THE PROPOSALS OF THE EUROPEAN COMMISSION FOR INVESTMENT PROTECTION AND AN INVESTMENT COURT SYSTEM

Remarks by Judge Stephen M. Schwebel of May 17, 2016 at Sidley Austin, Washington, D.C.

Disputes between foreign investors and governments of the host countries have for some years been primarily resolved not by national courts but by international arbitration. This informed audience is familiar with the systems established by the World Bank and by other international arbitral institutions. Those systems have adjudicated hundreds of cases in recent decades, with a very large measure of success.

International arbitration of foreign investment disputes was not born with the birth of ICSID. It goes back at least to the two decades between the two World Wars. But it moved from episodic appearance -- as in the notable case between the Royal Government of Saudi Arabia and Aramco 1954-1956 -- to an almost routine recourse only in the last twenty-five years. The jurisdictional basis of such arbitration, once found in clauses of concession agreements, has increasingly been provisions of bilateral investment treaties.

Criticism of what has come to be called “investor State dispute settlement” -- ISDS-- has rocketed in recent years. It has moved from a few modest -- or immodest -- think tanks to the center of international trade negotiations. The European Commission has made far-reaching proposals in the context of negotiations with the United States for a Transatlantic Trade and Investment Partnership, “T-TIP”. The EU has already crystallized these proposals in the EU-Canada Free Trade Agreement -- “CETA” -- a treaty that awaits ratification --and in an agreement with Singapore. My remarks this evening will address salient aspects of this latter-day approach of the EC. I shall also say a few words about developments in the UN, where the approach of the New International Economic Order which left the international stage some fifty years ago has now raised its unattractive head anew.

The bilateral investment agreements which are the prime jurisdictional source of international investment arbitration were pioneered by Germany. The Netherlands, the United Kingdom, and France, together with Germany, are among the leading members of the European Union that have entered into large numbers of exemplary “BITs”. Bilateral investment treaties to which European States are parties are about half of the almost 3000 BITs that have been concluded. Germany’s volte face in respect of BITs appears to have been mainly moved by its rejection of nuclear power in the wake of the tsunami in Japan. A prime servicer of nuclear power in Germany, the Swedish firm

Vattenfall, sued for damages not only in German courts but through international arbitration. German public opinion, whipped up by the Greens and other critics of nuclear power, by critics of globalization and other such evils, reacted adversely. Germany has unmatched influence In the EU. But do the Netherlands, the United Kingdom, France, Italy and other leading members of the EU, have little or no influence in the EC? A mystery is why the European Union as a whole has followed the German lead in supporting EC proposals to replace investor-State arbitration with an international investment court.

The EU Commissioner concerned, Cecilia Malmstrom, issued a Blog Post on 5 May 2015 entitled "Investments in TTIP and beyond -- toward an International Investment Court". She forthrightly stated that, "My assessment of the traditional ISDS system has been clear -- it is not fit for purpose in the 21st Century. I want the rule of law, not the rule of lawyers. Our new approach ensures that a state can never be forced to change legislation, only to pay fair compensation in cases where the investor is deemed to have been treated unfairly ...." The extensive Concept Paper attached to her Blog, subtitled "Enhancing the right to regulate and moving from current ad hoc arbitration towards an Investment Court", cites no case illustrative of the rule of lawyers, and no case where the State was forced to change legislation.

Preoccupied with preserving the unchallenged right of governments to regulate, the EU initially looked toward replacing investor/State arbitration by a system in which the parties to the dispute would not freely choose the arbitrators but where appointments would be limited to lists of persons vetted in advance by States, among other reforms. Its revised proposals go further. They are summarized in a "Fact Sheet" of 16 September 2015. It emphasizes that "the right to regulate for public policies is fully preserved" and says that "this is new". "It also clarifies that investment protection provisions shall not be interpreted as a commitment from governments not to change their legal framework, including in a manner that may negatively affect 'the investor's expectations of profits'".

The EU now proposes to replace investor-State arbitration by an Investment Court System, a Tribunal of the First Instance composed of 15 judges appointed jointly by the EU and the US, of which five would be EU nationals, five US nationals and five nationals of third countries. Three judges would be randomly assigned to each case; the disputing parties would not choose the particular judges.

The Fact Sheet states that the Commission's objective is to replace all investment dispute settlement mechanisms with a permanent International Investment Court and an Appeals Tribunal.

The EC proposals specify that its provisions “shall not affect the right of the Parties to regulate within their territories through measures necessary to achieve legitimate policy objectives...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.” While this is touted as “new”, in point of fact it is a codification of accepted practice, as notably set forth in the *Methanex* award. If there are awards sustaining the investor’s “expectations of profits”, they are not cited in the EU’s papers.

The EC proposals provide that each Party “shall accord in its territory to covered investments fair and equitable treatment and full protection and security”. They thus adopt a cardinal principle of BITs. But they define what is a breach of the obligation of fair and equitable treatment somewhat narrowly. For example, “A Party breaches the obligation of fair and equitable treatment...where a measure constitutes....manifest arbitrariness.” It is not enough that the investor suffers arbitrary treatment, that treatment must be “manifest”. Manifest means obvious. Why? If on judicial analysis the foreign investor is found to have been treated arbitrarily, that surely is a breach of the investor’s entitlement to fair and equitable treatment whether or not the breach is “manifest”.

