MOMENTUM TO MODERNISE THE EU APPROACH TO THE GLOBAL INVESTMENT POLICY REGIME

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### Introduction

If there is one single issue in the international trade environment on which all relevant actors agree it is that the existing global investment policy regime is obsolete and in urgent need of revision and reform.

In recent years, the United Nations Conference on Trade and Development (UNCTAD) has probably been the most active international institution in promoting and leading this discussion and reflection. Since 2010 this issue has been a central piece of UNCTAD's World Investment Report series and the arguments and evidence provided there are massive. UNCTAD clearly explained its general view of this issue in 2015 with these words:

Sixty years of International Investment Agreements (IIA) rule making reveal a number of lessons on how IIAs work in practice and what can be learned for future IIA rule making. The expected key function of IIAs is to contribute to predictability, stability and transparency in investment relations, and to help to move investment disputes from the realm of State-to-State diplomatic action into the realm of law-based dispute settlement and adjudication. IIAs can help improve countries' regulatory and institutional frameworks [...]; can reduce risks for foreign investors [...] and become part of broader economic integration agendas, which, if managed properly, can help achieve sustainable development objectives. At the same time, experience has shown that IIAs "bite" (i.e. their protection provisions can and have been enforced by arbitral tribunals at sometimes huge costs to the State), and that they limit the regulatory space of the contracting parties. As a result, concerns have been raised that these limits on regulatory space go too far, were not properly understood at the point of entry into IIAs or are inadequately balanced by safeguards for governments or by obligations on multinational enterprises (UNCTAD, 2015: 125-126).

UNCTAD's main contribution to this discussion was the launch in 2012 of their Investment Policy Framework for Sustainable Development (IPFSD),

which is providing guidance on the reform of investment policies at national and international level.

Academia has keenly joined in this discussion. Outstanding in this sense was the joint declaration produced in 2010 by 76 academics from universities around the world. In the declaration, this group of international experts stated “a shared concern for the harm done to the public welfare by the international investment regime, as currently structured, especially its hampering of the ability of governments to act for their people in response to the concerns of human development and environmental sustainability”(Van Harten, 2010). They also affirmed that “investment treaty arbitration as currently constituted is not a fair, independent, and balanced method for the resolution of investment disputes”. And finally recommend that, “States should review their investment treaties with a view to withdrawing from or renegotiating them in light of the concerns expressed above; should take steps to replace or curtail the use of investment treaty arbitration; and should strengthen their domestic justice system for the benefit of all citizens and communities, including investors”.

Civil society organisations and the general public, who have traditionally been little interested and concerned about international trade policy matters, have recently joined this public conversation. The main reason is the international civil society campaign against the Transatlantic Trade and Investment Partnership (TTIP) and the Canada-EU Trade Agreement (CETA), which since October 2014 has managed to collect almost 3.5 million signatures for a European citizens’ initiative (ECI) against the TTIP and CETA. Besides this quantitative success, the greatest achievement of the Stop-TTIP movement has been to get the general public to know and be interested in concepts and institutions – such as the investor-state dispute settlement system (ISDS) – that until now belonged to the exclusive realm of negotiators and policymakers. The main messages and slogans of the campaign concerning investment policy are rather vague and maximalist: “We want to prevent TTIP and CETA because they include several critical issues such as investor-state dispute settlement and rules on regulatory cooperation that pose a threat to democracy and the rule of law” (Stop TTIP, 2014). However, in essence, their concerns are not too far from those raised by UNCTAD or academia. The text of the “anti-TTIP initiative” explains its opposition to these treaties by saying that “the beneficiaries of these agreements will be big corporations, not citizens, as Canadian and US companies would have the right to sue for damages if they believe that they have suffered losses because of government decisions (for instance new laws to protect the environment or consumer rights)” (Stop TTIP, 2014).

Finally, the European Union has opened a reflection on the global investment regime, including some profound criticisms than can be considered extraordinary, given that this regime has remained almost untouched for more than 30 years. The EU recognises that many of the traditional approaches of this policy have to be revised and that some of the system’s building blocks need to be renewed. The recent European Commission (EC) strategy *Trade for All: Towards a more responsible trade and investment policy* asserts that:

While boosting investment is at the heart of the Commission's economic priorities, investment protection and arbitration have triggered a heated debate about fairness and the need to preserve the right of public authorities to regulate both in the EU and in partner countries, in particular in the context of the TTIP negotiations [...]. The current debate has cast light on the risk of the abuse of provisions common to many of those agreements, as well as lack of transparency and independence of the arbitrators. The need for reform is now largely acknowledged globally and 'while practically every country is part of the global investment regime, and has a real stake in it, no one seems really satisfied with it' (UNCTAD). The question is not whether the system should be changed but how this should be done. While the status quo is not an option, the basic objective of investment protection remains valid since bias against foreign investors and violations of property rights are still an issue (European Commission, 2015).

