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POLICY BRIEF

A COMPREHENSIVE APPROACH TO INVESTMENT PROTECTION

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SUMMARY

Investments are becoming the new "glue" of a globalised world. The EU remains the largest global investor but it is also the world's largest destination for investment. However, the rules-based international investment system is undergoing profound changes, with emerging economies taking up a larger share and starting to invest in Europe in a reverse of the traditional flow. The system of international dispute settlement is increasingly being challenged or disregarded, particularly by emerging economies. The Lisbon Treaty gave the EU exclusive competence for protecting the investments of member states and their companies. However, the various EU institutions do not share a common approach and there are also differences between the EU institutions and member states.

The EU should seek to improve its own coherence and strengthen global rules on investment protection. The European Commission should develop a standard template for future bilateral investment treaties (BIT) that strikes a balance between investment protection and other concerns such as sustainable development and a government's right to change policy. It should incorporate these standards into future international trade and investment agreements. To carry out this task, the EU should create a European investment task force that would also elaborate an "escalation ladder" of tools to use against governments that do not comply with international rules. Finally, member states should improve co-ordination in international organisations such as the World Bank.

Foreign direct investment (FDI) is, in the words of the European Commission, becoming the new "frontier of commercial policy".[1] Investments are now as important as, if not *more* important than, trade and services and goods in how the EU inserts itself into global financial flows. Notwithstanding the current crisis, Europe is still the world's largest foreign investor.[2] But the EU, which attracted a total of €225 billion in investments in 2011, is also the world's top destination for FDI.[3] An increasing share of this investment in Europe comes from emerging economies. In 2011, FDI from emerging countries totalled $384 billion – 23 percent of global outflows – and is likely to increase further in future.[4]

Although most investments still move across borders without problems, there are an increasing number of high-profile cases in which companies clash with local governments: in 2011, Philip Morris sued the Australian government over tobacco packaging legislation; in April 2012, the Argentine government seized Repsol's shares in local oil company YPF; in September 2012, the Chinese insurance company Ping An sued the Belgian government over the nationalisation of Fortis Bank. There are likely to be more cases of this kind in future. Since it was given exclusive competence over FDI in the Lisbon Treaty, whether and to what extent companies' investments beyond Europe should be protected is now a matter for the EU.[5]

The first question for the EU is whether, and if so when, it should intervene in commercial disputes between European companies and host governments. In the first instance, European companies operating abroad should rely on their own risk management and due diligence. The EU also has to take into consideration other legitimate public policies including sustainable development, human rights, environmental law, and health policy.

Nevertheless, the EU does have an interest in ensuring "that EU investors abroad enjoy a level playing field" and that their investments are protected.[6] The EU should not automatically assume that European companies are always in the right but will need a way of making judgments on how to handle individual cases. The EU also needs enforcement tools in cases of clear breaches of the rules.

The international investment system is currently being challenged by a number of developing countries. Their complaint is that the current rules, which are based on national investment treaties enshrining investment protection, are skewed towards company interests. Furthermore, arbitration, the legal system dealing with investments, is perceived as both opaque and prohibitively costly, particularly the related expenditures on legal advice. As a result, a group of countries, Argentina prominent among them, has started to opt out or disregard the rules, thus hollowing out global governance on investments. This is a problem for the EU, with its normative focus on ensuring global governance and the rule of law.

This brief explores the current state of the international investment system and argues that the EU should aim to set standards that strike a balance between investment protection and other legitimate public policies. The best way to do this would be to create a model agreement for future bilateral investment treaties (BIT), which would set standards on investment protection but also include provisions regarding sustainable development, human rights, health policy, and national security issues. It should also contribute to making the arbitration system more transparent and less expensive. A cheaper and more transparent system would give wayward countries incentives to follow international rules and thus ultimately provide better long-term protection for European companies. Also, an escalation ladder is necessary to establish different courses of action for the EU to act in case of a breach of the rules by other countries.

1 "Towards a Comprehensive European International Investment Policy", European Commission, 7 July 2010, available at http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147884.pdf (hereafter, European Commission, "Towards a Comprehensive European International Investment Policy").
2 Selen Sarisoy Guerin, "Do the European Union's Bilateral Investment Treaties Matter? The Way Forward after Lisbon", CEPS Working Document No. 33 / July 2012, available at http://www.ceps.eu/ceps/download/3629.
3 "EU takes key step to provide legal certainty for foreign investors", European Commission, DG Trade, press release, 21 June 2012, available at http://trade.ec.europa.eu/doclib/press/index.cfm?id=808 (hereafter, DG Trade, "EU takes key step to provide legal certainty for foreign investors").
4 United Nations Conference on Trade and Development (UNCTAD), World Investment Report 2012, available at http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/WIR2012_WebFlyer.aspx (hereafter, "UNCTAD WIR").
5 See article 207 of the Treaty on the Functioning of the European Union.
6 DG Trade, "EU takes key step to provide legal certainty for foreign investors".

