The Commission's factsheets: a declaration of faith in the EU BITs world?

By Laurence Burger

Last year at about the same period, I reported on two major events that had been taking place in the world of Intra- and Extra-EU BITs, the Regulation establishing transitional arrangements for bilateral investments agreements between Member States and Third Countries, on the one hand, and the Electrabel decision, on the other. See blog of 17 December 2012.

The course of this year was marked by another event that ended up to be much ado about nothing, the order granted in the matter Slovakia v. Eureko by the German Federal Supreme Court according to which the proceedings before it were redundant. These proceedings, in which the Commission had intervened to support the position that the arbitral tribunal lacked jurisdiction, had been brought by the Dutch company Eureko against the Slovak Republic under the Dutch-Slovak BIT (thus an intra-EU BIT). The arbitral tribunal held that it had jurisdiction because the BIT was fully valid and had not been terminated by the Slovak Republik's accession to the EU. Annulment proceedings against the award on jurisdiction had been brought by the Respondent before a court in Frankfurt, which rejected all claims. The Supreme Court's order is the result of an appeal against the Frankfurt court's decision. The problem is that in the meantime, the arbitral tribunal rendered a final award in favor of Eureko. It is because of the risk of contradicting decisions that the Supreme Court decided not to render a decision, and wait for the Slovak's appeal of the award on the merits. For more on this decision see blog of Peter Bert dated 16 October 2013, entitled German Federal Supreme Court: Procedural Order in Slovakia v. Eureko.

Obviously, this decision did nothing to reassure all those who are skeptical (while not necessarily being Euro-skeptics) about the soundness for the EU to be regulating Intra- and Extra-EU BITs, not to speak of the ability of the EU to do so.

Consequently, in what is probably an effort to let cooler heads prevail, the European Commission has recently published two factsheets, one in October and one in November 2013, aiming at explaining the Commission's position on investor-state dispute settlement.

In these factsheets, the Commission answers general questions about its jurisdiction to negotiate investment agreements, the need for investor-state agreements and their advantages, and considers more specific questions that arise out of investor-state dispute settlement mechanisms.

In particular, the Commission explains that investor-state dispute resolution mechanisms will not limit the EU's right to regulate, because even if a foreign investor were to challenge a piece of legislation adopted at EU or Member State level as being contrary to the obligations of an investment treaty, the Member State could pay compensation instead of repealing the regulation.

The Commission also expresses the intent to create specific obligations for arbitrators with a purpose to prevent conflict of interests and create ethical rules, and to include in the investment agreements a list of arbitrators who can act in a particular dispute, in order to create consistency in case law. The EU also wants to prevent investors from abusing investor-state dispute resolution by prohibiting parallel claims before different tribunals, and prohibiting forum-shopping for the purpose of benefiting of treaty protection.

The Commission envisages a two-pronged approach to rebalance the system: on the one hand, clarifying and improving investment protection rules by (1) reaffirming the right of States to regulate public policy issues; (2) give guidance to arbitrators on whether a government measure constitutes an indirect expropriation; (3) setting out precisely what elements are covered by the fair and equitable standard. On the other hand, improving the operation mechanisms of dispute settlement by (1) establishing a loser pays all rule, thus preventing investors

from bringing multiple or frivolous claims; (2) ensuring transparency of the arbitration system (by making documents available to the public, providing access to hearings and allowing interested third parties, like for example environmental NGOs, to make submissions); (3) introducing a code of conduct for arbitrators; (4) introducing guidelines for interpretation allowing states to maintain control on how investment provisions are being interpreted.

The EU free-trade agreement with Canada (CETA: Comprehensive Economic and Trade Agreement), on which a political agreement has been reached on 18 October 2013, will implement these improvements. In particular, the following provisions will be found in CETA:
1. Reaffirm the right to regulate to pursue legitimate public policy objectives such as the protection of health, safety, or the environment.
2. Precise definition of Fair and Equitable treatment in order to avoid too wide interpretations and provide clear guidelines to tribunals. Under the agreement, a breach of the fair and equitable treatment obligation arises in the following cases:
a. Denial of justice in criminal, civil or administrative proceedings;
b. Fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings.
c. Manifest arbitrariness;
d. Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;
e. Abusive treatment of investors, such as coercion, duress and harassment. In addition, a breach of legitimate expectations is limited to situations where the investment took place only because of a promise made by the State that was subsequently not honoured.
3. Detailed language on indirect expropriation, clarifying that indirect expropriation can only occur where there is substantial deprivation of the attributes of property, providing for a detailed step-by-step analysis to determine whether an indirect expropriation has taken place and clarifying that the sole fact that a measure increases costs for investors does not give rise in itself to a finding of expropriation, and providing moreover that legitimate public policy measures taken to protect health, safety or the environment do not constitute indirect expropriation, except in the rare cases where they are manifestly excessive in light of their objective.
4. Obligation to provide ‘full protection and security’ does not cover protection against changes of laws and regulations.
5. Definition of investment covers only assets that possess the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk, and a certain duration;
6. Shell companies are not protected. To be qualified as an “investor”, it is necessary to have substantive business operations in the territory of one of the Parties;
7. The investor-state dispute settlement system contains a number of key features designed to ensure that the system is effective and efficient, whilst providing important procedural safeguards which will improve the control of the parties of the interpretation of the agreement and ensure that frivolous cases are discouraged or swiftly dismissed. These key features include:
a. Prohibitions on seeking remedies in domestic courts and through investor-state dispute resolution at the same time, whilst encouraging the use of domestic court;
b. Increased certainty for states through the setting of time periods after which a claim cannot be made (in principle 3 years);
c. Increased consistency and strengthened protection against possible conflicts of arbitrators through the need for agreement on the arbitrators, failing which the arbitrator will be chosen from a roster of arbitrators, jointly decided by the European Union and Canada;
d. Introduction of a binding Code of Conduct for arbitrators;
e. Strong protections allowing for frivolous claims to be rejected very quickly where the case is manifestly unfounded and where the tribunal, even if facts are assumed to be correct, cannot rule in favor of the investor;
f. Strong protection against unfounded claims;
g. Full transparency – all documents public, all hearings open, submissions by interested parties.
h. Possible appellate mechanism.
i. Encouragement of alternative dispute resolution – explicit provisions for mediation for investment disputes.
j. Absolute clarity that a state cannot be forced to repeal a measure;

k. Effective mechanisms for the Parties to the agreement to issue binding interpretations on what they originally meant in the agreement and to take part in arbitrations on questions of interpretation;
l. Action against spiralling costs through effective limits to the costs of the arbitration;
m. Investor-state dispute resolution only applies to alleged breaches of the investment protection standards and does not apply to market access.

In negotiating CETA, the Commission will obviously seek to make good on what looked at first more like wishful thinking than reality. Yet, however progressive the investor-state dispute resolution reforms established by the Commission are, they remain for now a declaration of faith which has not yet undergone trial by fire. Only experience will tell whether they accomplish what they seek to achieve.