In the *Trade for All* strategy, the EC recognises that the EU is best placed and has special responsibility in the reform of the global investment regime "as its founder and main actor". Out of the 3,200 bilateral investment treaties (BITs) that constitute the dense "spaghetti bowl" of the global investment regime, almost 1,400 BITs involve EU member states. Therefore, there is great expectancy to see what the EU's next steps are and how they develop.

## Revealed intentions: how far from expectations?

On two different occasions since the beginning of 2015 the EC has specified how it envisages the future global investment regime and what concrete and immediate steps it is willing to take. The first of them was in the *Trade for All* strategy. Here the Commission committed:

- To put stronger emphasis on the right of the state to regulate, by including modern provisions in bilateral agreements;
- To reform the old investor-state dispute settlement system by transforming it into a public Investment Court System, composed of a tribunal of first instance and an appeal tribunal, formed of independent judges with high legal and technical qualifications and including a clear code of conduct to avoid conflicts of interests;
- And, in the longer term, to engage with partners to build consensus for a permanent International Investment Court.

These commitments already tackle three of the five main challenges that, following UNCTAD, global investment reform should address:

(i) safeguarding the right to regulate in the public interest so as to ensure that IIAs' limits on the sovereignty of States do not unduly constrain public policymaking; (ii) reforming investment dispute settlement to address the legitimacy crisis of the current system; and (v) enhancing the systemic consistency of the IIA regime so as to overcome the gaps, overlaps and inconsistencies of the current system and establish coherence in investment relationships (UNCTAD, 2015: xi-xii).<sup>1</sup>

**1** The other two challenges refer to: "(iii) promoting and facilitating investment by effectively expanding this dimension in IIAs; (iv) ensuring responsible investment to maximize the positive impact of foreign investment and minimize its potential negative effects".

Sceptics might have thought “talk is cheap” and that the commitments included in the *Trade for All* strategy had little value until they were endorsed in the text of an agreement or at least defended by the EC in the course of a negotiation. That is precisely why the publication in November 2015 of the EU proposal for “Investment Protection and Resolution of Investment Disputes” in the context of the TTIP negotiations with the US is so relevant. It allows analysts to check the Commission’s real level of ambition and verify the credibility of its promises to lead the reform and improvement of the global investment regime.

In the opinion of this author, the content of the EU proposal for the TTIP’s investment chapter is even more ambitious than the commitments the Commission had made under the *Trade for All* strategy, both in terms of safeguarding states’ policy space and granting that investment dispute settlement operates at least under minimum standards of independence, fairness, openness and subsidiarity. Furthermore, if finally approved, the text of the TTIP’s investment chapter would become, in comparative terms, one of the most progressive investment agreements in the current global investment regime, much more advanced and balanced than the average content that can be found in the *catalogue* of more than 3,000 existing BITs.

### **What are the most outstanding features of the EU’s TTIP proposal regarding the safeguard of the states’ right to regulate in the public interest?**

First of all, the chapter begins with a clear statement in favour of policy space: “The provisions of this section shall not affect the right of the Parties to regulate (...) through measures necessary to achieve legitimate policy objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity” (Art. 2.1). The text clarifies right afterwards that: “the provisions of this section shall not be interpreted as a commitment from a Party that it will not change the legal and regulatory framework, including in a manner that may negatively affect the operation of covered investments or the investor’s expectations of profits (Art. 2.2).

With this simple wording, the Commission is clearly positioning itself against one of the most controversial and challenging issues that has arisen through arbitral practices in recent years: the understanding that BITs protect foreign investors’ “legitimate expectations”, restricting countries’ ability to introduce or change investment-related policies (including those for the public good) if they could have a negative impact on individual foreign investors.

Secondly, the Commission’s proposal includes the traditional “fair and equitable” and “full protection and security” standards (Art. 3.1): “Each Party shall accord in its territory to covered investments of the other Party and investors (...) fair and equitable treatment and full protection and security”. Due to its largely undefined nature (what do “unfair”, “inequitable” and “full protection” mean exactly?) and the ambiguous way they have traditionally been drafted in BITs, these clauses have turned into all-encompassing provisions that investors have used to challenge

any type of governmental conduct that they deem unfair, leaving the task of determining the meaning to arbitral tribunals. At the end of the day, this has led to expansive, unexpected and inconsistent interpretations by arbitral tribunals, exposing host states to unforeseen legal and financial risks and helping investors challenge core domestic policy decisions, far beyond clear-cut infringements of private property.