Trends in international investments

International investment rules are not regulated by a single international organisation in the same way that the World Trade Organization (WTO) is responsible for trade matters. Instead, countries sign BITs, which confer investor rights and protection to their companies. The essential characteristics of these BITs is that they set standards to regulate the treatment of host states to investors, and that although they are actually signed between states, they grant private companies or individual investors the right to initiate claims against host states.[7] Europe is at the centre of this global web of agreements. In fact, the 1,200 BITs they have signed amount to approximately half of the global number.[8] The US has signed only 48 and Japan only 11.

The number of BITs increased dramatically during the 1990s and the 2000s, and helped enshrine a regime that was very protective for investors.[9] The so-called first- and second-generation BITs, which were concluded between 1979 and the mid-1990s, focused on investor protection and its enhancement through dispute-settlement mechanisms.[10] Standard clauses regarding dispute-settlement resolution allow for investor-state arbitration. This means that, when disputes arise, private investors can bring forward claims against host governments. These agreements are not reciprocal in the sense that the treaties do not confer any rights upon host governments, which aren't entitled to bring claims against investors under investment treaties, but states can naturally have recourse to other elements of national legislation.

The most frequently used mechanism for investor-state arbitration is the International Centre for Settlement of Investment Disputes (ICSID), which is part of the World Bank Group.[11] Unlike other arbitration forums such as the United Nations Commission on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC), ICSID was created solely to settle investment-related arbitration disputes. By 2009, 90 percent of all reported arbitration claims in investment-related disputes had been filed under ICSID.[12] It also holds an important advantage over the others in that its awards are equivalent to judicial rulings and, as such, are directly enforceable in most

7 N. Jansen Calamita, "The Making of Europe's International Investment Policy: Uncertain First Steps", in *Legal Issues of Economic Integration* 39, no. 3 (2012), p. 302 (hereafter, Calamita, "The Making of Europe's International Investment Policy").
8 European Commission, "Towards a Comprehensive European International Investment Policy".
9 European Commission, "Towards a Comprehensive European International Investment Policy".
10 Roos Van Os and Roeline Knottnerus, "Dutch Bilateral Investment Treaties: A Gateway to 'Treaty Shopping' for Investment Protection by Multinational Companies", Center for Research on Multinational Corporations (*Stichting Onderzoek Multinationale Ondernemingen*, SOMO), Amsterdam, 2011, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1974431 (hereafter, Van Os and Knottnerus, "Dutch BITs: A Gateway to 'Treaty Shopping'").
11 ICSID was established in 1966 and by 2006 it had 143 members. Only states can be party to it, which excludes the EU.
12 Barry Appleton, "Comparing ICSID and Ad hoc Treaty Arbitration: Will Changes in ICSID Senior Management Spur Changes?", *Global Arbitration Review*, Vol. 2, Issue 2, November 2007. Quoted by L. Yves Fortier in "Investment Protection and the Rule of Law: Change or Decline?" at the British Institute of International and Comparative Law, 50th Anniversary Event Series, 17 March 2009, in London, UK, available at http://www.arbitration-icca.org/media/0/12392785460140/0732_001.pdf.

countries. Arbitration awards rendered by other institutions such as UNCITRAL require additional domestic enforcement procedures and are therefore more cumbersome.[13]

Under arbitration, technically specialised legal experts rule on disputes. Supporters of this procedure argue that it provides for quicker settlements than traditional judicial proceedings, with the possibility of obtaining higher amounts of compensation than judicial courts would award, and that arbitration awards are final.[14] This has the advantage of limiting the length of proceedings, since there is no possibility of appeal. Indeed, when parties to an agreement voluntarily adhere to this system it becomes binding for them; in other words, an award rendered by an arbitration tribunal has the same binding force as a court ruling. However, enforcement of arbitration awards becomes a problem when countries stop complying with the rulings.

There is no consensus on the effectiveness of arbitration as a dispute-settlement mechanism in international investment. Critics say they lack transparency – most cases are confidential and, as such, it is even hard to know how many cases really exist – and that arbitrators tend to be too investor-friendly. In addition, proceedings have recently become lengthier, thus reducing their advantage in this regard over judicial courts. ICSID Secretary-General Meg Kinnear has recently acknowledged the challenge of logjams within the internal procedures of arbitration.[15]

Another major issue concerning the effectiveness of arbitration is the exorbitant costs it entails.[16] Some host countries, particularly those in developing countries, have learned the hard way that huge claims can be made against them.[17] For example, Ecuador was recently ordered to pay $2 billion in total damages to several American companies after an arbitration tribunal found it had acted disproportionately by terminating contracts.[18] The Philippine government spent $58 million defending itself against German company Fraport AG, an amount that "could have paid the salaries of 12,500 teachers for one year or vaccinated 3.8 million children against diseases such as TB, diphtheria, tetanus and polio".[19] But European governments have also faced big claims: the Czech Republic was ordered to pay CME/Lauder $353 million – roughly equal to the country's entire healthcare budget – after an arbitration tribunal found the investor had been deprived of its investment due to the gradual weakening of its legal situation as a services provider in the media sector.[20] In the biggest claim to date, Russia is currently being sued for $114 billion – roughly the size of Vietnam's economy – for expropriating the investments of the majority shareholders of oil company Yukos.[21] Such cases have led to questions about the fairness of the current system.