At the same time, a tribunal may "take into account" whether a Party made a specific representation to an investor to induce a covered investment that creates a legitimate expectation.

In respect of expropriation, direct or indirect, the EU proposals are sound in sustaining the BIT principles that expropriation shall be for a public purpose, under due process of law, non-discriminatory, and against payment of prompt, adequate and effective compensation. Despite the presence of these principles in nearly all modern BITs, these principles should not be taken for granted: rejection of them was a key element of the UN majority in the 1960's and 1970's and dispute over them was central to the expropriations of the Russian Revolution and Third World expropriations.

Another sound element of the EU proposals is that, where a Party has entered into any written contractual commitment with investors of another Party, that Party shall not breach the commitment through the exercise of governmental authority. The legal advisers of the United States and the United Kingdom delegations to the UN General Assembly succeeded in persuading the UN majority to include a provision to that effect in General Assembly Resolution 1803 (XVII). It is reassuring that the EC adheres to it today.

The EU's T-TIP proposals do break new ground however in substituting for investor-State arbitration a Tribunal of the

First Instance as well as an Appeal Tribunal. That proposal specifies courts made up of judges selected only by the EU and the United States. Investors would have no part in the appointment of the judges or in the composition of the three member panels that would be drawn from the members of the Tribunal to pass upon a particular dispute. The EU press releases make clear that these investment courts would be “a fundamental change compared to the old ISDS system which operates on an ad hoc basis with arbitrators chosen by the disputing parties....the elements proposed for the operation of an Investment Tribunal are an effective way to insulate judges from any real or perceived risk of bias.” According to EU Commissioner Malmstrom, “[w]hat has clearly come out of the debate is that the old, traditional form of dispute resolution suffers from a fundamental lack of trust.”

The inference to be drawn from the foregoing EU statements is that the system of arbitrators chosen by the parties to the dispute found in bilateral investment treaties and the ICSID Convention is not insulated from any real or perceived risk of bias. Yet the parties to cases before the Investment Tribunal will be investors and States. The question arises, if there is a risk, real or perceived, of bias of ad hoc arbitral tribunals, as the EU appears to insinuate, is there not a risk, real or perceived, of bias -- in favor of States and against investors -- in the EU Commission’s proposals? If the fact of appointment by a party of an arbitrator is taken to import bias, is not the appointment of judges solely by

States a formula for the establishment of courts biased against investors?

I do not believe that it Is the intention of the EU to entrench such bias in the courts proposed by the EU Commission. But if it is to be presumed that an arbitrator appointed by an investor is biased in favor of the investor -- a presumption that the record of investor/State arbitration does not sustain -- is there reason to presume that judges appointed only by States will not be biased in favor of States?

The EU proposals contain an exacting code respecting conflicts of interest which is intended to assure the objectivity of the members of the investment courts. But objectivity in the eyes of the judges apparently should not be carried to the point of differing in key respects from the States that appointed them. The EU proposals provide that, where "serious concerns arise as regards matters of interpretation relating to investment protection or resolution of investment disputes," a Committee composed of representatives of the EU and the United States may adopt decisions interpreting those provisions. Any such interpretation shall be binding on the Tribunal and the Appeal Tribunal in respect of pending as well as prospective cases.

There is much more in the EU's proposals than I have had time to address. Many of the proposals seem sound, others less so.

The fundamental objection to the EU Commission's proposal to replace investor/State arbitration with an investment court is that it would replace the current system, which on any objective analysis works reasonably well, with a system that would face substantial problems of coherence, rationalization, negotiation, ratification, establishment, functioning and financing. The costs of investor/State arbitration are borne by the parties, but under the EU's approach they would apparently be borne by States alone. Whether the compensation of judges contemplated would attract seasoned arbitrators remains to be seen. It may be that the intention is to discourage rather than encourage experienced arbitrators from consideration.

A paramount question is, should ICSID in particular really be left to wither and expire after having successfully administered a very large number of cases, not because the criticism mounted against it and investor/State arbitration more broadly is valid but because uninformed or misinformed critics have made so much uninformed and misinformed noise that the EU has been moved to appease the views of those critics?

Moreover, will appeasement successfully appease? On 19 April 2016, the Office of the United Nations High Commissioner for Human Rights issued a news release recounting that the Independent Expert on the promotion of a democratic and equitable international order appointed by the UN Human Rights Council explained to the

Parliamentary Assembly of the Council of Europe why ISDS mechanisms contained in trade agreements "are incompatible with democracy, the rule of law and human rights". He is quoted as saying, "Investor-State dispute settlement is unfortunately not dead, and the proposed TTIP Investment Court System is but an extension of ISDS, which suffers from many of the same flaws".

It thus appears that an upshot of the criticism of ISDS of recent years may be renewal of the inflamed yet sterile debates over the New International Economic Order and the Charter of Economic Rights and Duties of States that marked UN combat of the 1960's and 1970's. So much for the contribution of that criticism to the progressive development of international law.