On this issue, the European Commission has followed one of UNCTAD's suggestions, clarifying the commitments states make under these standards by indicating examples of what they cover through an open-ended list of obligations: the denial of justice; targeted discrimination on manifestly wrongful grounds such as gender or race; manifest arbitrariness, etc. Although a closed, exhaustive list of the assumed obligations would have been preferable in order to avoid the expansion of the meaning through subsequent arbitral interpretations, it already represents a meaningful improvement by comparison with the wording of most existing BITs.

Finally, the Commission's proposal also includes an expropriation provision, which is a key element of any BIT. This provision doesn't take away states' right to expropriate property, but makes the exercise of this right subject to certain conditions.

Here, the Commission, acknowledging that investors have used provisions on expropriation to challenge general non-discriminatory regulations that have had a negative effect on their investments, takes a step forward to establish a proper borderline between expropriation (for which compensation must be paid) and legitimate public policymaking (for which no compensation is due). In Annex 1 of the text, the Commission introduces clear definitions of what "direct and indirect" expropriation mean, establishes criteria to determine when a measure constitutes one or another and adds "for greater certainty" that "non-discriminatory measures of a Party that are designed and applied to protect legitimate policy objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity do not constitute indirect expropriations" [and, consequently, no compensation needs to be paid].

In conclusion, it is fair to say that the Commission's proposal for the TTIP's investment chapter, tabled for discussion with US negotiators at the end of 2015, makes a true effort to find an equilibrium between ensuring that both parties retain their right to regulate for pursuing public policy interests while contributing to a favourable investment climate and protecting foreign investors from unjustified discrimination measures by the host state.

### **What are the most outstanding features of the EU's TTIP proposal regarding the reform of the investment dispute settlement system to address the legitimacy crisis in the current system?**

When describing the legitimacy crisis of the investor-state dispute settlement system, UNCTAD highlights the following features as the most common flaws in the system's substance, procedure and functioning (UNCTAD, 2015):

- It grants foreign investors greater rights than domestic investors and privileged status relative to anyone else in international law;
- In most of the cases, it allows for fully confidential arbitration and denies the right to intervene to all parties with a direct and existing interest in the outcome of the dispute;
- It lacks sufficient legitimacy (in terms of transparency, independence, impartiality or due process);
- It does not allow for correcting erroneous decisions;
- It is highly expensive for users;
- And, related to the protection of states' policy space discussed in the previous section, UNCTAD affirms that this system can: "create the risk of a *regulatory chill* on legitimate government policymaking; provoke expansive, unexpected and inconsistent interpretations by arbitral tribunals; expose host States to legal and financial risks unforeseen for the parties and beyond clear-cut infringements of private property, without bringing any clear additional benefits"; and "elevate property rights over the State's right to regulate and other human rights"(Van Harten, 2014).

How many of these concerns are tackled by the Commission's proposal? In the first place, by shifting from the old investor-state dispute settlement system to an Investment Court System formed of independent judges with high legal and technical qualifications and including a clear code of conduct to avoid conflict of interests, the Commission is partly giving a response to the concerns related to the system's independence, impartiality and due process. By establishing an appeal tribunal, it allows the correction of erroneous decisions and, somehow, stunts the privileged status granted to investors by making a new defence tool available to the defendant state.

Secondly, the text doesn't only imply adhesion to the UNCITRAL Transparency Rules – which is the most ambitious of the existing international standards on transparency in treaty-based investor-state arbitration – but adds a list of additional transparency obligations. It also includes the right of any natural or legal person that can establish a direct and present interest in the result of the dispute to intervene as a third party.

Thirdly, the EC's proposal requires the tribunal to dismiss any claim by an investor who has submitted a claim to another domestic or international court concerning the same issue, unless it withdraws such a claim and refuses to initiate any new claim concerning the same issues in the future. This provision tackles the traditional criticism of the privileged status the international investment regime gives foreign investors relative to anyone else in international law.

Finally, the text establishes that upon an international agreement providing for a multilateral investment tribunal the articles of the TTIP related to the Investment Court System and the appeal tribunal shall cease to apply. This has to be understood as supporting UNCTAD's call for "enhancing the systemic consistency of the IIA regime" (UNCTAD, 2015).

However, the Commission's proposal doesn't yet give a direct answer to the problem caused by the exorbitant costs that these procedures

usually involve for the disputing parties. Neither does it adequately deal with the privileged status granted to foreign investors, as it doesn't include provisions on the investors responsibilities (actionable in the same way as foreign investors' rights) or recognise third parties' "right to standing" (which is one step further than the "right to intervene", as it recognises third party rights to participate in the proceedings alongside the claimant and the respondent: access to all documents, submitting evidence or proposing and questioning witnesses).