The number of investment-related disputes has soared from 38 in 1996 to an all-time high of 450 in 2011.[22] ICSID registered 39 new cases in 2012, which represented a 20 percent increase from the number of cases registered in 2011.[23] Defenders of the system argue that it is a sign that investors fully trust it and are turning to it when disputes arise. Opponents are worried that the current system encourages powerful multinationals to initiate arbitration proceedings. Some experts have pointed out that since ICSID was created in 1966, as many host states have won cases as investors, though in 2012 nine out of 15 cases upheld investors' claims whereas only three cases rejected all of the investors' claims.[24]

The increase in investment-related claims has led some emerging economies to denounce investment treaties. In March 2013, Ecuador revoked its investment treaty with the US. South Africa has recently announced its intention not to renew several BITs it had concluded with the Belgium–Luxembourg Economic Union.[25] Opposition has been particularly strong in Latin American countries: Bolivia

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13 Sergey Ripinsky, "Venezuela's Withdrawal from ICSID: What it Does and Does Not Achieve", Investment Treaty News, 13 April 2012, available at http://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/#_ftn1 (hereafter, Ripinsky, "Venezuela's Withdrawal from ICSID").

14 Nikos Lavranos, senior trade policy advisor, Dutch Ministry of Economic Affairs, "Bilateral Investment Treaties and EU Law", *ESIL Conference 2010*, Agora 5: Investment Protection.

15 Meg Kinnear, speech at a Conference in the Academy of Case Law, Madrid, hosted by the International Centre for Arbitration, Mediation and Negotiation (CIAMEN), 14 May 2013 (hereafter, Kinnear, Speech of 14 May 2013).

16 "[…] Lawyers at elite arbitration law firms charge up to US$1,000 per hour for their services, with cases often handled by teams of lawyers and taking years." Also according to this source, the legal and arbitration costs average more than $8 million per investor-state dispute, exceeding $30 million in some case. See Pia Eberhardt and Cecilia Olivet, "Profiting from injustice: How law firms, arbitrators and financiers are fuelling an investment arbitration boom", Corporate Europe Observatory and the Transnational Institute, November 2012, available at http://www.tni.org/sites/www.tni.org/files/download/profitingfrominjustice.pdf (hereafter, Eberhardt and Olivet, "Profiting from injustice").

17 Lauge N. Skovgaard Poulsen and Emma Aisbett, "When the Claim Hits: Bilateral Investment Treaties and Bounded Rational Learning", *World Politics*, vol. 65, no. 2, April 2013, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899342 (hereafter, Poulsen and Aisbett, "When the Claim Hits"). Apparently this is the case with Pakistan, which was sued in 2001 by a Swiss investor and could not even find a copy of the BIT the country had signed with Switzerland, since BITs had been considered "a piece of paper, something for the press – a token of goodwill".

18 In 2012, the highest known award of damages in the history of investment treaty arbitration featured in *Occidental v. Ecuador II*, where the investor was awarded $1.76 billion plus pre- and post-award compound interest. See UNCTAD's Investment Policy Framework for Sustainable Development (IPFSID), available at http://unctad.org/en/PublicationsLibrary/webdiaepcb2012d6_en.pdf (hereafter, "UNCTAD IPFSID").

19 Eberhardt and Olivet, "Profiting from injustice". Fraport AG acquired 30 percent of Piatco, a Philippine company which had been awarded the concession to build a new terminal of Manila's airport in 1997. In 2002, the Philippine government declared the concession null and expropriated the terminal, under promises of paying just compensation to Fraport AG. The company filed an arbitration claim before ICSID and its requests were rejected by a first award rendered in 2007. Fraport appealed against the award and asked for an ad hoc committee to review the decision. In December 2010, a second award favoured the German company's requests.

20 European Parliament, Directorate-General for External Policies, Policy Department, "The EU Approach to International Investment Policy After the Lisbon Treaty", International Trade Committee (INTA) 2010, p. 57, available at http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=33990 (hereafter, INTA, "The EU Approach to International Investment Policy After the Lisbon Treaty"). See also a case summary by the British Institute of International Comparative Law (BIICL), available at http://www.biicl.org/files/3919_2003_cme_v_czech_republic.pdf.

21 The largest claim to date has amounted to $114 billion – this is the aggregate amount of compensation sought by the three claimants constituting the majority shareholders of the former Yukos oil company in the ongoing arbitration proceedings against Russia. See Hulley Enterprises Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 226; Yukos Universal Limited (Isle of Man) v. The Russian Federation, PCA Case No. AA 227; Veteran Petroleum Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 228. See "UNCTAD IPFSD".

22 Poulsen and Aisbett, "When the Claim Hits".

23 ICSID Annual Report 2012, p. 5, available at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnualReports&year=2012_Eng (hereafter, "ICSID Annual Report 2012").

24 Kinnear, Speech of 14 May 2013; ICSID Annual Report 2012.

25 Webber Wentzel, "SA declines to renew bilateral investment treaties with EU member states", *Polity*, 1 October 2012, available at http://www.polity.org.za/article/sa-declines-to-renew-bilateral-investment-treaties-with-eu-member-states-2012-10-01.

renounced the ICSID Convention in 2007, Ecuador in 2009, and Venezuela in 2012.[26] Argentina is to this date still in the convention but routinely ignores its arbitration rulings and is unwilling to pay compensation to investors.

The most high-profile case involving Argentina is the dispute with Spanish oil company Repsol. In April 2012, the Argentine government seized Repsol's stake in YPF, its Argentine partner without any offer of compensation. The Argentine government's view was that Repsol had underinvested and, as Deputy Finance Minister Axel Kicillof put it, planned "to extract our resources and make profits to carry out explorations abroad" and "stripped YPF of its assets by paying dividends to third countries".[27] Repsol reacted by claiming compensation of around $10.5 billion. In December, the company brought forward a claim against Argentina before ICSID to initiate arbitration proceedings.

However, although traditionally most cases involved investors from developed countries suing emerging countries, 31 percent of the cases registered in ICSID in 2012 involved "high income economies" as host states.[28] In the most high-profile case against a European government – and the first-ever arbitration claim by a mainland Chinese company – the insurance company Ping An filed an arbitration claim based on the BIT between China and Belgium that was signed in 1986. After negotiations failed, the company sought compensation for its losses when Fortis Bank was nationalised and its banking activities were sold off to French bank BNP Paribas.

Many cases against OECD countries such as Australia and Canada relate to so-called third-generation BITs. In the mid-1990s, when some developed countries began to receive the first claims by foreign investors, they started to negotiate new BITs that struck more of a balance between investment protection and other interests and to avoid ambiguous terms that could be used against them.[29] For example, Canada, originally a major promoter of BITs, adopted a more open approach to investment policy in order to accommodate other concerns.[30] It passed the 2004 Foreign Investment Promotion and Protection Agreement, which introduced improvements regarding the transparency of arbitration proceedings and the legitimate interest of governments to regulate in the public interest. In particular, it included an explicit recognition of the importance of health, safety, and environmental measures over investments, as well as a clause establishing general exceptions to investors' rights and the scope of their investments.[31] It has since been used as the basis for negotiating other Canadian investment treaties.

Similarly, the North American Free Trade Agreement (NAFTA), signed by Canada, the US, and Mexico includes an explicit reference to environmental measures.[32] In 2011, Australia published a trade policy statement, which clearly opposed investor-state dispute settlement provisions in future international investment agreements.[33]

International organisations, NGOs, and civil society groups have also called for the incorporation of corporate responsibility and sustainability standards in investment agreements. Some of this thinking has been incorporated into United Nations documents such as the United Nations Conference on Trade and Development (UNCTAD).[34] UNCTAD has recently proposed a new Investment Policy Framework for Sustainable Development (IPFSD) to address challenges at the national level (integrating investment policy into development, incorporating sustainable investment into investment policy, ensuring investment policy is effective and relevant) and international level (strengthening the development dimension of international investment agreements, balancing the rights and obligations of states and investors).

26 See the Venezuelan government's declaration of 25 January 2012, available at http://www.mre.gov.ve.

27 Ramy Wurgaft, "Argentina dice que los archivos de Repsol revelan sus 'planes de vaciar YPF'" ("Argentina says Repsol files reveal their 'empty YPF plans'), *El Mundo*, 1 June 2012, available at http://www.elmundo.es/america/2012/06/01/argentina/1338567520.html.

28 Out of the 50 new cases that were registered by ICSID in 2012, 26 percent were against governments in Eastern Europe and Central Asia, followed by 24 percent against governments of South America. In contrast to this, North American and Western Europe countries only held 6 percent of the claims against governments each. See ICSID Caseload – Statistics (Issue 2013 – 1), available at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&CaseLoadStatistics=True&language=English41 (hereafter, "ICSID Caseload Statistics"). Overall, Latin American countries have been sued 153 times, which constitutes 34 percent of the total. See UNCTAD IIA Issues Note, No. 1, April 2012, available at http://unctad.org/en/PublicationsLibrary/webdiaeia2012d10_en.pdf. See also Lauge N. Skovgaard Poulsen, "The Importance of BITs for Foreign Direct Investment And Political Risk Insurance: Revisiting the Evidence", in *Yearbook on International Investment Law and Policy 2009/2010*, pp. 539–574; ICSID Annual Report 2012, p. 28.

29 Van Os and Knottnerus, "Dutch BITs: A Gateway to 'Treaty Shopping'", p. 10.

30 "Canada is a major promoter of these instruments. Canada has 23 FIPAs that were concluded between 1990 and 2001. In recent years, Ottawa has accelerated its pursuit of FIPAs and regional and bilateral trade agreements that include investment provisions. Since 2007, four FIPAs have been concluded and 20 are either under negotiation or planned for the future. The Canadian government has also recently concluded four trade agreements that include chapters on investment and has nine more such trade deals under negotiation or in exploration phase." See "Bilateral Investment Treaties: A Canadian Primer", by Canada's Coalition to End Global Poverty (CCIC), available at http://www.ccic.ca/_files/en/what_we_do/trade_2010-04_investmt_treaties_primer_e.pdf.

31 See FIPA Model 2004, articles 10 and 11, available at http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf.

32 Article 1114 of NAFTA on Environmental Measures states that: "1. Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns. 2. The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement."