## Pending issues

In this author's opinion, the European Commission's proposal to revise and reform its investment protection and arbitration policy has to be considered, overall, to be a meaningful improvement – compared with the status quo – and a sincere stand for the right to regulate and for an independent, fair and open investor-state dispute settlement system. Still, this reform process is far from being complete and there are some important pending elements to be dealt with that threaten to cast doubts on the EU's political will to lead the reform of the global investment regime.

The first of these concerns is whether the present EU "reform momentum" is a passing fashion or if it is here to stay. In this sense, it is fair to remember that the EC didn't make a move on the most controversial issues until the social pressure against the TTIP was so great that it didn't really have an option. What will happen with the reform process if the TTIP negotiations fail and the public interest on trade policy comes back to its usual below-freezing temperature levels? There are reasons to be optimistic. The negotiations on the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada (concluded in 2014) have recently been re-opened to reformulate the agreement's investor-state dispute settlement (ISDS) clause in line with the EU's new proposal. This same clause has also been included in the recent EU-Vietnam Free Trade Agreement.

The second concern has to do with the time lag before these reforms soak through the stock of almost 1,400 existing BITs involving EU member states. Since the Lisbon Treaty (2009), foreign direct investment has fallen within the common commercial policy of the EU and, as such, investment protection and dispute settlement became part of the sphere of the EU's exclusive competence. Since 2012 an EU regulation has addressed the status under EU law of EU member states' BITs that existed before the entry into force of the Lisbon Treaty:

- Those BITs signed before 1 December 2009 – none of which contain any of the improvements the EU is proposing these days – may be maintained in force until a BIT between the EU and the same third country enters into force. This means that unless the EU negotiates a new agreement with any of those countries, the old, obsolete BITs could still be in force for decades.
- For those BITs signed after December 2009 the Commission must decide the maintenance or entry into force of each agreement based on several grounds, one of which refers to the need for negotiations to be consistent with the European Union's principles and objectives

for external action – promotion of democracy, the rule of law, human rights and fundamental freedoms, or sustainable economic, social and environmental development. The same rules apply to those member states that seek to enter into new BIT negotiations with a third country.

Although this last provision potentially provides the EC with considerable political discretion when deciding on a BIT authorisation, it is hard to imagine that the Commission will deny the authorisation to an agreement based on its insufficient respect for the “right to regulate” or the “opacity and unfairness” of its dispute settlement system. In fact, since 2012 the Commission has denied none of the authorisations of pre-existing BITs, despite most of them not including the recognition of the state’s “right to regulate” and none of them including the innovations the EC is proposing on investor-state dispute settlement. Furthermore, by mid-2016 the Commission had given these same countries 93 authorisations to open new negotiations, 41 to open renegotiations, 16 authorisations to conclude new agreements and 21 authorisations to conclude protocols for existing BITs with third countries (Schacherer, 2016).

In conclusion, if the EU is serious in its analysis and diagnosis about the pressing need to reform the international investment regime and about making EU trade policy “promote and defend not only European interests but also European values”, it cannot look exclusively outward. The EC should present member states with the necessity of a gradual renegotiation of all their BITs to bring them up to the EU’s 2016 principles and values.

Last but not least, in the context of the TTIP negotiations there still is an “elephant in the room” that none of the negotiating parties have been able to explain and clarify properly. Public opinion doesn’t understand why a special, extrajudicial and private dispute settlement system is necessary in a trade agreement between two partners that have, probably, the strongest, most capable and most independent judiciary systems in the world. While the recourse to international arbitration courts might have seemed understandable to the general public opinion until now in the case of investment agreements between developed and developing countries – based on the need to provide a safe and stable environment for investors that is favourable for foreign investment – these become unacceptable reasons in the case of the TTIP.

Despite the fact that the reforms introduced by the EU in the TTIP and CETA negotiations already give an answer to most of the weaknesses attributed to the old-fashioned BITs (which are the reasons behind the BITs’ unpopularity and bad name), the failure of public authorities to properly explain why this system is still needed is fanning the flames of those who see the TTIP’s protection of investors as a matter of special and privileged treatment for corporations against the public interest of European citizens. The EC shouldn’t underestimate this fact. With it more than likely that the TTIP and CETA will be considered “mixed agreements” – requiring therefore the signature and ratification by each of the EU member states – the fate of these agreements will be as dependent on what happens in the negotiation rooms as on the hearts and minds of European citizens.

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