33 Jürgen Kurtz, "The Australian Trade Policy Statement on Investor-State Dispute Settlement", *American Society of International Law (ASIL)*, Volume 15, Issue 22, 2 August 2011, available at http://www.asil.org/pdfs/insights/insight110802.pdf.

34 The "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework", proposed by UN Special Representative John Ruggie, and also known as the Ruggie Principles, were endorsed by the UN Human Rights Council on 16 June 2011. The full text is available at http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf.

The EU's takeover of investment policy

Before the Lisbon Treaty was passed, member states would lobby on behalf of their own companies when they had disputes with governments – as, for example, Germany did with the Philippines on behalf of Fraport and the British government did on behalf of Vodafone in its ongoing investment case with the Indian government. The EU now has exclusive competence on FDI, although the exact scope of FDI is not defined in the treaties. The European Commission is now in charge of entering into negotiations to conclude future BITs on behalf of the EU, and the European Council and the European Parliament share legislative power pursuant to the co-decision procedure that applies to common commercial policy.[35] The European External Action Service (EEAS), another creation of the Lisbon Treaty, and its head – the high representative and vice-president of the Commission – has a say on the coherence of external affairs including the common commercial policy.[36] However, officials from the EEAS say that it still lacks the tools to exercise this competence.

The problem is that the various EU institutions that share the EU's exclusive competence on investment protection do not share a common approach to investment policy.[37] The Commission stresses the importance of strengthening investment protection and prioritising it above other considerations. The Council has endorsed this position and actually called for the EU to "increase the current level of protection and legal security for the European investor abroad". However, the European Parliament has called for a more balanced investment policy that takes into account other principles that it considers to be as important as investment protection.[38]

Another major divergence of opinions concerns how future BITs should be negotiated. The European Parliament publicly called for a "strong EU template for investment agreements, which would also be adjustable according to the level of development of a partner country".[39] However, the Commission has expressly ruled out the possibility of creating a model BIT for all future investment agreements. Instead, negotiations will take place with third countries on a case-by-case approach.[40] In addition to this lack of a common approach, co-ordination between the different institutions is poor. In fact, some don't even see the need to co-ordinate. As one EEAS official put it: "The main difference between us and DG Trade is that we know we need them but they don't know they need us."[41]

There also remain differences between the European Commission and the member states – in particular over the pre-existing BITs agreed by member states before the competence to subscribe such agreements was transferred to the Commission. Member states such as Germany, France, the Netherlands, Spain, and the UK were opposed to giving the Commission competence over investment protection because they feared it would negotiate weaker treaties than their own BITs and therefore clung on to them even after the Lisbon Treaty came into effect. In December, after more than two years of negotiations, the Council finally approved a BIT regulation, which contains a so-called grandfathering clause, which establishes that new investment treaties negotiated by the Commission would replace pre-existing BITs.[42] However, member states managed to squeeze in a clause that allows them to conclude bilateral agreements in the future under limited conditions.[43]

Meanwhile, over the last few years, member states such as France, Germany, Spain, and the UK have re-geared their national diplomacies towards purely commercial aims and increasingly are competing with each other in the race to secure profitable investments. This behaviour creates a risk that bilateralism will prevail over multilateralism, although with the backdrop of the current crisis, it is hard to blame this turn towards "commercial diplomacy".[44] If the EU has not managed to convey a message of the need for and, more importantly, the benefits of maintaining a united front on investments, it is no wonder that national governments aim to secure their own interests.

Some member states are relieved about the entry into force of the BIT regulation since it has given legal certainty to the standing of their pre-existing BITs. Paradoxically, some of the countries that were originally less keen to see the transfer of competence on investments to the EU are also among those that are now clamouring for the EU to be stronger on enforcement. After a number of conflicts with Latin American governments, Spain, which in the past defended the continuation of the national competence on investments, has now become convinced of the need to count on a strong EU to defend Spanish companies abroad. Meanwhile, representatives of private sector associations think that the system as it is today lacks sufficient tools to defend investment protection and that there is a lack of clarity about the division of labour between the national

35 See Article 207.2 of the Treaty on the Functioning of the European Union.
36 See Council Decision of 26 July 2010, establishing the organisation and functioning of the European External Action Service, available at http://www.eeas.europa.eu/background/docs/eeas_decision_en.pdf.
37 Calamita, "The Making of Europe's International Investment Policy".
38 See Council of the European Union, "Conclusions on a Comprehensive European International Investment Policy", 304st Foreign Affairs Council Meeting, 15 October 2010, as cited by Calamita, "The Making of Europe's International Investment Policy"; European Parliament, "Resolution of 6 April 2011 on the future European international investment policy", 6 April 2011, available at http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2011-0141&language=EN (hereafter, European Parliament Resolution on the future European international investment policy) as cited by Calamita, "The Making of Europe's International Investment Policy".
39 European Parliament Resolution on the future European international investment policy.
40 The European Commission communication states that "[...] a one-size-fits-all 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". See European Commission, "Towards a Comprehensive European International Investment Policy".
41 Unless stated otherwise, quotations are from interviews with the authors.
42 Regulation No. 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 (hereafter, BIT regulation).
43 See BIT regulation, article 7.
44 Nika Prislan and José Ignacio Torreblanca, "The UK, France and Spain: Commercial diplomacy rising", in Ana Martiningui and Richard Youngs (eds), *Challenges for European Foreign Policy in 2012. What kind of geo-economic Europe?*, FRIDE, 2011.

and the EU level. Furthermore, the lack of clear guidance for companies on whom to go to for investment disputes also makes it much harder and more costly for small and medium-sized enterprises to navigate the current system. Some European companies feel they are at a disadvantage in relation to their counterparts in the US, where enforcement mechanisms foreseen by US legislation are more unified and effective.[45]

A strong argument in favour of a common approach is the leverage that the EU – the world's largest trading bloc and a market of 500 million consumers – has when negotiating with third parties. The EU would benefit from the expertise of member states' officials. If they were kept in the loop of negotiations and felt they had a direct line to Brussels, it might help increase the support of national governments for the European Commission. The private sector could also be involved in the engineering of the new system, since many companies have invested abroad over the last few years and have experience – both good and bad – in dealing with host countries. Senior representatives from multinationals have expressed their interest in doing so but say the Commission has been lukewarm about involving them.

The European interest on investment protection

Now that the EU has competence over investment, it will have to figure out how to work with member states to ensure that European companies enjoy a level playing field. The immediate questions are whether, when, and how it should intervene in individual disputes between European companies and non-European states. The situation is somewhat analogous to trade cases. The EU does not automatically side with European companies in trade disputes. But if often relies on them as its ears on the ground to decide if a country engages in consistent rule-breaking. This has been the case with China on breaches of intellectual property rights. Equally, trade cases at the WTO or bilateral steps such as anti-dumping cases by the EU are mostly prompted by complaints by individual companies.

Another analogy can be made with consular protection, on which the EU is not normally competent but occasionally intervenes, as in the case of Bulgarian nurses in Libya, to ensure citizens abroad are treated in accordance with international rules. The aim is not to take sides but rather to ensure that the rule of law is respected and that citizens get a due process under the presumption of innocence. In the absence of better rules on investment, the legal basis for such an assessment must be the BITs concluded between the EU or its member states and third countries. In other words, the EU should find a middle way between two extremes: there should be no automatic assumption that European companies are in the right; but nor should the EU simply stand aside when actions against European companies threaten the sustainability of international rules.

Argentina is a case in point. Its break with international investors in 2001 led to 40 cases against it. Currently, Argentina has 24 cases against it pending at ICSID. Even when it loses cases, Argentina tends to leave fines unpaid. Even one of Brussels's most liberal investment policy thinkers describes it as "a country on a suicidal war path".[46] These controversies appear to have had a negative effect on the Argentine economy as well as on investors. As one Argentine expert said: "Where we have more controversies, worse commercial results appear. Today we are in conflict with 45 countries, which represent up to 50 percent of Argentinean exports."[47]

Various EU officials, including Trade Commissioner Karel De Gucht and High Representative Catherine Ashton, have supported Repsol in its case against Argentina. Ashton said that the Argentine government's nationalisation of Repsol's subsidiary was "cause for grave concern" and added that "the measure creates legal insecurity for all European Union and foreign firms in the country".[48] The European Parliament also deplored the move by the Argentine government and issued a statement to "call on the Commission and Council to explore any measures to avoid such situations in the future, including the partial suspension of tariff preferences".[49]

There was also a discussion of what further retaliatory measures could be taken, such as the possibility of revoking Argentina's right to benefit from trade preferential access to EU markets (GSP access). Commentators and private sector representatives have compared the EU's verbal response with the more robust approach taken by the US against Argentina. In March 2012, after Argentina had failed to pay more than $300 million in compensation awards in two disputes involving American companies, US President Barack Obama stated that the US would suspend trade benefits for Argentina. This illustrates how a government can step in to assist a company in an investment dispute by taking proportionate measures if another country doesn't respect an international ruling based on arbitration.

Although the EU now has competence for investment, it does not have a procedure for deciding what measures, if any, it should take in such disputes. As a senior representative of a multinational that suffered a major investment-related

45 In 2012, US President Barack Obama launched the Interagency Trade Enforcement Center (ITEC) within the Office of the United States Trade Representative (USTR). Through it, the USTR and the Department of Commerce co-operate with other government departments such as Agriculture, Homeland Security, Justice, State, and Treasury, and the intelligence community.

46 Fredrik Erixon, "A country on a suicidal war path", ECIPE, 19 April 2012, available at http://www.ecipe.org/media/media_hit_pdfs/F.erixon_on_Argentina.01.13.pdf.

47 Marcelo Elizondo, CEO of consulting company Desarrollo de Negocios Internacional (DNI) and former chair of the Exports Foundation, quoted by Argentine journal *La Nación* on 24 February 2013, available at http://www.lanacion.com.ar/1557167-descolgados-del-mundo-diplomacia-a-la-deriva.

48 "Remarks by HR/VP Catherine Ashton on Argentina's decision to expropriate the majority stake held by Repsol in YPF", European Parliament, 17 April 2012, available at http://europa.eu/rapid/press-release_MEMO-12-254_en.htm.

49 "Parliament deplores Argentina's decision to expropriate YPF", European Parliament, Plenary Session, 20 April 2012, available at http://www.europarl.europa.eu/news/en/pressroom/content/20120419IPR43561/html/Parliament-deplores-Argentina's-decision-to-expropriate-YPF.

dispute put it: "You had the overwhelming impression that they were making it up as they went along." A clear procedure would avoid politicising a case unnecessarily or stumbling into it and creating more of a political, legal, or economic mess. The EU does not even have a clear definition of the term "European company". Currently, companies are still defined by their member state origin. The clout and level of protection varies greatly from country to country: companies from Germany, France, and the UK benefit from a greater number of BITs and the more extensive diplomatic network at their disposal.

Reforming the international investment system

However, given the problems with the current system, it would not be in Europe's long-term interest to rely too much on punitive measures to ensure compliance on investment protection. Instead, the EU should be ready to think about reforming the international system and, in particular, finding a better balance between investment protection and other legitimate public-policy priorities such as regulating public health. In one recent intra-EU case that illustrates the problem, Germany was sued for its *Energiewende* (its move away from nuclear power) by Vattenfall, a Swedish company.[50] Legitimate EU regulation in the areas of health and environment could also be challenged in the future by outside investors relying on investment treaties.

Sufficient policy space should therefore be left for legitimate government action in such areas and the inclusion of standards on health, environmental, labour, and human rights. This would be a change from – and, in our view, an improvement on – most member states' current bilateral treaties, which do not include such concerns, in contrast to the US, Canadian, and Mexican standards set out in NAFTA. The EU's future BIT negotiations with third countries should be based on this balance between investment protection and other important concerns.

Some member states led by the Netherlands still take a very conservative approach to investment treaties and refuse to make concessions on issues such as respect for human rights, environmental concerns, or labour standards. As a result, they have been dubbed the "investment Taliban" by some experts. Cases like those of Philip Morris against Australia and Vattenfall against Germany suggest that this conservative approach will increasingly be challenged. The European Parliament, as co-legislator, can play an important role in pushing for a balance between investment protection and other equally important standards of public concern. It should continue to advocate for the inclusion of standards of sustainable development, human rights, and labour conditions in international investment agreements. It could use its influence to push for agreements to include these kinds of provisions or, if necessary, to veto those that don't.

Another reason to reconsider the necessary level of investment protection is that the EU is increasingly also a recipient of investments from emerging economies and can therefore expect to lose arbitration cases in the future. If Ping An wins its case against Belgium, it could lead to a wave of lawsuits against EU member states over the way they rescued their banks during the financial crisis. The recent "bail-in" of Russian investors in Cyprus also underscored that there are more and more non-Europeans who own assets inside the EU and could bring forward claims against Europeans.[51] So far there have been few cases against EU member states – Germany, for example, has only been sued twice and has not lost a case.[52] But this could change. One expert on investment protection predicts that "the moment a European country loses a major case and faces a huge fine, the praise of arbitration will diminish".

The EU should therefore explore ways to improve and shape the current arrangements into a system of global governance. This is in line with the findings of UNCTAD: "The need to address common sustainable development challenges and to respond effectively to global economic and financial turmoil to avoid future crises has instigated calls for new models of global economic governance."[53] Since there is unlikely to be a World Investment Organisation any time soon, the EU should co-operate with its allies such as the US to set the pace on investment protection. The US–EU free trade agreement currently being negotiated – dubbed a "policy laboratory" by Karel De Gucht – could be an opportunity to jointly set higher standards on investment.[54] The EU's possible investment treaty with China could also serve to anchor a new investment player into the international rules. A particular area in which improvement is needed is the lack of transparency of arbitration and the alleged bias of arbitrators. If states perceive the system to be biased against them and the conditions to be so draconian that they are likely to default at some point on their treaty arbitrations, they are less likely to engage in future investment treaty negotiations.[55]

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50 Eberhardt and Olivet write that: "In 2009, Swedish energy giant Vattenfall brought the first known investment treaty claim against Germany. The company demanded €1.4 billion (US$1.9 billion) in compensation for environmental measures restricting the use and discharge of cooling water for a coal-fired power plant on the banks of the Elbe river in Hamburg. After Germany agreed to dilute environmental standards, a settlement was reached." See Eberhardt and Olivet, "Profiting from injustice".

51 The capital-control regime introduced by the Cypriot government could potentially open the gates for many arbitration claims if deposits are deemed to be equivalent to investments. In the case of holders of sovereign bonds, by analogy to the Argentine crisis of 2001, it is most likely that bondholders will be able to initiate arbitration proceedings against the Cypriot government.

52 The second case also involves the Swedish company Vattenfall and revolves around compensation due to the closure of the country's nuclear power stations in response to the Fukushima crisis in Japan in 2011. The claimant initiated arbitration proceedings against Germany in June 2012 before ICSID.

53 "UNCTAD WIR", p. 100.

54 "A European Perspective on Transatlantic Free Trade", Karel De Gucht, European Commissioner for Trade, speech at the European Conference at Harvard Kennedy School: "Europe 2.0: Taking the Next Step", 2 March 2013, available at http://europa.eu/rapid/press-release_SPEECH-13-178_en.htm?locale=en.

55 Ripinsky, "Venezuela's Withdrawal from ICSID".

ICSID's efforts to improve efficiency and effectiveness by the implementation of best practices such as targeted timetables for the conclusion of procedural stages are a good step in the right direction.[56] The EU could set standards for arbitration in its future investment treaties by making it more affordable (with caps on legal fees), increasing public access to documents, and giving third parties such as civil society groups the right to be heard.[57]

In other words, the EU should work constructively with emerging countries in setting an acceptable level of investment protection that would protect European companies that invest beyond Europe but also be acceptable to the EU and its member states when emerging economies invest in the EU. These initiatives would help the EU set global standards on investment and would increase the buy-in from emerging powers in the multilateral investment system. As Martin Schulz, President of the European Parliament, put it: "Europe's soft power is transformative. [...] Europe makes countries change not by threatening intervention if they misbehave, but by promising them a place in the club if they behave."[58]

However, in order to strengthen global standards and the effectiveness of dispute-settlement mechanisms, EU member states may also need to act more coherently in international organisations. Although the Lisbon Treaty made the High Representative the Vice-President of the Commission and the chair of the Foreign Affairs Council, the EU still lacks unity and coherence in international institutions. In particular, the EU is still not a member of some of the most important Bretton Woods institutions such as the World Bank (although the European Commission is an observer in the Development Committee of the World Bank) and the International Monetary Fund (although the European Commission and the European Central Bank are observers at the International Monetary and Financial Committee).[59]

Policy recommendations

Given the challenges to the international system for resolving disputes on investment, the EU should seek both to improve its own coherence and to strengthen global rules on investment. In particular, it should do the following:

Create a model BIT

Taking inspiration from the American and Canadian approaches, the European Commission should create a standard template for future BITs. This template should set standards both for investment protection and for other important concerns such as environmental, social, and human rights standards. Furthermore, these standards should be integrated into the EU's negotiations with third partners such as the US and Canada to set an international gold standard for investment protection. In addition, it should seek to strengthen the arbitration system and dispute-settlement mechanisms. The EU should promote an institutional reform to make the current system more transparent and less costly and thus make it more accessible to emerging economies and improve its legitimacy. In the long term, this would also benefit the EU as a recipient of foreign investment.

Create a joint EEAS/European Commission task force

To carry out this task, we recommend creating a European investment enforcement task force. It should at least include DG Trade, the EEAS, DG Development, and DG Economic and Financial Affairs. Part of the thinking behind combining the roles of High Representative for Foreign Affairs and Vice-President of the Commission was to allow greater co-ordination of the various EU foreign policy institutions and tools – a so-called comprehensive approach. So far, however, the potential hasn't been realised. The creation of such a task force would make it easier for companies, particularly smaller companies, to know whom to approach on investment issues and speed up the evaluation of their case by experts in the field.

European companies would ideally approach this task force rather than their own national governments. It would also give member states an option to pool their resources by adding experienced national staff to the EU's personnel. This would be a smarter way to pool European power in a time of austerity. Member states could transfer their civil servants with knowledge of investment to the EU level and thus strengthen the joint resources of the EU. It could be staffed in a way similar to the EEAS, in which a third of the staff are seconded from the diplomatic services of member states.

56 ICSID Annual Report 2012, p. 40.
57 In all fairness, ICSID is already moving in that direction, albeit slowly, and there is now a register of cases and increased transparency in some other areas. Yet other arbitration courts haven't followed that example.
58 "European Union foreign policy in the 21st century: vision, ambition, reality", speech by Martin Schulz, President of the European Parliament, 26 February 2013, available at http://www.europarl.europa.eu/the-president/en/press/press_release_speeches/speeches/sp-2013/sp-2013-february/speeches-2013-february-4.html.
59 The current rules of the IMF establish that membership is only available to countries. To amend this, it would require a positive vote from three fifths of the IMF's members, representing at least 85 percent of the voting power. See Daniel Gros, Cinzia Alcidi, and Alessandro Giovannini, "Brazil and the EU in the Global Economy", CEPS, February 2013, available at www.ceps.eu/ceps/dld/7722/pdf.

Create an "escalation ladder"

Another key function of the task force should be to elaborate a transparent, proportional, and rule-bound list of the tools – what we call an "escalation ladder" – that the EU is able and willing to use against governments that do not comply with international rules or rulings. By doing this, it will also create additional legitimacy for its competence on investments in member states and among business, and will demonstrate the added value of a protective EU umbrella. Elements in the "escalation ladder" could include condemnatory statements from the High Representative for Foreign Affairs as well as other EU officials, as in the Repsol case, and other stronger measures such as the postponement and/or cancellation of meetings.

Use the World Bank and the IMF

As well as taking action itself against non-compliant states, the EU could also use the financial institutions of the World Bank and the IMF to put pressure on them. This makes particular sense since ICSID is part of the World Bank group. The EU should also work to enhance the link between ICSID and the IMF and the World Bank. For example, a bad track record on complying with ICSID could lead to sanctions through the World Bank system, including the barring of lending facilities or full rights in the World Bank or the IMF. But here the EU's capacity to act is hampered by its own lack of coherence. In the short term, member states that have a seat in these institutions should co-ordinate more effectively. In the long term, EU should aim to have a single seat in institutions such as the World Bank and the IMF.

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